Armstrong World (AWI)

$100.32 (As of 01/13/20)

Price Target (6-12 Months): **$105.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 07/16/19) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5) Zacks Style Scores: Value: C | Growth: B | Momentum: F	**2-Buy** VGM:C

Summary

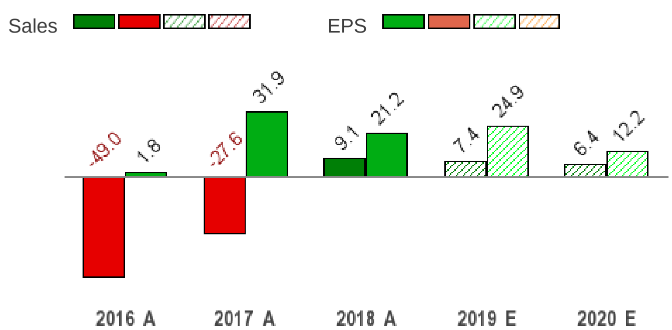
Shares of Armstrong World have broadly outperformed its industry in the past year. Higher price realization, strong repair and remodel activity along with the continuation of new building construction activity bode well for Armstrong World. Meanwhile, earnings estimates for 2020 have been trending upward over the past seven days, reflecting analysts' optimism surrounding the company's earnings growth potential. However, higher freight and raw material costs have been dampening company's earnings over the past few quarters. The steel and aluminum tariffs continue to impact its material costs. Moreover, operational headwinds in the company's manufacturing facilities along with stretched valuation raise concern.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	$104.34 - $62.57
20 Day Average Volume (sh)	219,760
Market Cap	$4.9 B
YTD Price Change	6.8%
Beta	1.57
Dividend / Div Yld	$0.80 / 0.8%
Industry	[Building Products - Miscellaneous]
Zacks Industry Rank	Top 29% (73 out of 254)
Last EPS Surprise	6.2%
Last Sales Surprise	-4.3%
EPS F1 Est- 4 week change	0.2%
Expected Report Date	02/24/2020
Earnings ESP	0.0%
P/E TTM	22.1
P/E F1	19.6
PEG F1	1.2
P/S TTM	4.7

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	258 E	284 E	293 E	269 E	1,114 E
2019	242 A	272 A	277 A	256 E	1,047 E
2018	227 A	249 A	261 A	239 A	975 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	$1.12 E	$1.40 E	$1.53 E	$1.10 E	$5.13 E
2019	$1.10 A	$1.27 A	$1.38 A	$0.85 E	$4.57 E
2018	$0.79 A	$1.01 A	$1.11 A	$0.80 A	$3.66 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 01/13/2020. The reports text is as of 01/14/2020.

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.

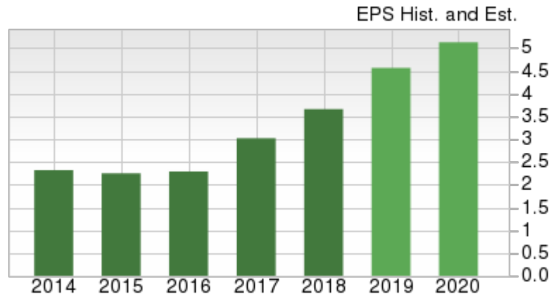
As of Sep 30, 2019, the company operated 13 manufacturing plants in three countries, including 10 plants located throughout the United States.

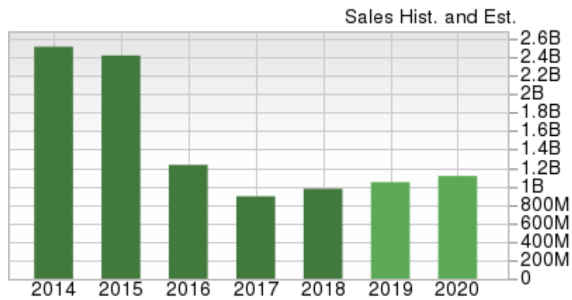
On Sep 30, Armstrong World completed the divesture of its EMEA (Europe, the Middle East and Africa) and Pacific Rim businesses. Armstrong World currently operates in three reporting segments — Mineral Fiber, Architectural Specialties and Unallocated Corporate.

Mineral Fiber (accounting for 78.9% of third-quarter 2019 revenues) produces suspended mineral fiber and soft fiber ceiling systems for use in commercial and residential settings.

Architectural Specialties (21.1%) 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 Buy:

Armstrong World will gain from AUV improvement, focus on restructuring activities and investment in new products as well as the Tectum acquisition.

▲ **Strong Performance & Prospects**: Shares of Armstrong World have outperformed its industry in the past year. The company has been recording solid earnings and revenue improvement over the last few quarters. In addition, it ended the first nine months of 2019 on a solid note, with sales increasing 7.5%, adjusted earnings per share rising 22%, adjusted EBITDA up 14.5% and adjusted EBITDA margin expanding 248 basis points (bps). The strong performance was mainly driven by solid volume growth in the Architectural Specialties unit and higher AUVs in the Mineral Fiber segment, along with lower manufacturing expenses and higher equity earnings from WAVE. During the said period, the company managed to increase free cash flow by 16.9% to $173 million. Also, solid organic growth and its recent acquisitions added to the positives.

Overall, the business has been gaining momentum and growing significantly faster than the underlying market. Armstrong World expects net sales between $1.04 billion and $1.05 billion, reflecting 7-8% growth in 2019, aided by robust pipeline and focus on actively expanding strategic capabilities.

The company expects EBITDA improvement of 13-15% during the year, driven by sales gain, productivity improvements in plants and the impact of announced restructuring activities, which will in turn support the bottom line. The company's results will also be aided by strong repair and remodel activity, as well as the continuation of positive new building construction activity.

▲ **In-organic Moves to Bolster Product Offering**: Armstrong World follows a systematic inorganic strategy to enhance its portfolio. On Mar 4, 2019, the company acquired Architectural Components Group, Inc. ("ACGI"), a leading custom wood ceilings and walls solution provider. The ACGI acquisition — the largest to date for Armstrong World — added $7 million to its total net sales in the third quarter.

In 2018, the company acquired Steel Ceilings (SCI), an OH-based manufacturer of aluminum and stainless metal ceilings, and Plasterform, a Canada-based manufacturer of architectural cast ceilings, walls, facades, columns and moldings. The buyout is providing it manufacturing and selling capabilities for ultra-expressive, custom architectural cast ceilings, and walls and other items. Notably, the company has announced another acquisition

Apart from strategic acquisitions, Armstrong World entered into an agreement in November 2017 to divest its EMEA and Pacific Rim businesses to Knauf. The divestment is a significant step of the company's ongoing transformation plan. On Dec 7, European Commission ("EC") approved the proposed sale. This move addresses EC's apprehension that the Armstrong-Knauf deal would significantly reduce the level of competition in certain markets, as well as lead to increased prices for commercial and public customers. Notably, on Sep 30, it completed the sale of EMEA and Pacific Rim businesses.

▲ **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. Notably, its adjusted EBITDA grew 13.4% and adjusted EBITDA margin expanded 275 bps year over year in the third quarter, courtesy of higher volume, price and mix. Resultantly, the company adjusted earnings in the said period grew more than 20% 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. Again later in 2019, it intends to introduce 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 2019 and beyond.

Reasons To Sell:

- **Raw Material & Freight Costs Inflation**: Higher freight and raw material costs remains a concern for Armstrong World. In the past nine months, its selling, general and administrative expenses grew 153 bps year over year. Although inflation was moderate in the third quarter, it may concern the company in future.

Raw-material and freight cost remain causes of concern.

  The steel and aluminum tariffs continued to impact its material costs. Although the company has been working to recover higher commodity cost through price increases, we expect this ongoing volatility in material costs to continue in the near term.

- **Soft Volumes**: Volumes in the Mineral Fiber segment have been soft over the last few quarters, due to weakness in Latin-America, its Big Box channel and weather-related challenges in the upper Midwest and parts of Canada. Although the segment's volume improved during the third quarter, the same remained soft in Canada and the big box channels. 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.

  Net sales in the segment grew nearly 3% year over year during the quarter, of which volumes contributed just 1% improvement. Meanwhile, the company has lowered the upper limit of its 2019 sales growth guidance to 8% from 10%.

- **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 (P/E) ratio is 222.05, which is higher than the industry's 15.87. This implies that the stock is overvalued compared to its peers.

Last Earnings Report

Quarter Ending	09/2019
Report Date	**Oct 28, 2019**
Sales Surprise	**-4.27%**
EPS Surprise	**6.15%**
Quarterly EPS	**1.38**
Annual EPS (TTM)	**4.55**

Armstrong World's (AWI) Q3 Earnings Beat, Revenues Miss

Armstrong World Industries, Inc. reported third-quarter 2019 results, wherein earnings surpassed the Zacks Consensus Estimate, while revenues missed the same.

The company reported adjusted earnings of $1.38 per share, surpassing the consensus estimate of $1.30 by 6.2%. Also, the reported figure increased 20.1% from $1.15 per share in the year-ago quarter.

Although its net sales of $277.1 million lagged analysts' expectation of $289.5 million by 4.3%, the figure increased 6.4% year over year, driven by increased volumes in the Architectural Specialties segment and higher Mineral Fiber average unit value ("AUV") on the back of positive like-for-like pricing and favorable mix.

Operational Update

Selling, general and administrative (SG&A) expenses increased 17% year over year.

Adjusted operating income increased 13.1% year over year to $95 million, mainly driven by positive Mineral Fiber AUV, volume growth in the Architectural Specialties segment and higher equity earnings from its WAVE joint venture. Adjusted EBITDA also improved 13.4% year over year to $114 million.

Segmental Performance

Mineral Fiber (accounting for 78.9% of net sales): The segment's sales were up 2.7% on a year-over-year basis to $218.6 million, backed by higher AUV and volume.

Operating income grew 44.2% from the prior-year quarter, attributable to higher equity earnings from WAVE, increased sales and lower SG&A expenses. Adjusted EBITDA also grew 12.7% from the prior-year quarter to $99 million.

Architectural Specialties (21.1%): Net sales in the segment grew 22.6% year over year to $58.5 million, courtesy of higher volumes owing to increased market penetration. Acquisitions of Architectural Components Group, Plasterform and Steel Ceilings also added to the positives.

The segment's operating profit improved 2.7% year over year, primarily on the back of higher sales volume, partially offset by more investments in selling and design capacities. Moreover, adjusted EBITDA of $14 million increased 18.1% from the year-ago level.

Notably, **Unallocated Corporate** expense of $1.8 million was flat year over year.

Financials

As of Sep 30, 2019, Armstrong World had cash and cash equivalents of $98 million compared with $337 million in the comparable period of 2018.

Net cash provided by operations was $74 million in the third quarter compared with $70 million recorded in the year-ago period.

The company's free cash flow (on an adjusted basis) was $99 million during the quarter compared with $74 million in the prior-year period.

2019 Guidance

Given its robust pipeline and focus on actively expanding strategic capabilities, Armstrong World expects mergers and acquisitions activity to continue. The company also announced another acquisition recently, marking its fifth one in the last three years. It is to be noted that the company's board approved a 14% increase in quarterly dividend. Encouragingly, it expects to continue the trend of increasing free cash flow at double digits.

Armstrong World has tightened its 2019 guidance. It now expects sales in the range of $1.04-$1.05 billion, indicating an annual growth of 7-8%, backed by volume gains in Architectural Specialties, AUV expansion in Mineral Fiber and acquisitions. However, upper range of the said growth rate is lowered from the prior expectation of 10%.

The company expects adjusted EBITDA between $400 and $405 million, suggesting 13-15% growth from a year ago.

Valuation

Armstrong World shares are up 58.2% in the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Construction sector are up 39.7% and 36.1% in the past year, respectively.

The S&P 500 index is up 27.7% in the past year.

The stock is currently trading at 19.51X forward 12-month price to earnings, which compares to 14X for the Zacks sub-industry, 15.38X for the Zacks sector and 19X for the S&P 500 index.

Over the past five years, the stock has traded as high as 24.37X and as low as 12.62X, with a 5-year median of 17.03X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $105 price target reflects 20.39X 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	19.51	14	15.38	19
	5-Year High	24.37	17.91	18.83	19.34
	5-Year Low	12.62	7.19	10.63	15.17
	5-Year Median	17.03	14	15.97	17.44
P/S F12M	Current	4.36	1.21	1.92	3.52
	5-Year High	4.46	3.63	2.23	3.52
	5-Year Low	0.8	0.69	1.25	2.54
	5-Year Median	1.9	0.87	1.63	3
EV/EBITDA TTM	Current	14.21	22.02	19.09	12.12
	5-Year High	16.23	30.09	22.53	12.86
	5-Year Low	7.82	17.59	14.4	8.48
	5-Year Median	10.76	23.43	19.39	10.67

As of 01/13/2020

Industry Analysis **Zacks Industry Rank:** Top 29% (73 out of 254)

Top Peers

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

Industry Comparison Industry: Building Products - Miscellaneous

Industry Peers

	AWI Neutral	X Industry	S&P 500	NX Neutral	ROCK Neutral	SSD Neutral
VGM Score	C	-	-	A	A	B
Market Cap	4.87 B	1.07 B	24.31 B	568.59 M	1.68 B	3.68 B
# of Analysts	4	3	13	1	2	2
Dividend Yield	0.80%	0.00%	1.76%	1.86%	0.00%	1.11%
Value Score	C	-	-	A	C	C
Cash/Price	0.02	0.08	0.04	0.05	0.08	0.05
EV/EBITDA	15.00	9.40	14.12	7.09	13.90	16.06
PEG Ratio	1.20	1.47	2.05	NA	NA	NA
Price/Book (P/B)	13.25	1.86	3.34	1.73	2.55	4.23
Price/Cash Flow (P/CF)	18.39	10.03	13.66	3.67	18.51	21.11
P/E (F1)	19.56	17.40	18.82	17.22	18.39	23.63
Price/Sales (P/S)	4.72	1.29	2.64	0.64	1.63	3.30
Earnings Yield	5.11%	5.56%	5.29%	5.81%	5.44%	4.24%
Debt/Equity	1.77	0.65	0.72	0.47	0.03	0.03
Cash Flow ($/share)	5.46	2.50	6.94	4.69	2.81	3.93
Growth Score	B	-	-	A	A	A
Hist. EPS Growth (3-5 yrs)	16.19%	22.67%	10.56%	20.03%	34.49%	21.37%
Proj. EPS Growth (F1/F0)	12.32%	14.47%	7.49%	5.26%	10.98%	19.15%
Curr. Cash Flow Growth	7.22%	13.50%	14.83%	108.85%	17.08%	40.71%
Hist. Cash Flow Growth (3-5 yrs)	3.47%	13.23%	9.00%	28.42%	13.23%	18.17%
Current Ratio	2.09	1.76	1.23	1.73	1.81	3.83
Debt/Capital	63.91%	40.61%	42.99%	32.14%	3.02%	3.01%
Net Margin	19.55%	5.51%	11.08%	-5.23%	6.20%	10.89%
Return on Equity	78.13%	12.44%	17.16%	8.77%	12.74%	14.76%
Sales/Assets	0.57	1.06	0.55	1.30	1.08	1.06
Proj. Sales Growth (F1/F0)	6.41%	3.80%	4.23%	2.43%	3.88%	6.94%
Momentum Score	F	-	-	F	B	C
Daily Price Chg	1.70%	0.72%	0.73%	0.47%	1.48%	1.39%
1 Week Price Chg	2.85%	0.57%	0.39%	1.96%	1.75%	0.60%
4 Week Price Chg	6.01%	0.16%	1.84%	-10.96%	0.33%	7.00%
12 Week Price Chg	0.09%	6.12%	6.48%	-8.65%	14.63%	13.33%
52 Week Price Chg	55.17%	34.86%	23.15%	11.17%	44.01%	42.06%
20 Day Average Volume	219,760	219,760	1,578,594	350,501	143,877	289,609
(F1) EPS Est 1 week change	0.24%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.24%	0.00%	0.00%	-4.76%	0.00%	0.00%
(F1) EPS Est 12 week change	0.15%	-2.80%	-0.48%	-4.76%	4.43%	7.99%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	NA	0.00%	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	C
Growth Score	B
Momentum Score	F
VGM Score	C

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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