

Armstrong World (AWI)

\$103.62 (As of 02/26/20)

Price Target (6-12 Months): **\$119.00**

Long Term: 6-12 Months

Zacks Recommendation: **Outperform**

(Since: 02/25/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: C

Growth: C

Momentum: A

Summary

Shares of Armstrong World have outperformed its industry so far this year. The trend is likely to continue, given better-than-expected fourth-quarter 2019 earnings. Its earnings topped the Zacks Consensus Estimate by 30.6% and increased a whopping 40% from the year-ago quarter, aided by positive Mineral Fiber AUV, volume growth in Architectural Specialties, manufacturing productivity and lower SG&A expenses. The company expects adjusted EPS to improve 9-13% during 2020, driven by sales gain and productivity improvement in plants. However, soft volumes in the Mineral Fiber segment have been a pressing concern. This is due to ongoing 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.

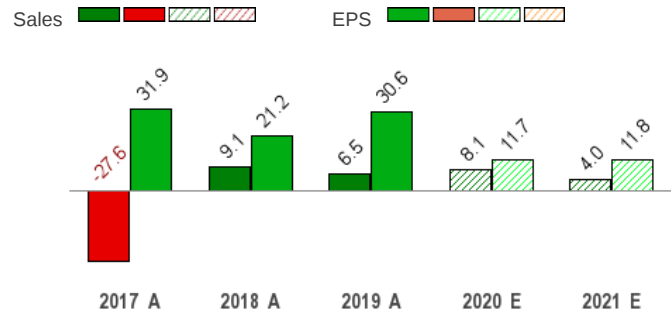
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$111.46 - \$72.11
20 Day Average Volume (sh)	320,800
Market Cap	\$5.0 B
YTD Price Change	10.3%
Beta	1.58
Dividend / Div Yld	\$0.80 / 0.8%
Industry	Building Products - Miscellaneous
Zacks Industry Rank	Top 28% (72 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	30.6%
Last Sales Surprise	-3.5%
EPS F1 Est- 4 week change	2.3%
Expected Report Date	05/04/2020
Earnings ESP	0.0%
P/E TTM	21.3
P/E F1	19.7
PEG F1	1.2
P/S TTM	4.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	273 E	311 E	317 E	281 E	1,167 E
2020	257 E	290 E	296 E	267 E	1,122 E
2019	242 A	272 A	277 A	247 A	1,038 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.33 E	\$1.68 E	\$1.80 E	\$1.40 E	\$5.97 E
2020	\$1.16 E	\$1.49 E	\$1.55 E	\$1.15 E	\$5.34 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 02/26/2020. The reports text is as of 02/27/2020.

Overview

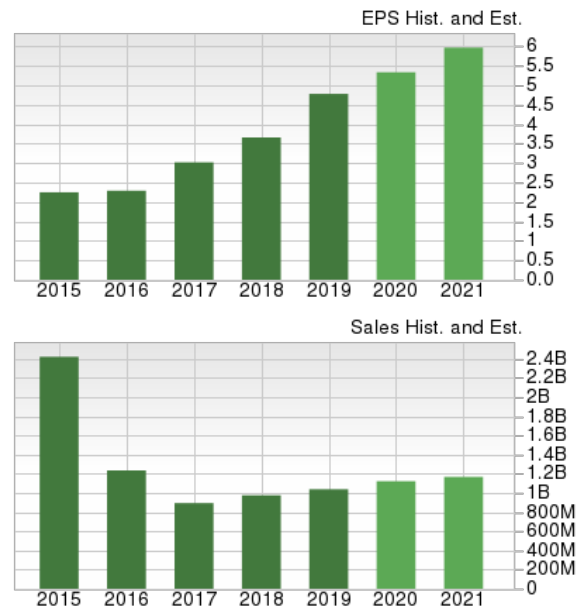
Pennsylvania-based **Armstrong World** is a leading global producer of ceiling systems for use primarily in the construction and renovation of commercial, institutional and residential buildings. It designs, manufactures and sells ceiling systems (primarily mineral fiber, fiberglass wool and metal) globally.

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 Buy:

- ▲ **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 2019 on a solid note, with sales increasing 6%, adjusted earnings per share rising 31%, adjusted EBITDA improving 14% and adjusted EBITDA margin expanding 270 basis points (bps). The strong performance was mainly driven by solid volume growth in the Architectural Specialties unit, higher AUVs in the Mineral Fiber segment, improved manufacturing productivity and higher equity earnings from WAVE. During the said period, the company managed to increase free cash flow by 3% to \$244 million. Also, solid organic growth and its recent acquisitions added to the positives.

Armstrong World will gain from AUV improvement, investment in new products as well as acquisitions.

Overall, the business has been gaining momentum and growing significantly faster than the underlying market. Armstrong World expects 2020 net sales between \$1.1 billion and \$1.125 billion, reflecting 6-8% growth, aided by its robust pipeline and focus on actively expanding strategic capabilities. The company expects adjusted EPS to improve 9-13% during 2020, driven by sales gain and productivity improvements in plants, which will in turn support the bottom line. The company's results will also be aided by the continuation of positive new building construction activity.

- ▲ **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. The ACGI acquisition — the largest to date for Armstrong World — added \$7 million to its total net sales in the third quarter.

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. Notably, its adjusted EBITDA grew 14% and EBITDA margin expanded 270 bps year over year in 2019, courtesy of higher volume, price and mix. Resultantly, the company's adjusted earnings grew 31% 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.

Risks

- **Soft Volumes:** 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.

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 23.33, which is higher than the industry's 15.72. This implies that the stock is overvalued than its peers.
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Last Earnings Report

Armstrong World's (AWI) Q4 Earnings Beat, Revenues Miss

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

The company reported adjusted earnings of \$1.11 per share, surpassing the consensus estimate of 85 cents by 30.6%. Also, the reported figure reflected a whopping 40% year-over-year growth.

Although its net sales of \$246.9 million lagged analysts' expectation of \$256 million by 3.5%, the figure increased 3.3% 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.

Quarter Ending **12/2019**

Report Date	Feb 24, 2020
Sales Surprise	-3.45%
EPS Surprise	30.59%
Quarterly EPS	1.11
Annual EPS (TTM)	4.86

Operational Update

Selling, general and administrative (SG&A) expenses decreased 11.7% year over year to \$40 million in the quarter.

Adjusted EBITDA advanced 13.9% from the prior-year quarter to \$90 million. The company recorded EBITDA growth in 39 out of the last 40 quarters, demonstrating the stability of business. EBITDA margins expanded 330 bps in the quarter.

Adjusted operating income increased 11.5% year over year to \$68 million, driven by higher sales, manufacturing productivity, and increased equity earnings from WAVE, which included a gain on the sale of European and Pacific Rim businesses.

Segmental Performance

Mineral Fiber (accounting for 79.9% of net sales): Backed by higher AUV, the segment's sales were up 3.1% on a year-over-year basis to \$197.2 million, partly offset by lower volume.

Operating income grew 20.9% from the prior-year quarter, attributable to higher sales, improved manufacturing productivity and lower SG&A expenses. Adjusted EBITDA also grew 15% from the prior-year quarter to \$81 million, given higher AUV, productivity and WAVE.

Architectural Specialties (20.1%): Net sales in the segment grew 4.4% year over year to \$49.7 million, courtesy of higher volumes owing to increased market penetration.

The segment's operating profit declined 8.2% year over year due to additional investments in selling and design capacities and the integration of acquisitions, partially offset by the positive impact of higher sales volume. Moreover, adjusted EBITDA of \$8 million increased 2.2% from the year-ago level.

Notably, unallocated corporate expense of \$2.5 million was flat year over year.

2019 Highlights

Net sales grew 6% from a year ago to \$1,038 million. Adjusted EBITDA advanced 14% to \$403 million and adjusted EPS increased 31% to \$4.78.

Financials

As of Dec 31, 2019, Armstrong World had cash and cash equivalents of \$45.3 million compared with \$335.7 million in the comparable period of 2018.

Net cash provided by operations was \$182.7 million in 2019 compared with \$203.2 million recorded in 2018.

The company's free cash flow (on an adjusted basis) was \$71 million during the quarter and \$244 million in 2019 compared with \$88 million and 236 million in the respective prior-year periods.

2020 Guidance

In 2020, Armstrong World expects to witness the same market conditions as were in 2019. It expects to increase sales in the high-single digit range, expand adjusted EBITDA margins and generate sector leading adjusted free cash flow of more than 25% of sales.

The company expects adjusted EBITDA between \$435 and \$445 million. Operating income is expected within \$360-\$370 million and adjusted EPS in the range of \$5.20-\$5.40. The Zacks Consensus Estimate for 2020 EPS is currently pegged at \$5.13.

Valuation

Armstrong World shares are up 41.6% in the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Construction sector are up 12.4% and 16.4% in the past year, respectively.

The S&P 500 index is up 11% in the past year.

The stock is currently trading at 19.96X forward 12-month earnings, which compares to 12.83X for the Zacks sub-industry, 14.96X for the Zacks sector and 17.81X 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 Outperform recommendation indicates that the stock will perform better than the market. Our \$119 price target reflects 22.93X 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	19.96	12.83	14.96	17.81
	5-Year High	24.37	17.9	18.86	19.34
	5-Year Low	12.62	7.13	10.71	15.18
	5-Year Median	17.03	13.87	15.96	17.47
P/S F12M	Current	4.49	1.12	1.82	3.28
	5-Year High	4.61	3.59	2.23	3.43
	5-Year Low	0.8	0.69	1.25	2.54
	5-Year Median	1.93	0.88	1.65	3
EV/EBITDA TTM	Current	15.47	22.21	19.58	12
	5-Year High	16.23	30.62	22.6	12.87
	5-Year Low	7.82	17.85	14.43	8.48
	5-Year Median	10.81	23.45	19.38	10.77

As of 02/26/2020

Industry Analysis Zacks Industry Rank: Top 28% (72 out of 254)



Top Peers

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

Industry Comparison Industry: Building Products - Miscellaneous				Industry Peers		
	AWI Outperform	X Industry	S&P 500	NX Neutral	ROCK Neutral	SSD Neutral
VGM Score	C	-	-	-	B	B
Market Cap	4.97 B	935.06 M	22.59 B	593.18 M	1.64 B	3.56 B
# of Analysts	3	2	13	0	1	2
Dividend Yield	0.77%	0.00%	1.92%	1.78%	0.00%	1.14%
Value Score	C	-	-	-	B	D
Cash/Price	0.02	0.08	0.04	0.05	0.08	0.06
EV/EBITDA	15.29	9.66	13.29	7.34	13.59	15.37
PEG Ratio	1.21	1.18	1.93	NA	NA	NA
Price/Book (P/B)	13.68	1.61	3.03	1.80	2.50	3.99
Price/Cash Flow (P/CF)	18.99	9.65	12.33	3.82	18.12	20.42
P/E (F1)	19.74	16.17	17.79	NA	18.07	23.56
Price/Sales (P/S)	4.79	1.14	2.47	0.66	1.60	3.14
Earnings Yield	5.07%	5.92%	5.60%	NA%	5.53%	4.24%
Debt/Equity	1.77	0.54	0.70	0.47	0.03	0.03
Cash Flow (\$/share)	5.46	2.63	7.02	4.69	2.81	3.93
Growth Score	C	-	-	NA	A	A
Hist. EPS Growth (3-5 yrs)	16.19%	21.79%	10.85%	20.03%	34.49%	21.79%
Proj. EPS Growth (F1/F0)	9.78%	13.38%	6.79%	NA	10.59%	14.43%
Curr. Cash Flow Growth	7.22%	8.31%	6.53%	108.85%	17.08%	40.71%
Hist. Cash Flow Growth (3-5 yrs)	3.47%	13.33%	8.38%	28.42%	13.23%	18.17%
Current Ratio	2.09	1.76	1.22	1.73	1.81	4.03
Debt/Capital	63.91%	39.45%	42.37%	32.14%	3.02%	3.04%
Net Margin	20.66%	4.52%	11.57%	-5.23%	6.20%	11.79%
Return on Equity	80.83%	11.67%	16.80%	8.77%	12.74%	15.43%
Sales/Assets	0.58	1.05	0.54	1.30	1.08	1.06
Proj. Sales Growth (F1/F0)	7.64%	3.58%	4.06%	2.43%	7.93%	6.70%
Momentum Score	A	-	-	-	F	D
Daily Price Chg	-1.87%	-1.22%	-0.98%	-1.97%	-1.24%	0.14%
1 Week Price Chg	2.50%	0.04%	-0.94%	2.99%	-0.05%	-0.15%
4 Week Price Chg	1.88%	-7.12%	-6.27%	0.73%	-9.05%	-7.12%
12 Week Price Chg	10.56%	-2.90%	-3.33%	-5.33%	-3.23%	-1.22%
52 Week Price Chg	37.83%	10.60%	6.81%	3.64%	25.93%	34.70%
20 Day Average Volume	320,800	162,296	2,109,774	182,284	154,142	242,222
(F1) EPS Est 1 week change	2.34%	0.00%	0.00%	NA	-0.70%	0.00%
(F1) EPS Est 4 week change	2.34%	-0.14%	-0.08%	NA	-0.70%	-2.99%
(F1) EPS Est 12 week change	2.59%	-0.49%	-0.22%	NA	-0.35%	-2.99%
(Q1) EPS Est Mthly Chg	2.46%	0.00%	-0.61%	NA	-10.53%	5.47%

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	C
Momentum Score	A
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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