Armstrong Flooring, Inc.
Form 10-Q
August 12, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 001-37589
ARMSTRONG FLOORING, INC.
(Exact name of Registrant as specified in its charter)

Delaware	47-4303305
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer Identification number)

2500 Columbia Avenue, PO Box 3025, Lancaster, Pennsylvania 17604
(Address of principal executive offices)

(717) 672-9611
(Registrant's telephone number, including area code).

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that registrant was required to submit and post such files.) Yes þ No ¨

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ¨ Accelerated filer ¨
Non-accelerated filer þ Smaller reporting company ¨

Indicate by check mark whether the Registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).
Yes ¨ No þ

The Registrant had 27,792,748 shares of common stock, $0.0001 par value, outstanding at August 5, 2016.

Armstrong Flooring, Inc.

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Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)
(Unaudited)
(Dollars in millions, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net sales	$323.7	$326.6	$608.1	$586.0
Cost of goods sold	260.5	260.2	497.7	478.1
Gross profit	63.2	66.4	110.4	107.9
Selling, general and administrative expenses	51.4	51.8	103.2	96.7
Operating income	11.8	14.6	7.2	11.2
Interest expense	0.7	—	0.7	—
Other non-operating expense	1.9	0.1	2.2	0.1
Other non-operating income	0.2	—	0.4	0.2
Income from continuing operations before income taxes	9.4	14.5	4.7	11.3
Income tax expense	3.7	5.7	3.3	6.4
Income from continuing operations	5.7	8.8	1.4	4.9
Net (loss) gain on disposal of discontinued business, net of tax benefit (expense) of $-, $(0.1), $1.8 and $43.6	—	(0.2)	1.7	42.3
Net (loss) income from discontinued operations	—	(0.2)	1.7	42.3
Net income	5.7	8.6	3.1	47.2
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(2.6)	1.4	(6.7)	(3.5)
Derivative loss	(0.1)	(1.2)	(1.9)	(0.3)
Postretirement adjustments	0.8	—	0.9	—
Total other comprehensive (loss) income	(1.9)	0.2	(7.7)	(3.8)
Total comprehensive income (loss)	$3.8	$8.8	$(4.6)	$43.4
Per share data:				
Basic earnings (loss) per share of common stock:				
Basic earnings per share of common stock from continuing operations	$0.21	$0.32	$0.05	$0.18
Basic (loss) earnings per share of common stock from discontinued operations	—	(0.01)	0.06	1.52
Basic earnings per share of common stock	$0.21	$0.31	$0.11	$1.70
Diluted earnings (loss) per share of common stock:				
Diluted earnings per share of common stock from continuing operations	$0.20	$0.32	$0.05	$0.18
Diluted (loss) earnings per share of common stock from discontinued operations	—	(0.01)	0.06	1.52
Diluted earnings per share of common stock	$0.20	$0.31	$0.11	$1.70

See accompanying notes to condensed consolidated financial statements.

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Armstrong Flooring, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(Dollars in millions)

	June 30, 2016 (Unaudited)	December 31, 2015
Assets		
Current assets:		
Cash	$ 101.6	$ —
Accounts and notes receivable, net	111.8	72.2
Inventories, net	243.9	242.8
Deferred income taxes	—	3.0
Prepaid expenses and other current assets	27.6	31.7
Total current assets	484.9	349.7
Property, plant, and equipment, less accumulated depreciation and amortization of $321.2 and $311.1, respectively	441.9	434.5
Intangible assets, net	42.7	42.6
Deferred income taxes	14.0	23.5
Other non-current assets	2.6	13.1
Total assets	$ 986.1	$ 863.4
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 168.0	$ 161.0
Income tax payable	4.7	—
Deferred income taxes	—	0.3
Total current liabilities	172.7	161.3
Long-term debt	100.0	10.0
Postretirement benefit liabilities	79.4	3.3
Pension benefit liabilities	28.5	—
Other long-term liabilities	8.5	12.4
Noncurrent income taxes payable	0.7	56.4
Deferred income taxes	—	2.1
Total noncurrent liabilities	217.1	84.2
Stockholders' equity:		
Common stock with par value $.0001 per share: 100,000,000 shares authorized; 27,746,939 issued and outstanding	—	—
Preferred stock with par value $.0001 per share: 15,000,000 shares authorized; none issued	—	—
Additional paid-in capital	650.5	—
Net Armstrong World Industries ("AWI") investment, prior to Separation	—	615.9
Retained earnings	5.7	—
Accumulated other comprehensive (loss) income	(59.9)	2.0
Total stockholders' equity	596.3	617.9
Total liabilities and stockholders' equity	$ 986.1	$ 863.4

See accompanying notes to condensed consolidated financial statements.

Armstrong Flooring, Inc. and Subsidiaries
Condensed Consolidated Statements of Stockholders' Equity (Unaudited)
(Dollars in millions)

	Common Stock		Net AWI Investment	Additional Paid-in Capital	Accumulated Other Comprehensive (Loss) Income	Retained Earnings	Total Equity
	Shares	Amount					
December 31, 2015	—	$ —	$ 615.9	$ —	$ 2.0	$ —	$ 617.9
Net (loss) income			(2.6)		—	5.7	3.1
Net transfers from (to) AWI	—	—	85.1	—	(54.2)	—	30.9
Cash distribution paid to AWI	—	—	(50.0)	—	—	—	(50.0)
Reclassification of net parent investment to additional paid-in capital	—	—	(648.4)	648.4	—	—	—
Issuance of common stock at separation	27,738,779	—	—	—	—	—	—
Stock-based employee compensation, net	8,160	—	—	2.1	—	—	2.1
Other comprehensive loss	—	—	—	—	(7.7)	—	(7.7)
June 30, 2016	27,746,939	$ —	$ —	$ 650.5	$ (59.9)	$ 5.7	$ 596.3
December 31, 2014	—	$ —	$ 561.7	$ —	$ 13.7	$ —	$ 575.4
Net income	—	—	47.2	—	—	—	47.2
Net transfers from AWI	—	—	8.8	—	—	—	8.8
Other comprehensive loss	—	—	—	—	(3.8)	—	(3.8)
June 30, 2015	—	$ —	$ 617.7	$ —	$ 9.9	$ —	$ 627.6

See accompanying notes to condensed consolidated financial statements.

Armstrong Flooring, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)
(Dollars in millions)

	Six Months Ended June 30,	
	2016	2015
Cash flows from operating activities:		
Net income	$3.1	$47.2
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	22.2	18.7
Loss on disposal of discontinued operations	—	0.8
Deferred income taxes	(3.8)	(44.5)
Stock-based compensation	2.2	—
U.S. pension expense	2.2	—
Other non-cash adjustments, net	0.2	(0.1)
Changes in operating assets and liabilities:		
Receivables	(32.7)	(17.2)
Inventories	(1.2)	(16.1)
Accounts payable and accrued expenses	23.3	23.2
Income taxes payable	4.8	4.9
Other assets and liabilities	4.0	(1.9)
Net cash provided by operating activities	24.3	15.0
Cash flows from investing activities:		
Purchases of property, plant and equipment	(18.0)	(22.7)
Proceeds from the sale of assets	0.5	0.1
Other investing activities	0.2	0.2
Net cash used for investing activities	(17.3)	(22.4)
Cash flows from financing activities:		
Proceeds from revolving credit facility	100.0	—
Financing costs	(1.4)	—
Payments of long-term debt	(10.0)	—
Distribution paid to AWI	(50.0)	—
Net transfers from AWI	55.6	7.4
Net cash provided by financing activities	94.2	7.4
Effect of exchange rate changes on cash and cash equivalents	0.4	—
Net increase in cash and cash equivalents	101.6	—
Cash and cash equivalents at beginning of year	—	—
Cash and cash equivalents at end of period	$101.6	$—
Supplemental Cash Flow Disclosure:		
Amounts in accounts payable for capital expenditures	$3.5	$13.7
Interest paid	0.5	—
Income taxes paid, net	0.5	—

See accompanying notes to condensed consolidated financial statements.

Armstrong Flooring, Inc. and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements

NOTE 1. BUSINESS AND BASIS OF PRESENTATION

Background

We are a leading global producer of flooring products for use primarily in the construction and renovation of residential, commercial and institutional buildings. We design, manufacture, source and sell resilient and wood flooring products in North America and the Pacific Rim.

On April 1, 2016, Armstrong Flooring, Inc. ("AFI") became an independent company as a result of the separation by Armstrong World Industries ("AWI"), a Pennsylvania corporation, of its Resilient Flooring and Wood Flooring segments from its Building Products ("Ceiling") segment (the "Separation"). The Separation was effected by allocating the assets and liabilities related primarily to the Resilient Flooring and Wood Flooring segments to AFI and then distributing the common stock of AFI to AWI’s shareholders (the "Distribution"). The Separation and Distribution (together, the "Spin-off") resulted in AFI and AWI becoming two independent, publicly traded companies, with AFI owning and operating the Resilient Flooring and Wood Flooring segments and AWI continuing to own and operate a ceilings business. When we refer to "AFI," "the Company," "we," "our," and "us" in this report, we are referring to Armstrong Flooring, Inc., a Delaware corporation, and its consolidated subsidiaries unless the context requires otherwise.

Basis of Presentation

Prior to April 1, 2016, AFI operated as a part of AWI. The financial information for these periods was prepared on a combined basis from AWI’s historical accounting records and is presented herein on a stand-alone basis as if the operations had been conducted independently of AWI. Beginning April 1, 2016, the financial information was prepared on a consolidated basis. The Condensed Consolidated Financial Statements of AFI presented are not indicative of our future performance, and do not necessarily reflect what our historical results of operations, financial position and cash flows would have been if we had operated as a separate, stand-alone entity during all reported periods.

For periods prior to April 1, 2016, AFI was comprised of certain stand-alone legal entities for which discrete financial information was available, as well as portions of legal entities for which discrete financial information was not available ("Shared Entities"). For the Shared Entities for which discrete financial information was not available, such as shared utilities, taxes, and other shared costs, allocation methodologies were applied to allocate amounts to AFI. The Condensed Consolidated Statements of Operations and Comprehensive Income for these periods include all revenues and costs attributable to AFI, including costs for facilities, functions and services used by AFI. The results of operations for those periods also include allocations of costs for administrative functions and services performed on behalf of AFI by centralized staff groups within AWI, AWI’s general corporate expenses and certain pension and other retirement benefit costs for those periods. All of the allocations and estimates in the Condensed Consolidated Financial Statements are based on assumptions that AFI management believes are reasonable. These statements should be read in conjunction with the Combined Financial Statements and notes for the fiscal year ended December 31, 2015 (the "Combined Financial Statements") in our Information Statement, dated March 24, 2016 (the "Information Statement", filed as Exhibit 99.1 to our Current Report on Form 8-K dated March 24, 2016).

All charges and allocations of cost for facilities, functions and services performed by AWI prior to the Spin-off were deemed paid by AFI to AWI in cash, in the period in which the cost was recorded in the Condensed Consolidated Statements of Operations and Comprehensive Income (Loss). Prior to the Spin-off, transactions between AWI and AFI were accounted for through Net AWI investment.

Prior to the Spin-off, AFI’s portion of current income taxes payable was deemed to have been remitted to AWI in the period the related tax expense was recorded. AFI’s portion of current income taxes receivable was deemed to have been remitted to AFI by AWI in the period to which the receivable applies only to the extent that a refund of such taxes could have been recognized by AFI on a stand-alone basis under the law of the relevant taxing jurisdiction.

These Condensed Consolidated Financial Statements are prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP"). The statements include management estimates and

Armstrong Flooring, Inc. and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements

judgments, where appropriate. Management uses estimates to record many items including certain asset values, allowances for bad debts, inventory obsolescence and lower of cost or market charges, warranty reserves, workers compensation, general liability and environmental claims and income taxes. When preparing an estimate, management determines the amount based upon the consideration of relevant information. Management may confer with outside parties, including outside counsel. Actual results may differ from these estimates. In the opinion of management, all adjustments of a normal, recurring nature have been included to provide a fair statement of the results for the reporting periods presented. Operating results for the three and six months ended June 30, 2016 and 2015 included in this report are unaudited. Quarterly results are not necessarily indicative of annual earnings, primarily due to the different level of sales in each quarter of the year and the possibility of changes in economic conditions between periods.

The accounting policies used in preparing the Condensed Consolidated Financial Statements are the same as those used in preparing the Combined Financial Statements for the year ended December 31, 2015 as disclosed in our information statement included in our Registration Statement (the "Information Statement").

All significant intercompany transactions within AFI have been eliminated from the Condensed Consolidated Financial Statements.

The impact of the separation activities on equity is reflected in Net transfers (to)/ from AWI on the Condensed Consolidated Statements of Stockholders' Equity. The components of Net transfers (to)/ from AWI on the Condensed Consolidated Statements of Stockholders' Equity and the related cash flow were as follows:

	June 30, 2016	
(Dollars in millions)	Condensed Consolidated Statements of Stockholders' Equity	Condensed Consolidated Statements of Cash Flows - Financing Activities
Net transfers from AWI for three months ended March 31, 2016	$53.6	$ 53.6
Net transfers (to) from AWI upon separation	(22.7)	9.0
Other activity concurrent with separation	—	(7.0)
	30.9	55.6
Cash distribution to AWI upon separation	(50.0)	(50.0)
Net transfers (to) from AWI	$(19.1)	$ 5.6

Recently Adopted Accounting Standards

In November 2015, the FASB issued Accounting Standards Update ("ASU") 2015-17, "Balance Sheet Classification of Deferred Taxes." The guidance requires entities with a classified balance sheet to present all deferred tax assets and liabilities as noncurrent. The new guidance may be applied retrospectively or prospectively and is effective for annual reporting periods beginning after December 15, 2016, but early adoption is permitted. We adopted this standard effective April 1, 2016; the balance sheet as of December 31, 2015 was not retrospectively adjusted. Adoption of this standard did not impact our financial condition, results of operations or cash flows.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting." The guidance simplifies accounting for share-based payments, most notably by requiring all excess tax benefits and tax deficiencies to be recorded as income tax benefits or expense on the statement of operations and by allowing entities to elect to recognize forfeitures of awards when they occur. The new guidance may be applied retrospectively or prospectively and is effective for annual reporting periods beginning after December 15, 2016, but early adoption is permitted. We adopted this guidance prospectively effective April 1, 2016. We elected to estimate forfeitures based on historical forfeiture activity, when appropriate depending on the number of award recipients. Adoption did not have a material impact on our financial condition, results of operations and cash flows.

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Armstrong Flooring, Inc. and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements

Recently Issued Accounting Standards
In May 2014, the FASB issued ASU 2014-09 "Revenue from Contracts with Customers." The guidance requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to a customer. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers: Deferral of the Effective Date" which defers the effective date for ASU 2014-09 by one year. In March 2016, the FASB issued ASU 2016-08, "Principal versus Agent Considerations (Reporting Gross versus Net)," which clarifies the implementation guidance in ASU 2014-09 relating to principal versus agent considerations. In April 2016, the FASB issued ASU 2016-10, "Identifying Performance Obligations and Licensing," which clarifies guidance related to the impact of goods and services on a performance obligation and timing and pattern of recognition issues related to intellectual property contracts. In May 2016, the FASB issued ASU 2016-12, "Narrow-Scope Improvements and Practical Expedients," which clarify certain narrow provisions of ASU 2014-09. These Accounting Standards Codification (“ASC”) updates are effective for annual reporting periods beginning after December 15, 2017, but early adoption is permitted. We have not selected a transition method and are currently evaluating the impact these ASC updates will have on our financial condition, results of operations and cash flows.
In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory." The guidance requires that inventory that is measured on a first-in, first-out or average cost basis to be measured at lower of cost and net realizable value, as opposed to the lower of cost or market. For inventory that is measured under the last-in, first-out basis or the retail recovery method, there is no change to current measurement requirements. This new guidance must be applied prospectively and is effective for annual reporting periods beginning after December 15, 2016, but early adoption is permitted. We are currently evaluating the impact the adoption of this standard would have on our financial condition, results of operations and cash flows.
In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities." The guidance addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Most notably, this new guidance requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. This new guidance is effective for annual reporting periods beginning after December 15, 2017. We are currently evaluating the impact the adoption of this standard would have on our financial condition, results of operations and cash flows.
In February 2016, the FASB issued ASU 2016-02, "Leases." The guidance amends accounting for leases, most notably by requiring a lessee to recognize the assets and liabilities that arise from a lease agreement. Specifically, this new guidance will require lessees to recognize a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term, with limited exceptions. The accounting applied by a lessor is largely unchanged from that applied under existing U.S. GAAP. This new guidance is effective for annual reporting periods beginning after December 15, 2018 and must be adopted under a modified retrospective basis. We are currently evaluating the impact the adoption of this standard would have on our financial condition, results of operations and cash flows.

In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Instruments." The guidance requires immediate recognition of estimated credit losses that are expected to occur over the remaining life of many financial assets. This new guidance is effective for annual and interim periods in fiscal years beginning after December 15, 2019, but early adoption is permitted for annual and interim periods in fiscal years beginning after December 15, 2018. We are currently evaluating the impact the adoption of this standard would have on our financial condition, results of operations and cash flows.

Armstrong Flooring, Inc. and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements

NOTE 2. DISCONTINUED OPERATIONS

European Resilient Flooring

On December 4, 2014, AWI's Board of Directors approved the cessation of funding to its DLW subsidiary, which at the time was our European flooring business. As a result, DLW management filed for insolvency in Germany on December 11, 2014.

The DLW insolvency filing in December 2014 resulted in presenting DLW for all historical periods prior to the Separation as a discontinued operation. However, the insolvency filing did not meet the U.S. tax criteria to be considered disposed of until the first quarter of 2015. In determining the U.S tax impact of the disposition, the liabilities, including an unfunded pension liability of approximately $115 million, were considered proceeds. However, pension deductions for tax purposes result only when the benefit payments are made. Accordingly, a deferred tax asset and non-cash income tax benefit of $43.4 million was recorded in the first quarter of 2015 within discontinued operations for the tax benefit of the future pension deductions. AWI is solely responsible for any shortfall, and the beneficiary of any excess, at the closure of the DLW insolvency proceedings. Therefore, DLW is excluded from our balance sheets, results of operations and cash flows after the Spin-off.

The following is a summary of the operating results of DLW, which are reflected in these financial statements for periods prior to the Separation.

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in millions)	2016	2015	2016	2015
Loss on disposal of discontinued business before income tax	$—	$(0.1)	$(0.1)	$(1.3)
Income tax (expense) benefit	—	(0.1)	1.8	43.6
Net (loss) gain on disposal of discontinued business	$—	$(0.2)	$1.7	$42.3

NOTE 3. RELATIONSHIP WITH AWI AND RELATED ENTITIES

Allocation of general corporate and other expenses

These Condensed Consolidated Financial Statements include expense allocations for certain functions provided by AWI, including, but not limited to finance, legal, information technology, and human resources as well as pension expenses for periods prior to the Spin-off. In 2015, these expenses were allocated on the basis of direct usage when identifiable, with the remainder allocated on the basis of revenue, headcount, or other measures. Beginning in the first quarter of 2016, such expenses were incurred directly by our segments. No expenses were allocated to us after the Separation.

Armstrong Flooring, Inc. and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements

The presentation of these costs allocated to us by AWI in our Condensed Consolidated Statements of Operations and Comprehensive Income is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Dollars in millions)	2016	2015	2016	2015
Expense (income), net:				
Cost of goods sold	$ —	$ 2.7	$ —	$ 5.0
Selling, general and administrative expenses	—	7.2	0.5	14.5