

## TURNAROUND TRENDS

# Armstrong Flooring Bankruptcy

## The Alchemy of Creating Value from Accounts Receivable

BY MORTEN KUCEY

**Finding the right combination of capital resources and strategic knowledge in the sale and restructuring of a business is complicated; but when it works, this seemingly magical process of transformation creates incremental value for all constituents involved in the bankruptcy process.**

Take the case of Armstrong Flooring, and three affiliated companies, that each filed petitions in the United States Bankruptcy Court for the District of Delaware seeking relief under Chapter 11 on May 8, 2022.

### What caused Armstrong Flooring to file bankruptcy?

The company struggled through COVID as approximately 70% of its business was commercial, thus missing the boon in consumer spending on home improvements while simultaneously facing losses in demand from its traditional customer base. During the 12 months prior to filing, the company struggled with product and transportation cost increases. Armstrong experienced additional product and transportation costs of \$85 million, according to Michel Vermette, president and CEO of Armstrong Flooring. Though Armstrong raised prices for retail customers by 10 percent and for commercial customers by 15 percent, it was not enough to stave off bankruptcy. "Simply stated, the company's increasing costs significantly outpaced its pricing power," Vermette said in a court filing.

### What was the outcome of the auction of the assets as part of the 363 Sale Process?

The proposed transactions stemmed from a court-supervised auction that began on June 27, 2022. A consortium, formed among AHF Products, VION Investments, and Gordon Brothers, would acquire substantially all the assets of Armstrong North America for approximately \$107 million in cash and the assumption of specified liabilities. AHF planned to continue operating the Lancaster, Kankakee, and Beech Creek locations, and Gordon Brothers would pursue a winddown of the Jackson and Stillwater locations.

As part of the asset disposition of certain parts of the operations, VION partnered with Gordon Brothers in the purchase of a substantial portion of Armstrong Flooring Inc.'s assets. VION was responsible for Armstrong Flooring's accounts receivable while Gordon Brothers acquired real estate in Stillwater, Oklahoma, and machinery and equipment in Stillwater and Jackson, Mississippi plants for resale. Gordon Brothers was also responsible for inventory and other assets.

"We worked with our going-concern partners to provide an immediate solution for the valuation, acquisition and disposition of receivable assets that did not fit with their overall strategic goals," said Stacey Schacter, CEO of VION. "Our ability to move quickly and help them offer a total solution contributed to the final success of their purchase."



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**What were some of the positive synergies and challenges that were overcome in partnering with other companies?**

"It is helpful when you are comfortable with your partner," said Schacter. "We have worked with Gordon Brothers for decades and that mutual confidence in each other allowed us to focus on what we each do best." For example, there are always concerns about when inventory can be returned. In this case, returned inventory meant a reduction in the receivable balance and that inventory then must be resold for an amount that is usually less than the original receivable balance. "This can be a point of stress in relationships, but in our case, it was resolved in less than 10 minutes. Rather, we focused on saving over 600 U.S. jobs and working with our partners to provide continuity to the company's vendors and customers. Further, this deal was international. It took a fair amount of coordination between us and our partners to ensure legal issues didn't get in the way of enforcing amounts due," said Schacter.

As for a going-concern buyer, they want to ensure we don't "beat up" their future customers while trying to collect payment while, of course, we want to collect as much as possible. It is a balancing act, but it is one worth pursuing as our belief was our offer was stronger than others because we were prepared to make certain concessions to save jobs and protect our partners' interests in relationships. Of course, we were aggressive when we had to be, but overall, we were very measured in what we did and how we approached each individual case.

Lastly, as with most transactions, we needed to coordinate with the debtor, Gordon Brothers and others on staffing and data issues. Often, staff were shared across different job duties. There were compensation and retention issues. We were fortunate in the quality of the staff we had from Armstrong and their willingness to complete the project in a very professional manner. Without them there is no doubt results would have been different and bumpier.

**In analyzing the accounts receivable from a collection's standpoint, what variables affected the overall recovery?**

Managing the valid concerns of wholesale distributors certainly posed a challenge in the collection process. Distributors with ongoing

operations owned AHF inventory ready to be sold to consumers and commercial dealers and they were apprehensive about potential future liabilities resulting from returns and warranty claims by the end-using customers, which were precluded under the bankruptcy. Several distributors attempted to short pay their existing AR balance to offset exposure to potential and, in some cases, imminent, claims. “The teams worked together to quickly gather and stratify historical data on past claims by each distributor allowing us to determine reasonable settlement offers. Retained Armstrong sales and collections personnel also did a great job in advising us about which distributors we would receive push-back from. In the end, limited pressure was applied where needed, but we were able to negotiate payments with most key distributors within 90 days,” said Anthony Azizeh, director at VION.

Additionally, some distributors submitted pricing and short-term sales promotion adjustments as credit offsets to their existing AR. Many of the claims presented by distributors were valid under previously established terms with Armstrong, although several were not. Fortunately, Armstrong personnel assisting us were very knowledgeable about the various distributor sales programs and able to decipher the individual claims expeditiously to determine which were valid and which were not. Reconciling the numerous, and detailed, claims without intrinsic understanding of the underlying pricing structures would have delayed settlement negotiations and significantly extended the collections process.

In structuring the asset purchase agreement, what key considerations needed to be negotiated given the various partners on the deal (i.e. use of IP, customer lists, vendor relationships, etc.)?

**The key elements we tried to address in the APA are as follows:**

A. Clearly defining what we are buying and specifically what we are not. It is not as clear as you might think.

In any 363 transaction, whether it be a going concern or liquidation, the accounts receivable portfolio is constantly changing, whether it be in its delinquency, customer concentrations, or account balances. Also, we wanted to make sure we were not paying for accounts that were in some sort of dispute, litigation, or other status that we deem “ineligible.” “Accordingly, it was essential for us to

negotiate a working capital adjustment for changes in the A/R file from the evaluation file to the closing file,” said Neil Brodsky, chief legal officer at VION.

B. Making sure our operations team has access to the resources they need to collect.

“We have to balance the desire of the trustee to minimize company expenses with the need for our team to have access to company resources that are essential for servicing and collection of the portfolio,” said Brodsky. Negotiating an adequate transition period was crucial to not only have adequate access to systems, personnel, and bank accounts in order to collect, but have time to extract the data and gain inside knowledge as the portfolio transferred from the company’s systems as it was winding down. Lastly, it was important to have the

ability to use certain IP, like the Armstrong name, as experience shows it would facilitate collections.

The VION agreement with Gordon Brothers was a key element to our success. In this instance it was easier due to a long-standing relationship; however, the allocation of costs for shared systems, personnel and resources needed to be clearly defined. Furthermore, inventory sales and A/R collection go hand and hand, as inventory discounts are used as an incentive to receivable collections and vice versa. “We were able to align our interests and set proper settlement thresholds and

procedures which worked well for our joint efforts,” said Brodsky.



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**Following the partial sale of the business as a going concern to AHF, how did that affect the collections of the Accounts Receivable from a winddown standpoint?**

According to Jason Van Vacter, VP of operations at VION, “having our partner acquire and liquidate the inventory at the same time as VION collecting the accounts receivable, did have a positive impact on collections and recoveries. This gave us leverage for those customers that had outstanding AR, but also wanted to acquire additional inventory at a reduced cost. Some customers did this to drive down their overall average cost of inventory on hand.”

On the other hand, the ongoing concern piece of the transaction had a much smaller impact on the collections and recovery of the portfolio. Since AHF was not involved in the asset sale of the AR, VION

had to ensure all customers understood the AR prior to the “asset purchase” date was due and owed to the partnership versus what they were purchasing from AHF on a go-forward basis. “Having the Armstrong AR team stay in place made this transition go a lot smoother than if we removed servicing to another entity,” said Van Vacter.

### **In the collection of the accounts receivable, how did VION utilize the existing company infrastructure in the collection process?**

Keeping the company’s infrastructure and personnel in place was critical to achieving the highest return on the AR. Any time you transition accounts off one system and move them onto a new platform you lose recovery value. Whether that is losing historical information on the accounts or just the “lost” time to migrate the information, there is a cost either on the expense side or recovery side. Not to mention many customers had automated processes in place with Armstrong and transitioning accounts would have compromised that system, in turn delaying collections due to redoing reconciliations or having to set up new payment processes.

Keeping Armstrong’s collections group ensured continuity with understanding the customers nuances and specific issues that might arise for each customer, including holdbacks, offsets, billing issues, etc. Those variables are critical when trying to maximize a portfolio’s value. “We were able to create a targeted approach to collecting on the AR and knew the difference of who could pay, but wouldn’t, versus who didn’t have the ability to. This allowed for a streamlined and targeted approach while at the same time not wasting resources on accounts that needed more attention,” said Cheryl Karcher, chief investment officer at VION.

### **Lessons Learned**

Experience matters. It is interesting to think you have something figured out, that you have a theory of how something will work, but not until you implement it do you realize how accurate you are. Some transactions look very easy to the outsider. What’s so tough? The company shut down, just go out there and collect. These people have never really done it themselves or they would understand that every transaction has nuances. For instance, you can read about riding a bike and even looking at a bike it seems easy, but experiencing how to balance on one is a practical skill that requires practice. This is a business of balance. You tip too far either way, you will fall.

Real-world activities often present unanticipated challenges, thus having decades of experience means that chances are, when we see something that might appear new to one person, it does not appear new to us. Further, every single deal provides a “teaching” moment, and every deal team should do a postmortem after their transactions to understand what those teaching moments are.

**Know the law.** Issues on this transaction arose due to one debtor owing to multiple parties for what they deemed to be one receivable. For example, if there is an offset on the AR due to the successor Armstrong entity, they will try to take it off any available Armstrong AR they find, even though that is not allowed, nor legal. In this case, knowing how the AR was historically treated for discounts and similar offsets put into focus just how aggressive some customers were going

to be in trying to avoid paying the bill. They thought using an argument of “future damages” for warranty claims might give them some ability to just hold off paying until that future liability was determined. However, there was no legal justification for this, nor was it likely there was going to be a surge in claims. If there were, they had recourse back to the estate, but knowing the law on top of the history was important. In most cases, they knew that too and backed down, but some were at the brink before finally paying.

**Know the players.** Another lesson is making sure the right people are involved at the debtor. When we had difficult accounts, we would set up calls, but when things got really tough, we required the CEOs of the company to also be involved (in a large company, obviously this would be someone at the appropriate level), on both sides of the transaction. It is easier to be pigheaded on the sidelines than in person. Psychology is an important aspect of this business.

**Take care of your people.** Give up some profit to your staff. Yes, we said it, give the staff a reason to stay. This deal happened in one of the toughest labor markets in decades and their jobs were going to be eliminated. We needed to provide much higher retention bonus plans and, more importantly, still allow the staff time off to interview and otherwise move on with their lives. In some cases, staff worked after hours as they had already obtained a new job. We were flexible and the staff rewarded us with outstanding results and support. Well worth the price.

If all you get out of a deal is one lesson, that is a win. We learned lessons from the point of negotiation all the way to the final collections and we hope to continue learning. Eric Hoffer, American philosopher, and writer, once wrote, “In a time of drastic change it is the learners who inherit the future. The learned usually find themselves equipped to live in a world that no longer exists.” This quote stresses the importance of ongoing learning, especially in times of rapid change, as opposed to resting on past knowledge. In this business, one thing is certain, it is a rapidly changing one and that despite our deep-rooted past knowledge, we must embrace that which we learn every day. ▣

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*About VION Investments: Vion Investments LLC provides flexible solutions to businesses with unique or complex capital needs, often in the form of senior or mezzanine debt and/or investment through a company’s receivables. Unlike a traditional factor we specialize in receivables with a duration longer than three months. VION invests between \$10 and \$100 million per deal and its capital may be utilized in a range of situations including for growth initiatives, liquidity purposes, recapitalizations, balance sheet deleveraging,*