

Armstrong World (AWI)

\$78.46 (As of 06/03/20)

Price Target (6-12 Months): **\$67.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 06/02/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:B

Value: D

Growth: A

Momentum: B

Summary

Volume growth in Architectural Specialties, manufacturing productivity and lower SG&A expenses have been benefiting Armstrong World. The company's first-quarter results improved year over year owing to the above-mentioned tailwinds. However, unfavorable Mineral Fiber average unit value (AUV) owing to volume growth in Latin America and the Big Box channel has been a pressing concern. Notably, the company has revoked its 2020 guidance due to the ongoing coronavirus-induced crisis. Demand in April declined due to the COVID-19 outbreak. In fact, the present scenario has compelled it to take measures to reduce production and manage inventory. Shares of the company have underperformed the industry year to date.

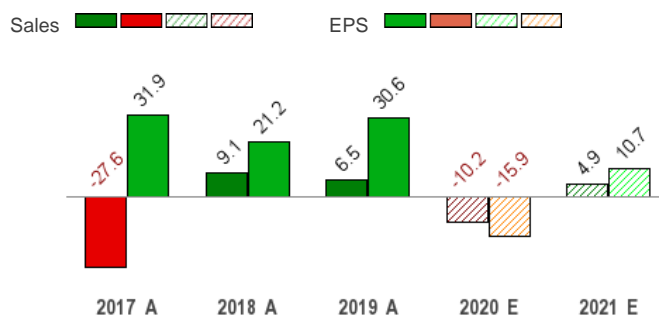
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$111.46 - \$62.03
20 Day Average Volume (sh)	538,989
Market Cap	\$3.8 B
YTD Price Change	-16.5%
Beta	1.20
Dividend / Div Yld	\$0.80 / 1.0%
Industry	Building Products - Miscellaneous
Zacks Industry Rank	Bottom 19% (204 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-3.5%
Last Sales Surprise	-2.7%
EPS F1 Est- 4 week change	-7.3%
Expected Report Date	08/03/2020
Earnings ESP	-2.8%
P/E TTM	16.1
P/E F1	19.5
PEG F1	1.2
P/S TTM	3.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	256 E	250 E	274 E	244 E	978 E
2020	249 A	215 E	237 E	231 E	932 E
2019	242 A	272 A	277 A	247 A	1,038 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.18 E	\$1.16 E	\$1.32 E	\$1.02 E	\$4.45 E
2020	\$1.10 A	\$0.90 E	\$1.11 E	\$0.91 E	\$4.02 E
2019	\$1.10 A	\$1.27 A	\$1.38 A	\$1.11 A	\$4.78 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 06/03/2020. The reports text is as of 06/04/2020.

Overview

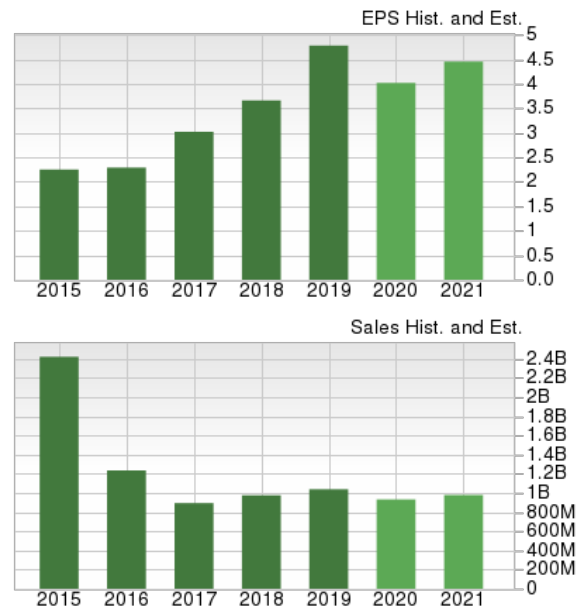
Pennsylvania-based **Armstrong World** is a leading global producer of ceiling systems for use primarily in the construction and renovation of commercial, institutional and residential buildings. It designs, manufactures and sells ceiling systems (primarily mineral fiber, fiberglass wool and metal) globally.

As of Dec 31, 2019, the company operated 12 active manufacturing facilities throughout the United States. Armstrong World currently operates in three reporting segments — Mineral Fiber, Architectural Specialties and Unallocated Corporate.

Mineral Fiber (accounting for 79.6% of 2019 revenues) produces suspended mineral fiber and soft fiber ceiling systems for use in commercial and residential settings.

Architectural Specialties (20.4%) produces and sources ceilings and walls for use in commercial settings.

The **Unallocated Corporate** contains cash, debt, fully funded U.S. pension plan and certain other miscellaneous balance-sheet items.



Reasons To Sell:

- ▼ **COVID-19 to Hurt Near-Term Results:** The recent economic slowdown owing to the COVID-19 outbreak has created significant market volatility and may impact the company's upcoming results. It withdrew its 2020 guidance owing to uncertainty surrounding the economic impact of coronavirus.

During the first-quarter earnings call, the company highlighted that it anticipates April sales to be down 25-30% year over year based on the monthly shipment trend. Weakness across the markets — specifically in California, New York and Massachusetts — is a major concern.

- ▼ **Soft Volumes & Lower AUV:** Volumes in the Mineral Fiber segment have been soft over the last few quarters. In fourth-quarter 2019, Mineral Fiber volume was down 2% due to softness in the lower end of its product range that is directly connected to the big box channel, continued uneven R&R activity across various verticals and a weak economy in Canada. Soft volume in Mineral Fiber still remains a pressing concern, despite improvement in the same in first-quarter 2020.

Average unit value ("AUV") in first-quarter 2020 was impacted by significant weakness in premium markets like New York City and Boston. In the Mineral Fiber segment, AUV was negative due to non-product mix factors.

Political and economic issues in Canada, and inventory balancing in the big box channels impacted the result. Also, R&R activity in the U.S. retail and healthcare verticals continued to be softer and uneven across the regions.

- ▼ **Oil Price Volatility & Continued Geopolitical Uncertainty:** International markets that are closely linked to oil, such as the Middle East will be impacted by oil price volatility and continued geopolitical uncertainty in the region.
 - ▼ **Overvalued Compared to Peers:** Armstrong World's stretched valuation is another concern. The company's trailing 12-month price to earnings ratio is 15.86, which is higher than the industry's 14.66. This implies that the stock is overvalued than its peers.
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Coronavirus-led weakness, soft volumes in the Mineral Fiber segment and stretched valuation remain causes of concern.

Risks

- **Inorganic Moves to Bolster Product Offering:** Armstrong World follows a systematic inorganic strategy to enhance its portfolio. The company's recent buyout was that of MRK Industries in November 2019. MRK Industries, a manufacturer of specialty metal ceilings and walls, generates annual revenues of approximately \$14 million. On Mar 4, 2019, the company acquired Architectural Components Group, Inc. ("ACGI"), a leading custom wood ceilings and walls solution provider. These acquisitions added \$8.2 million to total net sales in first-quarter 2020.

The company wrapped up two additional acquisitions in Architectural Specialties, bringing the count to five in the last three years through 2019. Meanwhile, it has closed the divestiture of businesses in Europe and Asia, realizing \$290 million of benefits for its shareholders. That made the company an Americas-only business with minimal exposure to tariffs or the impact of coronavirus.

- **Higher Price Realization to Offset Input Cost Inflation:** Higher input costs, including the extra freight activity, have been a major headwind. To offset the rising costs, the company has been implementing higher prices. Going forward, the company is expected to maintain its pricing power in ceilings, based on its strong distribution network and innovation. Its adjusted EBITDA grew 5.2% and EBITDA margin expanded 100 basis points (bps) year over year in the first quarter, courtesy of higher volume growth in the Architectural Specialties segment as well as the ACGI acquisition. Resultantly, the company's adjusted earnings grew 10% year over year.
- **Investment in New Products:** Since its separation from the flooring business in 2016, Armstrong World has been strategically investing in new products, sales and support services, and advanced manufacturing capabilities. The company's new product launches include Sustain and Total Acoustics product families, and DESIGNFlex, which in turn fortified the Mineral Fiber category. Not just this, the company is also rolling out new digitally-enabled solutions like Revit families to its website for the DESIGNFlex products. In 2019, it introduced a digitally-enabled solution called Project Works.

Meanwhile, with the Flex line at the Marietta facility operating well, the company has automated the production of circles, triangles and trapezoids in any color. These launches have experienced extraordinary rates of adoption by architects, and the company expects the penetration of these products to continue in 2020 and beyond.

Notably, the company recently received an urgent request for products at healthcare facilities in New York City in response to the coronavirus pandemic.

- **Enough Liquidity to Overcome Coronavirus Woes:** Armstrong World has been maintaining a strong liquidity position to navigate through the current environment. The company ended the first quarter with \$452 million liquidity, including \$147 million cash and cash equivalents, and \$305 million of available capacity on the \$500-million revolving credit facility. Its current cash level has increased sequentially and is sufficient to meet the short-term obligation of \$43 million.

Total long-term debt of \$678.5 million was slightly up from \$604.5 million at 2019-end. Although debt to total capital at March-end increased to 66.1% from 62.6% at 2019-end, the company has no significant debt maturities in the near term. First-quarter adjusted free cash flow increased 105.6% to \$36 million from \$18 million a year ago. It expects adjusted free cash flow margin within 22-25% in 2020, even in worst-case scenarios.

Last Earnings Report

Armstrong World Misses on Q1 Earnings, Cancels '20 View

Armstrong World Industries, Inc. reported first-quarter 2020 results, wherein both earnings and revenues missed the Zacks Consensus Estimate. While the bottom line missed the consensus mark after beating in the trailing four quarters, the top line lagged the same for the fifth straight quarter. However, both the top and bottom lines improved year over year. The company revoked 2020 guidance on account of the coronavirus pandemic.

Quarter Ending **03/2020**

Report Date	Apr 27, 2020
Sales Surprise	-2.73%
EPS Surprise	-3.51%
Quarterly EPS	1.10
Annual EPS (TTM)	4.86

Earnings & Revenues Discussion

The company reported adjusted earnings of \$1.10 per share, lagging the Zacks Consensus Estimate of \$1.14 by 3.5%. However, the reported figure improved 10% year over year.

Although net sales of \$248.7 million lagged the consensus mark of \$256 million by 2.7%, the figure improved 2.7% year over year on the back of increased volumes in the Architectural Specialties segment and higher Mineral Fiber volume. However, growth was marginally overshadowed by unfavorable Mineral Fiber average unit value ("AUV") owing to volume growth in Latin America and the Big Box channel, which have lower AUV than the Mineral Fiber segment average.

Operational Update

Selling, general and administrative (SG&A) expenses decreased 37.4% year over year to \$34.8 million in the quarter.

Adjusted EBITDA advanced 5.4% from the prior-year quarter to \$97 million. The company recorded EBITDA growth in 40 of the trailing 41 quarters, highlighting the stability of business. EBITDA margins expanded 90 basis points (bps) in the quarter.

Adjusted operating income increased 2.6% year over year to \$78 million driven by manufacturing productivity, lower SG&A expenses and volume growth in the Architectural Specialties segment.

Segmental Performance

Mineral Fiber (accounting for 79.5% of net sales): Backed by higher volume, the segment's sales were up 0.5% on a year-over-year basis to \$197.7 million, partly offset by unfavorable AUV.

Operating income increased 47.1% from the prior-year quarter, attributable to a \$20 million decline in legal and professional fees related to the 2019 litigation matter with Rockfon and a \$4 million decrease in manufacturing costs. Adjusted EBITDA also grew 6.1% from the prior-year quarter to \$87 million due to robust performance of manufacturing operations.

Architectural Specialties (20.5%): Net sales in the segment grew 12.3% year over year to \$51 million, courtesy of higher sales volumes from the recently acquired ACGI, marginally offset by unfavorable project timing.

The segment's operating profit declined 18.1% year over year due to additional investments in selling and design capacities, and the integration of acquisitions, partially negated by the positive impact of higher sales volume. Moreover, adjusted EBITDA of \$8 million decreased 2.1% from the year-ago level.

Notably, unallocated corporate expense of \$1.5 million, declined from \$2.1 million in the prior-year quarter.

Financials

As of Mar 31, 2020, Armstrong World had cash and cash equivalents of \$146.9 million compared with \$283.8 million in the comparable period of 2019.

Net cash provided by operations was \$25.7 million in the reported quarter compared with \$14.7 million in the prior-year quarter.

The company's free cash flow (on an adjusted basis) was \$36 million during the quarter compared with \$18 million in the year-ago quarter.

Coronavirus Update

Demand in April declined due to the ongoing coronavirus-induced crisis. The scenario has compelled the company to take proper measures to reduce production and manage inventory. It also continues to maintain service levels. Further, the company is taking care of its supply chain so that sufficient raw materials and finished goods are available at appropriate locations.

In an effort to reduce costs in view of the current scenario, the company has trimmed spending, suspended hiring, and delayed non-essential and non-growth oriented capital investments. The company has also suspended share repurchase program.

Although the company has withdrawn guidance for 2020, it anticipates generating a free cash flow margin of 22-25% this year.

Valuation

Armstrong World shares are down 16.5% in the year-to-date period and 15.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Construction sector are down 0.3% and 7.1% in the year-to-date period, respectively. Over the past year, the Zacks sub-industry is up 19% and sector is up 8.3%.

The S&P 500 index is down 4.4% in the year-to-date period but up 9.2% in the past year.

The stock is currently trading at 18.67X forward 12-month earnings, which compares to 19.77X for the Zacks sub-industry, 19.77X for the Zacks sector and 22.29X for the S&P 500 index.

Over the past five years, the stock has traded as high as 23.45X and as low as 12.4X, with a 5-year median of 16.86X. Our Underperform recommendation indicates that the stock will perform worst than the market. Our \$67 price target reflects 15.95X forward 12-month earnings.

The table below shows summary valuation data for AWI

Valuation Multiples - AWI					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	18.67	20.74	19.77	22.29
	5-Year High	23.45	20.74	19.77	22.29
	5-Year Low	12.4	7.15	10.75	15.23
	5-Year Median	16.86	13.75	15.87	17.49
P/S F12M	Current	3.95	1.35	1.91	3.47
	5-Year High	4.76	3.59	2.12	3.47
	5-Year Low	0.8	0.69	1.17	2.53
	5-Year Median	2.26	0.91	1.6	3.02
EV/EBITDA TTM	Current	6.34	19.81	17.52	11.4
	5-Year High	16.26	30.63	21.19	12.86
	5-Year Low	5.6	13.62	12.39	8.26
	5-Year Median	10.94	23.18	17.87	10.81

As of 06/03/2020

Industry Analysis Zacks Industry Rank: Bottom 19% (204 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Frontdoor, Inc. (FTDR)	Neutral	3
GCP Applied Technologies Inc. (GCP)	Neutral	3
Lumber Liquidators Holdings, Inc (LL)	Neutral	2
Quanex Building Products Corporation (NX)	Neutral	3
PGT, Inc. (PGTI)	Neutral	3
Construction Partners, Inc. (ROAD)	Neutral	3
Gibraltar Industries, Inc. (ROCK)	Neutral	4
Simpson Manufacturing Company, Inc. (SSD)	Neutral	4

Industry Comparison Industry: Building Products - Miscellaneous				Industry Peers		
	AWI	X Industry	S&P 500	NX	ROCK	SSD
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	3	4	4
VGM Score	B	-	-	B	D	D
Market Cap	3.75 B	1.12 B	22.50 B	452.38 M	1.59 B	3.79 B
# of Analysts	4	3	14	1	2	2
Dividend Yield	1.02%	0.00%	1.88%	2.33%	0.00%	1.06%
Value Score	D	-	-	B	D	F
Cash/Price	0.04	0.10	0.06	0.06	0.06	0.09
EV/EBITDA	10.38	7.69	12.98	6.09	14.34	16.77
PEG Ratio	1.21	4.55	3.05	NA	NA	NA
Price/Book (P/B)	10.13	1.51	3.11	1.38	2.35	4.60
Price/Cash Flow (P/CF)	12.20	9.34	12.18	2.93	15.23	22.42
P/E (F1)	19.74	25.33	22.19	13.73	20.71	37.41
Price/Sales (P/S)	3.59	1.17	2.40	0.51	1.49	3.26
Earnings Yield	5.12%	3.88%	4.31%	7.28%	4.84%	2.67%
Debt/Equity	1.83	0.22	0.76	0.51	0.04	0.21
Cash Flow (\$/share)	6.43	2.31	7.01	4.69	3.23	3.89
Growth Score	A	-	-	C	D	C
Hist. EPS Growth (3-5 yrs)	20.32%	20.32%	10.87%	14.17%	26.31%	22.04%
Proj. EPS Growth (F1/F0)	-15.95%	-20.60%	-10.74%	5.26%	-7.95%	-21.81%
Curr. Cash Flow Growth	15.31%	-4.68%	5.48%	108.85%	15.67%	-4.69%
Hist. Cash Flow Growth (3-5 yrs)	3.83%	15.36%	8.55%	28.42%	21.12%	13.26%
Current Ratio	2.03	2.03	1.29	1.91	1.64	4.62
Debt/Capital	64.69%	32.75%	44.75%	33.57%	3.56%	17.30%
Net Margin	-4.86%	2.76%	10.59%	-4.82%	6.62%	12.76%
Return on Equity	71.34%	11.84%	16.29%	10.18%	13.74%	17.03%
Sales/Assets	0.64	1.07	0.55	1.32	1.11	1.04
Proj. Sales Growth (F1/F0)	-10.25%	-3.21%	-2.65%	0.00%	2.56%	-14.37%
Momentum Score	B	-	-	B	D	C
Daily Price Chg	2.64%	2.23%	2.42%	3.94%	4.24%	6.73%
1 Week Price Chg	5.72%	4.63%	4.60%	6.53%	6.05%	6.39%
4 Week Price Chg	7.13%	13.88%	13.40%	24.14%	6.98%	21.83%
12 Week Price Chg	-14.33%	8.57%	12.78%	-6.54%	5.06%	16.09%
52 Week Price Chg	-15.64%	-0.78%	0.89%	-18.76%	31.49%	35.61%
20 Day Average Volume	538,989	222,748	2,528,787	173,006	222,748	234,658
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-7.27%	0.00%	-0.14%	0.00%	-21.10%	0.00%
(F1) EPS Est 12 week change	-23.98%	-31.67%	-16.00%	0.00%	-21.10%	-31.67%
(Q1) EPS Est Mthly Chg	-14.35%	0.00%	-0.02%	NA	-51.83%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	A
Momentum Score	B
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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