

Armstrong Flooring, Inc.
Form 10-K
March 05, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018

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)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of exchange on which registered

Common Stock, \$0.0001 par value

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the

Act. Yes ☐ No ☒

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 ☒

No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files.) Yes ☒ No ☐

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ Smaller reporting company ☐

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the Registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The aggregate market value of the Common Stock of Armstrong Flooring, Inc. held by non-affiliates based on the closing price (\$14.04 per share) on the New York Stock Exchange (trading symbol AFI) as of June 30, 2018 was approximately \$292.3 million. As of February 28, 2019 the number of shares outstanding of the registrant's Common Stock was 25,835,850.

DOCUMENTS INCORPORATED BY REFERENCE

Certain sections of Armstrong Flooring, Inc.'s definitive Proxy Statement for use in connection with its 2019 annual meeting of stockholders, to be filed no later than April 30, 2019 (120 days after the last day of our 2018 fiscal year), are incorporated by reference into Part III of this Form 10-K Report where indicated.

Armstrong Flooring, Inc.

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CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

[illegible]

- global economic conditions;

competition;

- availability and costs of raw materials and energy;

- key customers;

- construction activity;

- costs savings and productivity initiatives;

- strategic transactions;

- information systems and transition services;

personnel;

- intellectual property rights;

- international operations;

labor;

claims and litigation;

liquidity;

debt;

- debt covenants;

outsourcing;

environmental and regulatory matters; and

other risks detailed from time to time in our filings with the Securities and Exchange Commission ("SEC"), press

releases and other communications, including those set forth under “Risk Factors” included elsewhere in this Form 10-K and in the documents incorporated by reference.

Such forward-looking statements speak only as of the date they are made. We expressly disclaim any obligation to release publicly any updates or revisions to any forward-looking statements to reflect any change in our expectations with regard thereto or change in events, conditions or circumstances on which any statement is based.

PART I

Item 1. Business

Armstrong Flooring, Inc. ("AFI" or the "Company") is a Delaware corporation incorporated in 2015. When we refer to "AFI," "the Company," "we," "our," and "us" in this report, we are referring to Armstrong Flooring, Inc. and its consolidated subsidiaries.

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

On April 1, 2016, we became an independent company as a result of the separation by Armstrong World Industries, Inc. ("AWI"), a Pennsylvania corporation, of its Resilient Flooring and Wood Flooring segments from its Building Products 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.

In November 2018, we entered into a definitive agreement to sell our North American wood flooring business to Tarzan Holdco, Inc. ("TZI"), a Delaware corporation and an affiliate of American Industrial Partners ("AIP"). The sale was completed on December 31, 2018. See Note 9 to the Consolidated Financial Statements for additional information related to discontinued operations. The historical financial results of the North American wood flooring business have been reflected in our Consolidated Financial Statements as a discontinued operation for all periods presented.

Products and Markets

We hold leadership or significant market share positions in the product categories and markets in which we operate. We compete in the resilient flooring product category in North America and the Pacific Rim. The majority of our sales are in North America, where we serve both commercial and residential markets. In the Pacific Rim, we are principally focused on commercial markets.

The major markets in which we compete are:

North American Commercial — Our products are used in commercial and institutional buildings. Our revenue opportunities come from new construction as well as renovation of existing buildings. Industry analysts estimate that renovation work represents the majority of the total North American commercial market opportunity. Most of our revenue comes from four major segments of commercial building: education, healthcare, retail and office. We monitor U.S. construction starts and follow project activity. Our revenue from new construction can lag behind construction starts by as much as twenty-four months given that the installation of flooring typically occurs later in the construction process. We also monitor office vacancy rates, architectural activity, gross domestic product ("GDP") and general employment levels, which can indicate movement in renovation and new construction opportunities. We believe that these statistics, taking into account the time-lag effect, provide a reasonable indication of our future revenue opportunity from commercial renovation and new construction. We also believe that consumer preferences for product type, style, color, availability and affordability also significantly affect our revenue.

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North American Residential — We sell products for use in single and multi-family housing. Homeowners, contractors, builders, and property management firms can choose from our innovative flooring products. We compete directly with other domestic and international suppliers of these products. Our flooring products also compete with carpet, stone, wood and ceramic products, which we do not offer.

Our products are used in new home construction and existing home renovation work. Industry analysts estimate that existing home renovation (also known as replacement/remodel) work represents a majority of the total

North American residential market opportunity. We monitor key U.S. statistics including existing home sales (a key indicator for renovation opportunity), housing starts, housing completions, home prices, interest rates and consumer confidence. We believe there is some longer-term correlation between these statistics and our revenue after reflecting a lag period of several months between a change in these indicators and our operating results. However, we believe that consumers' preferences for product type, style, color, availability and affordability also significantly affect our revenue. Further, changes in inventory levels and/or product focus at national home centers and independent wholesale flooring distributors can significantly affect our revenue.

Outside of North America — We also serve commercial markets in the Pacific Rim region with over 80% of the sales in this region coming from China and Australia. The commercial segments we serve are similar to the North American market (education, retail, office and healthcare). However there is a higher penetration of resilient flooring in the hospitality (retail) and office segments in China than we see in North America. For the countries where we have significant revenue, we monitor various national statistics (such as GDP) as well as construction data (starts and project-related information).

LVT Investment — Luxury vinyl tile ("LVT") represents the fastest growing resilient flooring product category. Through enhanced wear layers and coatings, LVT delivers improved durability and lower maintenance over traditional vinyl tile. In addition, the utilization of advanced printing and embossing technology provides LVT with upgraded visual realism in a wide variety of attractive wood and stone designs. LVT's modular format offers a wide range of installation options for the professional and do-it-yourself installer, with an enhanced ease of installation when compared to other products such as wood or ceramic tile; this can be seen with the growing popularity of floating and rigid LVT floors. The largest market for LVT is North America. Historically, this market has been largely served by imported product manufactured in the Pacific Rim. In addition to our existing LVT capacity at our Kankakee, Illinois plant, we completed construction of an expansion to our Lancaster, Pennsylvania plant in 2016 and repurposed a portion of our Stillwater, Oklahoma vinyl sheet plant in 2017 to add LVT manufacturing capacity.

The following table provides an estimate of our 2018 net sales, by major markets.

North American Commercial		North American Residential		Outside of North America		Total
New	Renovation	New	Renovation	New	Renovation	
5%	35%	5%	35%	15%	5%	100%

Management has estimated the above data as the end-use of our products is not easily determinable.

Customers

We use our reputation, capabilities, service and brand recognition to develop long-standing relationships with our customers. We principally sell products through independent wholesale flooring distributors, who re-sell our products to retailers, builders, contractors, installers and others. In the commercial sector, we also have important relationships with subcontractors' alliances, large architect and design firms, and major facility owners in our focus segments. In the North American retail channel, which sells to end-users in the residential and light commercial segments, we have important relationships with national home centers and flooring retailers. In the North American residential sector, we also have important relationships with major home builders and retail buying groups. Additionally, when market conditions and available capacity warrant, we also provide products on an OEM basis to other flooring companies.

Approximately 75% of our consolidated net sales in 2018 are to distributors. Sales to large home centers account for approximately 15% of our consolidated sales in 2018. Our remaining sales are primarily to other retailers, end-use

customers and contractors.

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The Belknap White Group, which includes J. J. Haines and Company, Inc., accounted for 10% or more of our total consolidated net sales in 2018.

Working Capital

We produce goods for inventory and sell on credit to our customers. Our distributors carry inventory as needed to meet local or rapid delivery requirements. We sell the vast majority of our products to select, pre-approved customers using customary trade terms that allow for payment in the future. These practices are typical within the industry.

Competition

We face strong competition in all of our businesses. Principal attributes of competition include product performance, product styling, service and price. Competition in North America comes from both domestic and international manufacturers. Additionally, some of our products compete with alternative products or finishing solutions. Our resilient flooring products compete with carpet, stone, wood and ceramic products. There is excess industry capacity for certain products in some geographies, which tends to increase price competition. The following companies are our primary competitors:

Beaulieu International Group, N.V., Congoleum Corporation, Forbo Holding AG, Gerflor Group, Halstead International (including Metroflor Corporation), Interface, Inc., Krono Holding AG, Mannington Mills, Inc., Mohawk Industries, Inc., Nora Systems GmbH (division of Interface, Inc), Shaw Industries, Inc., and Tarkett AG.

Raw Materials

We purchase raw materials from numerous suppliers worldwide in the ordinary course of business. The principal raw materials include: polyvinylchloride ("PVC") resins and films, plasticizers, fiberglass and felt backings, limestone, pigments, inks, stabilizers and coatings.

We also purchase significant amounts of packaging materials and consume substantial amounts of energy, such as electricity and natural gas, and water.

In general, adequate supplies of raw materials are available to all of our businesses. However, availability can change for a number of reasons, including environmental conditions, laws and regulations, shifts in demand by other industries competing for the same materials, transportation disruptions and/or business decisions made by, or events that affect, our suppliers. If these suppliers were unable to satisfy our requirements, we believe alternative supply arrangements would be available.

Prices for certain high usage raw materials can fluctuate dramatically. Cost increases for these materials can have a significant adverse impact on our manufacturing costs.

Sourced Products

Some of our products are sourced from third parties. Our primary sourced products include LVT, vinyl sheet, installation and maintenance materials and accessories, and laminate. We purchase most of our sourced products from suppliers that are located outside of the U.S., primarily from Asia. Sales of sourced products represented approximately 35% of our total consolidated revenue in 2018.

In general, adequate supplies of sourced products are available to all of our businesses. However, availability can change for a number of reasons, including environmental conditions, laws and regulations, production and transportation disruptions and/or business decisions made by, or events that affect, our suppliers. If these suppliers were unable to satisfy our requirements, we believe alternative supply arrangements would be available.

Seasonality

Generally, our sales in North America tend to be stronger in the second and third quarters of our fiscal year due to more favorable weather conditions, customer business cycles and education renovations typical during the summer months. We see similar patterns with respect to our sales in the Pacific Rim, though the timing of the Chinese New Year can affect buying behaviors.

Patent and Intellectual Property Rights

Patent protection is important to our business. Our competitive position has been enhanced by U.S. and foreign patents on products and processes developed or perfected within AFI, including those before and after the Spin-off, or obtained through acquisitions and licenses. In addition, we benefit from our trade secrets for certain products and processes.

Patent protection extends for varying periods according to the date of patent filing or grant and the legal term of a patent in the various countries where patent protection is obtained. The actual protection afforded by a patent, which can vary from country to country, depends upon the type of patent, the scope of its coverage and the availability of legal remedies. Although we consider that, in the aggregate, our patents, licenses and trade secrets constitute a valuable asset of material importance to our business, we do not regard any of our businesses as being materially dependent upon any single patent or trade secret, or any group of related patents or trade secrets.

We own or have a license to use certain trademarks, including, without limitation, Armstrong®, Alterna®, BBT®, Diamond 10® Technology, Excelon®, Imperial®, Initiator™, Inspiring Great Spaces®, Lock&Fold®, Luxe Plank®, Medintech®, Memories™, Natural Creations®, Station Square™, StrataMax®, Timberline®, and Vivero®, which are important to our business because of their significant brand name recognition. Trademark protection continues in some countries as long as the mark is used, and continues in other countries as long as the mark is registered. Registrations are generally for fixed, but renewable, terms.

We sublicense certain patents and trademarks to American Hardwood Flooring Company ("AHFC"), a subsidiary of TZI.

Employees

As of December 31, 2018, we had approximately 1,800 full-time and part-time employees worldwide. Approximately 35% of our 900 production and maintenance employees are represented by labor unions. As of March 5, 2019, approximately 150 employees at one of our domestic plants continue to work under an expired collective bargaining agreement and negotiations continue. Contracts for remaining employees expire between 2019 and 2020. We believe that our relations with our employees are satisfactory. Out of our 1,800 employees, approximately 100 employees are part of the transition services agreement with TZI, and we expect most of them to transfer to TZI by the end of 2019.

Legal and Regulatory Proceedings

AFI's manufacturing and research facilities are affected by various federal, state and local requirements relating to the discharge of materials and the protection of the environment. We make expenditures necessary for compliance with applicable environmental requirements at each of our operating facilities. These regulatory requirements continually change, therefore we cannot predict with certainty future expenditures associated with compliance with environmental requirements.

We are involved in various lawsuits, claims, investigations and other legal matters from time to time that arise in the ordinary course of conducting business, including matters involving our products, intellectual property, relationships with suppliers, distributors and competitors, employees and other matters. For example, we are currently a party to various litigation matters that involve product liability, tort liability and other claims under a wide range of allegations, including illness due to exposure to certain chemicals used in the workplace, or medical conditions arising from exposure to product ingredients or the presence of trace contaminants. In some cases, these allegations involve multiple defendants and relate to legacy products that we and other defendants purportedly manufactured or sold. We believe these claims and allegations to be without merit and intend to defend them vigorously. While complete assurance cannot be given to the outcome of these proceedings, we do not believe that any of these matters, individually or in the aggregate, will have a material adverse effect on our financial condition, results of operations or cash flows.

We have not experienced a material adverse effect upon our capital expenditures or competitive position as a result of environmental control legislation and regulations. There were no material liabilities recorded at December 31, 2018 for potential environmental liabilities, on a global basis, that we consider probable and for which a reasonable estimate of the probable liability could be made. See Note 22 to the Consolidated Financial Statements and Risk Factors in this Form 10-K for information regarding the possible effects that compliance with environmental laws and regulations may have on our businesses and operating results.

Website

We maintain a website at www.armstrongflooring.com. Information contained on our website is not incorporated into this document. Reference in this Form 10-K to our website is an inactive text reference only. Annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, all amendments to those reports and other information about us are available free of charge through this website as soon as reasonably practicable after the reports are electronically filed with the SEC.

Item 1A. Risk Factors

Worldwide economic conditions could have a material adverse impact on our financial condition, liquidity or results of operations.

Our business is influenced by conditions in domestic and foreign economies, including inflation, deflation, interest rates, availability and cost of capital, consumer spending rates, energy availability and the effects of governmental initiatives to manage economic conditions. Volatility in financial markets and the continued softness or further deterioration of national and global economic conditions could have a material adverse effect on our financial condition, liquidity or results of operations, including as follows:

the financial stability of our customers or suppliers may be compromised, which could result in additional bad debts for us or non-performance by suppliers;
commercial and residential consumers of our products may postpone spending in response to tighter credit, negative financial news and/or stagnation or further declines in income or asset values, which could have a material adverse impact on the demand for our product;

the fair value of the investment funds underlying our defined-benefit pension plans may decline, which could result in negative plan investment performance and additional charges, and may involve significant cash contributions to such plans to meet obligations or regulatory requirements; and

- our asset impairment assessments and underlying valuation assumptions may change, which could result from changes to estimates of future sales and cash flows that may lead to substantial impairment charges.

Continued or sustained deterioration of economic conditions would likely exacerbate and prolong these adverse effects.

We compete with numerous flooring manufacturers in highly competitive markets. Competition can affect customer preferences, reduce demand for our products, negatively affect our product sales mix, leverage greater financial resources, or cause us to lower prices.

Our markets are highly competitive. We compete for sales of flooring products with many manufacturers and independent distributors of resilient flooring as well as with manufacturers who also produce other types of flooring products. Some of our competitors have greater financial resources than we do. Competition can reduce demand for our products, negatively affect our product sales mix or cause us to lower prices. Our failure to compete effectively through management of our product portfolio, by meeting consumer preferences, maintaining market share positions in our traditional categories and gaining market leadership in growth product categories such as LVT, could have a material adverse effect on our financial condition, liquidity or results of operations. Our customers consider our products' performance, product styling, customer service and price when deciding whether to purchase our products. Shifting consumer preference in our highly competitive markets whether for performance or styling preferences or our inability to develop and offer new competitive performance features, could have an adverse effect on our sales.

In addition, excess industry capacity for certain products in several geographic markets could lead to industry consolidation and/or increased price competition. We are also subject to potential increased price competition from overseas competitors, which may have lower cost structures.

If the availability of raw materials or energy decreases, or these and other sourcing costs increase and we are unable to pass along increased costs, our financial condition, liquidity or results of operations could be adversely affected.

The availability and cost of raw materials, packaging materials, energy and sourced products are critical to our operations. For example, we use substantial quantities of petroleum-based raw materials in our manufacturing operations. The cost of some of these items has been volatile in recent years and availability has been limited at times. We source some materials from a limited number of suppliers, which, among other things, increases the risk of unavailability. We also source from overseas and could be subject to international trade costs, such as tariffs. This dependency and any limited availability could cause us to reformulate products or limit our production. Decreased access to raw materials and energy or significant increased cost to purchase these items, as well as increased transportation and trade costs, and any corresponding inability to pass along such costs through price increases could have a material adverse effect on our financial condition, liquidity or results of operations.

Sales fluctuations to and changes in our relationships with key customers could have a material adverse effect on our financial condition, liquidity or results of operations.

Some of our business lines and markets are dependent on a few key customers, including independent distributors. The loss, reduction, or fluctuation of sales to one of these major customers, or any adverse change in our business relationship with any one of them, could have a material adverse effect on our financial condition, liquidity or results

of operations.

Our business is dependent on construction activity. Downturns in construction activity could adversely affect our financial condition, liquidity or results of operations.

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