Palo Alto Networks Inc
Form DEF 14A
October 23, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE

SECURITIES EXCHANGE ACT OF 1934

Filed by the Registrant Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material under §240.14a-2

PALO ALTO NETWORKS, INC.

(Name of Registrant as Specified In Its Charter)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

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(1) Amount Previously Paid:

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(3) Filing Party:

(4) Date Filed:

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PALO ALTO NETWORKS, INC.

3000 TANNERY WAY

SANTA CLARA, CALIFORNIA 95054

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To Be Held at 10:00 a.m. Pacific Standard Time on Friday, December 8, 2017

Dear Stockholders of Palo Alto Networks, Inc.:

The 2017 annual meeting of stockholders and any postponements, adjournments or continuations thereof (the Annual Meeting) of Palo Alto Networks, Inc., a Delaware corporation, will be held on **Friday, December 8, 2017 at 10:00 a.m. Pacific Standard Time**, at our headquarters, located at 3000 Tannery Way, Santa Clara, California 95054, for the following purposes, as more fully described in the accompanying proxy statement:

1. To elect three Class III directors to serve until our 2020 annual meeting of stockholders and until their successors are duly elected and qualified;
2. To ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for our fiscal year ending July 31, 2018;
3. To approve, on an advisory basis, the compensation of our named executive officers;
4. To approve the Palo Alto Networks, Inc. Executive Incentive Plan;
5. To consider and vote upon a stockholder proposal regarding a diversity report, if properly presented at the annual meeting; and
6. To transact any and all such other business that may properly come before the Annual Meeting.

Our board of directors has fixed the close of business on October 16, 2017 as the record date for the Annual Meeting. Only stockholders of record on October 16, 2017 are entitled to notice of and to vote at the Annual Meeting. Further information regarding voting rights and the matters to be voted upon is presented in the accompanying proxy statement.

On or about October 23, 2017, we expect to mail to our stockholders a Notice of Internet Availability of Proxy Materials (the Notice) containing instructions on how to access our proxy statement and our annual report. The Notice provides instructions on how to vote via the Internet or by telephone and includes instructions on how to receive a paper copy of our proxy materials by mail. The accompanying proxy statement and our annual report can be accessed directly at the following Internet address: http://www.proxyvote.com. All you have to do is enter the control number located on your proxy card.

YOUR VOTE IS IMPORTANT. Whether or not you plan to attend the Annual Meeting, we urge you to submit your vote via the Internet, telephone or mail as soon as possible to ensure your shares are represented.

We appreciate your continued support of Palo Alto Networks, Inc. and look forward to either greeting you personally at the Annual Meeting or receiving your proxy.

By order of the Board of Directors,

Mark McLaughlin

Chairman and Chief Executive Officer

Santa Clara, California

October 23, 2017

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PALO ALTO NETWORKS, INC.

PROXY STATEMENT

FOR 2017 ANNUAL MEETING OF STOCKHOLDERS

To Be Held at 10:00 a.m. Pacific Standard Time on Friday, December 8, 2017

This proxy statement and your proxy card are furnished in connection with the solicitation of proxies by our board of directors for use in connection with the 2017 annual meeting of stockholders of Palo Alto Networks, Inc. (Palo Alto Networks), a Delaware corporation, and any postponements, adjournments or continuations thereof (the Annual Meeting). The Annual Meeting will be held on Friday, December 8, 2017 at 10:00 a.m. Pacific Standard Time, at our headquarters, located at 3000 Tannery Way, Santa Clara, California 95054. A Notice of Internet Availability of Proxy Materials (the Notice) containing instructions on how to access this proxy statement and our annual report is first being mailed on or about October 23, 2017 to all stockholders entitled to vote at the Annual Meeting. Information contained on, or that can be accessed through, our website is not intended to be incorporated by reference into this proxy statement and references to our website address in this proxy statement are inactive textual references only.

The information provided in the question and answer format below is for your convenience only and is merely a summary of the information contained in this proxy statement. You should read this entire proxy statement carefully.

What matters am I voting on?

You will be voting on:

- the election of three Class III directors to serve until our 2020 annual meeting of stockholders and until their successors are duly elected and qualified;

- a proposal to ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for our fiscal year ending July 31, 2017;

- a proposal to approve, on an advisory basis, the compensation of our named executive officers;

- a proposal to approve the Palo Alto Networks, Inc. Executive Incentive Plan;

- a stockholder proposal regarding a diversity report, if properly presented at the Annual Meeting; and

- any other business as may properly come before the Annual Meeting.

How does the board of directors recommend I vote on these proposals?

Our board of directors recommends a vote:

FOR the election of Frank Calderoni, Carl Eschenbach and Daniel J. Warmenhoven as Class III directors;

FOR the ratification of the appointment of Ernst & Young LLP as our independent registered public accounting firm for our fiscal year ending July 31, 2018;

FOR the approval, on an advisory basis, of the compensation of our named executive officers;

FOR the approval of the Palo Alto Networks, Inc. Executive Incentive Plan (Executive Incentive Plan); and

AGAINST the stockholder proposal regarding a diversity report.

Who is entitled to vote?

Holders of our common stock as of the close of business on October 16, 2017 (the Record Date), may vote at the Annual Meeting. As of the Record Date, 91,977,343 shares of our common stock were outstanding. In deciding all matters at the Annual Meeting, each stockholder will be entitled to one vote for each share of our common stock held by them on the Record Date. Stockholders may not cumulate votes in the election of directors.

Registered Stockholders. If shares of our common stock are registered directly in your name with our transfer agent, you are considered the stockholder of record with respect to those shares, and the Notice was provided to you directly by us. As the stockholder of record, you have the right to grant your voting proxy directly to the individuals listed on the proxy card or to vote in person at the Annual Meeting. Throughout this proxy statement, we refer to these registered stockholders as stockholders of record.

Street Name Stockholders. If shares of our common stock are held on your behalf in a brokerage account or by a bank or other nominee, you are considered to be the beneficial owner of shares that are held in street name, and the Notice was forwarded to you by your broker, bank or other nominee, who is considered the stockholder of record with respect to those shares. As the beneficial owner, you have the right to direct your broker, bank or other nominee as to how to vote your shares. Beneficial owners are also invited to attend the Annual Meeting. However, since a beneficial owner is not the stockholder of record, you may not vote your shares in person at the Annual Meeting unless you follow your broker, bank, or other nominee s procedures for obtaining a legal proxy and present your legal proxy at the Annual Meeting. If you request a printed copy of our proxy materials by mail, your broker, bank or other nominee will provide a voting instruction form for you to use. Throughout this proxy statement, we refer to stockholders who hold their shares through a broker, bank or other nominee as street name stockholders.

Can I attend the Annual Meeting?

You may attend the Annual Meeting if you are a stockholder of record or a beneficial owner as of October 16, 2017. All stockholders must bring proof of identification, such as a driver s license or passport, for admission to the Annual Meeting.

If you are a stockholder of record, your name will be verified against the list of stockholders of record prior to admittance to the Annual Meeting.

If you are a street name stockholder, you will be asked to provide proof of beneficial ownership as of the Record Date, such as a brokerage account statement, a copy of the Notice or voting instruction card provided by the broker, bank or other nominee that is the stockholder of record, or other similar evidence of beneficial ownership, as well as proof of identification, for admission. If you wish to be able to vote in person at the Annual Meeting, you must obtain a legal proxy from your broker, bank or other nominee and present it to the inspector of elections with your ballot at the Annual Meeting.

Registration will begin at 9:30 a.m. Pacific Standard Time on the date of the Annual Meeting. If you do not provide proof of identification and comply with the other procedures outlined above, you may not be admitted to the Annual Meeting.

Cameras, recording devices and other electronic devices will not be permitted at the Annual Meeting.

You may contact us at (408) 753-4000 for directions to the Annual Meeting.

How do I vote?

If you are a stockholder of record, there are four ways to vote:

by Internet at http://www.proxyvote.com, 24 hours a day, seven days a week (have your proxy card in hand when you visit the website);

by toll-free telephone at 1-800-690-6903 until 11:59 p.m. Eastern Standard Time, on December 7, 2017 (have your proxy card in hand when you call);

- by completing and mailing your proxy card so it is received prior to the Annual Meeting (if you received printed proxy materials); or
- by written ballot at the Annual Meeting.

Even if you plan to attend the Annual Meeting, we recommend that you also vote by proxy so that your vote will be counted if you later decide not to attend the Annual Meeting.

If you are a street name stockholder, you will receive voting instructions from your broker, bank or other nominee. You must follow the voting instructions provided by your broker, bank or other nominee in order to direct your broker, bank or other nominee on how to vote your shares. Street name stockholders should generally be able to vote by returning a voting instruction form, or by telephone or on the Internet. However, the availability of telephone and Internet voting will depend on the voting process of your broker, bank or other nominee. As discussed above, if you are a street name stockholder, you may not vote your shares live at the Annual Meeting unless you obtain a legal proxy from your broker, bank or other nominee.

Can I change my vote?

Yes. If you are a stockholder of record, you can change your vote or revoke your proxy any time before the Annual Meeting by:

- entering a new vote by Internet or by telephone;
- returning a later-dated proxy card;
- notifying the Corporate Secretary of Palo Alto Networks, in writing, at the address listed on the front page of this proxy statement; or
- completing a written ballot at the Annual Meeting (although attendance at the Annual Meeting will not, by itself, revoke a proxy).

If you are a street name stockholder, your broker, bank or other nominee can provide you with instructions on how to change your vote or revoke your proxy.

What is the effect of giving a proxy?

Proxies are solicited by and on behalf of our board of directors. The persons named in the proxy have been designated as proxies by our board of directors. When a proxy card is properly dated, executed and returned, the shares represented by such proxies will be voted at the Annual Meeting in accordance with the instruction of the stockholder. If a proxy card is signed, but no specific instructions are given, the shares represented by such proxy card will be voted in accordance with the recommendations of our board of directors, as described above. If any matters not described in this proxy statement are properly presented at the Annual Meeting, the proxy holders will use their own judgment to determine how to vote the shares subject to proxies. If the Annual Meeting is adjourned, the proxy holders can vote your shares subject to proxies when the Annual Meeting is rescheduled, unless you have properly revoked your proxy instructions, as described above.

Why did I receive the Notice instead of a full set of proxy materials?

In accordance with the rules of the Securities and Exchange Commission (SEC), we have elected to furnish our proxy materials, including this proxy statement and our annual report, primarily via the Internet. The Notice containing instructions on how to access our proxy materials is first being mailed on or about October 23, 2017 to all stockholders entitled to vote at the Annual Meeting. Stockholders may request to receive all future proxy materials in printed form by mail or electronically by e-mail by following the instructions contained in the Notice. We encourage stockholders to take advantage of the availability of our proxy materials on the Internet to help reduce the environmental impact of our annual meetings of stockholders.

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What is a quorum?

A quorum is the minimum number of shares required to be present for the Annual Meeting to be properly held under our amended and restated bylaws and Delaware law. The presence, in person or by proxy, of a majority of all issued and outstanding shares of our common stock entitled to vote at the Annual Meeting will constitute a quorum at the Annual Meeting. A proxy submitted by a stockholder may indicate that all or a portion of the shares represented by the proxy are not being voted (stockholder withholding) with respect to a particular matter. Similarly, a broker may not be permitted to vote shares held in street name on a particular matter in the absence of instructions from the beneficial owner of such shares (broker non-vote). See the section titled How may my broker, bank or other nominee vote my shares if I fail to timely provide voting instructions? The shares of our common stock subject to a proxy that are not being voted on a particular matter because of either stockholder withholding or a broker non-vote will count for purposes of determining the presence of a quorum. Abstentions are also counted in the determination of a quorum.

How many votes are needed for approval of each proposal?

Proposal No. 1: The election of directors requires a plurality vote of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. Plurality means that the nominees who receive the largest number of votes cast for such nominees are elected as directors. As a result, any shares not voted for a particular nominee (whether as a result of stockholder abstention or a broker non-vote) will not be counted in such nominee s favor and will have no effect on the outcome of the election. You may vote for or withhold on each of the nominees for election as a director.

Proposal No. 2: The ratification of the appointment of Ernst & Young LLP as our independent registered public accounting firm for our fiscal year ending July 31, 2018 requires the affirmative vote of a majority of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. You may vote for, against, or abstain with respect to this proposal. Abstentions are considered votes present and entitled to vote on this proposal, and thus will have the same effect as a vote against this proposal. Broker non-votes will have no effect on the outcome of this proposal.

Proposal No. 3: The approval, on an advisory basis, of the compensation of our named executive officers requires the affirmative vote of a majority of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. You may vote for, against, or abstain with respect to this proposal. Abstentions are considered votes present and entitled to vote on this proposal, and thus will have the same effect as votes against this proposal. Broker non-votes will have no effect on the outcome of this proposal. Although the advisory vote is non-binding, our board of directors values stockholders opinions. The compensation committee will review the results of the vote and, consistent with our record of stockholder responsiveness, consider stockholders concerns and take into account the outcome of the vote when considering future decisions concerning our executive compensation program.

Proposal No.4: The approval of the Executive Incentive Plan requires the affirmative vote of a majority of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. You may vote for, against, or abstain with respect to this proposal. Abstentions are considered votes present and entitled to vote on this proposal, and thus will have the same effect as a vote against this proposal. Broker non-votes will have no effect on the outcome of this proposal.

Proposal No. 5: The stockholder proposal requesting additional diversity disclosure requires the affirmative vote of a majority of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. You may vote for, against, or abstain with respect to this proposal. Abstentions are considered votes present and entitled to vote on this proposal, and thus will have the same effect as votes against this proposal. Broker non-votes will have no effect on the outcome of this proposal.

How are proxies solicited for the Annual Meeting?

Our board of directors is soliciting proxies for use at the Annual Meeting. All expenses associated with this solicitation will be borne by us. We will reimburse brokers, banks or other nominees for reasonable expenses that they incur in sending our proxy materials to you if a broker, bank or other nominee holds your shares of our common stock. In addition to using the internet, our directors, officers and employees may solicit proxies in person and by mail, telephone, facsimile, or electronic transmission, for which they will not receive any additional compensation. We have retained Saratoga Proxy Consulting LLC to assist us in soliciting proxies for a fee of $15,000, plus reasonable out-of-pocket expenses incurred in the process of soliciting proxies.

How may my broker, bank or other nominee vote my shares if I fail to timely provide voting instructions?

Brokerage firms, banks or other nominees holding shares of our common stock in street name for beneficial owners are generally required to vote such shares in the manner directed by the beneficial owner. In the absence of timely directions, your broker, bank or other nominee will have discretion to vote your shares on our sole routine matter, the proposal to ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for our fiscal year ending January 31, 2018. Your broker will not have discretion to vote on any other proposals, which are non-routine matters, absent direction from you.

Is my vote confidential?

Proxy instructions, ballots, and voting tabulations that identify individual stockholders are handled in a manner that protects your voting privacy. Your vote will not be disclosed either within Palo Alto Networks or to third parties, except as necessary to meet applicable legal requirements, to allow for the tabulation of votes and certification of the vote, or to facilitate a successful proxy solicitation. Occasionally, stockholders provide written comments on their proxy cards, which may be forwarded to management and our board of directors.

Where can I find the voting results of the Annual Meeting?

We will announce preliminary voting results at the Annual Meeting. We will also disclose voting results on a Current Report on Form 8-K that we will file with the SEC within four business days after the Annual Meeting. If final voting results are not available to us in time to file a Current Report on Form 8-K within four business days after the Annual Meeting, we will file a Current Report on Form 8-K to publish preliminary voting results and will provide the final voting results in an amendment to the Current Report on Form 8-K as soon as they become available.

I share an address with another stockholder, and we received only one paper copy of the proxy materials. How may I obtain an additional copy of the proxy materials?

We have adopted a procedure called householding, which the SEC has approved. Under this procedure, we deliver a single copy of the Notice, and if applicable, our proxy materials, to multiple stockholders who share the same address unless we receive contrary instructions from one or more of the stockholders sharing the same address. This procedure reduces our printing costs, mailing costs, and fees. Stockholders who participate in householding will continue to be able to access and receive separate copies of the Notice, or if applicable, our proxy materials. Upon written or oral request, we will deliver promptly separate copies of the Notice and, if applicable, our proxy materials, to any stockholder at a shared address which we delivered a single copy of any of these materials. To receive a separate copy, or, if a stockholder is receiving multiple copies, to request that we only send a single copy of the Notice or, if applicable, our proxy materials, stockholders may contact us at the following: Palo Alto Networks, Inc., Attention: Investor Relations, 3000 Tannery Way, Santa Clara, California 95054 or Tel: (408) 753-4000.

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Stockholders who hold shares of our common stock in street name may contact their brokerage firm, bank, broker-dealer or other similar organization to request information about householding.

What is the deadline to propose actions for consideration at next year s annual meeting of stockholders or to nominate individuals to serve as directors?

Stockholder Proposals

Stockholders may present proper proposals for inclusion in our proxy statement and for consideration at the next annual meeting of stockholders by submitting their proposals in writing to our Corporate Secretary in a timely manner. For a stockholder proposal to be considered for inclusion in our proxy statement for our 2018 annual meeting of stockholders, our Corporate Secretary must receive the written proposal at our principal executive offices not later than June 25, 2018. In addition, stockholder proposals must comply with the requirements of Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the Exchange Act) regarding the inclusion of stockholder proposals in company-sponsored proxy materials. Stockholder proposals should be addressed to:

Palo Alto Networks, Inc., Attention: Corporate Secretary, 3000 Tannery Way, Santa Clara, California 95054.

Our amended and restated bylaws also establish an advance notice procedure for stockholders who wish to present a proposal before an annual meeting of stockholders but do not intend for the proposal to be included in our proxy statement. Our amended and restated bylaws provide that the only business that may be conducted at an annual meeting is business that is (i) specified in our proxy materials with respect to such annual meeting, (ii) otherwise properly brought before the annual meeting by or at the direction of our board of directors, or (iii) properly brought before the annual meeting by a stockholder of record entitled to vote at the annual meeting who has delivered timely written notice to our Corporate Secretary, which notice must contain the information specified in our amended and restated bylaws. To be timely for our 2018 annual meeting of stockholders, our Corporate Secretary must receive the written notice at our principal executive offices:

- not earlier than the close of business August 9, 2018; and
- not later than the close of business on September 8, 2018.

In the event that we hold our 2018 annual meeting of stockholders more than 30 days before or more than 60 days after the one-year anniversary of the Annual Meeting, then notice of a stockholder proposal that is not intended to be included in our proxy statement must be received no earlier than the close of business on the 120th day before such annual meeting and no later than the close of business on the later of the following two dates:

- the 90th day prior to such annual meeting; or
- the 10th day following the day on which public announcement of the date of such annual meeting is first made.

If a stockholder who has notified us of his, her or its intention to present a proposal at an annual meeting does not appear to present his, her or its proposal at such annual meeting, we are not required to present the proposal for a vote at such annual meeting.

Recommendation and Nomination of Director Candidates

You may recommend director candidates for consideration by our nominating and corporate governance committee. Any such recommendations should include, among other requirements, information about the candidate, a statement of support by the recommending stockholder, evidence of the recommending stockholder s ownership of our common stock and a signed letter from the candidate confirming willingness to

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serve on our board of directors, and should be directed to our Corporate Secretary at the address set forth above. For additional information regarding stockholder recommendations for director candidates, see the section titled Board of Directors and Corporate Governance Stockholder Recommendations for Nominations to the Board of Directors.

In addition, our amended and restated bylaws permit stockholders to nominate directors for election at an annual meeting of stockholders. To nominate a director, the stockholder must provide the information required by our amended and restated bylaws. In addition, the stockholder must give timely notice to our Corporate Secretary in accordance with our amended and restated bylaws, which, in general, require that the notice be received by our Corporate Secretary within the time periods described above under the section titled Stockholder Proposals for stockholder proposals that are not intended to be included in a proxy statement.

Availability of Bylaws

A copy of our amended and restated bylaws may be obtained by accessing our public filings on the SEC s website at www.sec.gov. You may also contact our Corporate Secretary at our principal executive offices for a copy of the relevant bylaw provisions regarding the requirements for making stockholder proposals and nominating director candidates.

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PROPOSAL NO. 1

ELECTION OF DIRECTORS

Our business affairs are managed under the direction of our board of directors, which is currently composed of eleven members. Nine of our directors are independent within the meaning of the listing standards of the New York Stock Exchange (NYSE) and SEC rules and regulations. Our board of directors is divided into three staggered classes of directors. At each annual meeting of stockholders, a class of directors will be elected for a three-year term to succeed the same class whose term is then expiring.

Each director s term continues until the election and qualification of his or her successor, or such director s earlier death, resignation, or removal. Any increase or decrease in the number of directors will be distributed among the three classes so that, as nearly as possible, each class will consist of one-third of our directors. This classification of our board of directors may have the effect of delaying or preventing changes in control of our company.

The names and certain other information as of October 23, 2017 for each of the nominees for election as a director, for each of the continuing members of the board of directors are set forth below.

	Class	Age	Position	Director Since	Current Term Expires	Expiration of Term For Which Nominated
Nominees						
Frank Calderoni (1)	III	60	Director	2016	2017	2020
Carl Eschenbach (2) (3)	III	50	Director	2013	2017	2020
Daniel J. Warmenhoven (2) (3) (4)	III	66	Director	2012	2017	2020
Continuing Directors						
John M. Donovan (1)	I	57	Director	2012	2018	
Stanley J. Meresman (1)	I	70	Director	2014	2018	
Nir Zuk	I	46	Director and Chief Technology Officer	2005	2018	
Mary Pat McCarthy (1)	I	62	Director	2016	2018	
Mark D. McLaughlin	II	51	Chairman and Chief Executive Officer	2011	2019	
Asheem Chandna (2) (3)	II	53	Director	2005	2019	
James J. Goetz (2) (3)	II	51	Director	2005	2019	
Sridhar Ramaswamy (3)	II	51	Director	2017	2019	

(1) Member of our audit committee
(2) Member of our compensation committee
(3) Member of our nominating and corporate governance committee
(4) Lead Independent Director

Nominees for Director

Frank Calderoni has served as a member of our board of directors since February 2016. Since January 2017, Mr. Calderoni has served as President, Chief Executive Officer and a director of Anaplan, Inc., a planning and performance management platform. From June 2015 to January 2017, Mr. Calderoni served as Executive Vice President, Operations and Chief Financial Officer of Red Hat, Inc., a software company. From May 2004 to January 2015, Mr. Calderoni served in various positions at Cisco Systems, Inc., a multinational technology company, including as Executive Vice President and Chief Financial Officer. Mr. Calderoni currently serves on the board of directors of Adobe Systems Incorporated, a global software company, and has previously served on the board of directors of Nimble Storage, Inc., a data storage company. Mr. Calderoni holds a B.S. in Accounting

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and Finance from Fordham University and an M.B.A. from Pace University. Mr. Calderoni was selected to serve on our board of directors because of his extensive financial and accounting expertise from his current and prior experience as Chief Financial Officer of various public companies, a deep understanding of financial reporting rules and regulations as well as his extensive experience in the technology industry.

Carl Eschenbach has served as a member of our board of directors since May 2013. Mr. Eschenbach has been a general partner at Sequoia Capital Operations, LLC, a venture capital firm, since April 2016, and continues to serve as a strategic advisor to VMware, Inc., a provider of cloud and virtualization software and services. Prior to joining Sequoia Capital Operations, LLC, Mr. Eschenbach served as Chief Operating Officer and President of VMware, Inc. a role he held from December 2012 to February 2016. Mr. Eschenbach previously served as VMware s President and Chief Operating Officer from April 2012 to December 2012, as VMware s Co-President, Customer Operations from January 2011 to April 2012 and as VMware s Executive Vice President of Worldwide Field Operations from May 2005 to January 2011. Prior to joining VMware in 2002, he was Vice President of North America Sales at Inktomi from 2000 to 2002. Mr. Eschenbach also held various sales management positions with 3Com Corporation, Lucent Technologies Inc. and EMC. Mr. Eschenbach was selected to serve on our board of directors because of his extensive experience in the technology industry and his previous public company management experience.

Daniel J. Warmenhoven has served as the Lead Independent Director of our board of directors since March 2012. From October 1994 to August 2009, Mr. Warmenhoven was Chief Executive Officer at NetApp, Inc., a provider of computer storage and data management, and on their board of directors as Executive Chairman from August 2009 through September 2014. Mr. Warmenhoven previously served on the board of directors of Aruba Networks, a vendor of data networking solutions. Mr. Warmenhoven holds a B.S. degree in Electrical Engineering from Princeton University. Mr. Warmenhoven was selected to serve on our board of directors because of his extensive experience in the technology industry and his public company management and board experience.

If you are a stockholder of record and you sign your proxy card or vote by telephone or over the Internet but do not give instructions with respect to the voting of directors, your shares will be voted FOR the re-election of Messrs. Calderoni, Eschenbach and Warmenhoven. We expect that each of Messrs. Calderoni, Eschenbach and Warmenhoven will accept such nomination; however, in the event that a director nominee is unable or declines to serve as a director at the time of the Annual Meeting, the proxies will be voted for any nominee who shall be designated by our board of directors to fill such vacancy. If you wish to give specific instructions with respect to the voting of directors, you may do so by indicating your instructions on your proxy card or when you vote by telephone or over the Internet. If you are a street name stockholder and you do not give voting instructions to your broker or nominee, your shares will not be voted on this matter.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR EACH

OF THE NOMINEES NAMED ABOVE.

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BOARD OF DIRECTORS AND CORPORATE GOVERNANCE

Continuing Directors

Asheem Chandna has served as a member of our board of directors since April 2005. Mr. Chandna has been a Partner at Greylock Partners, a venture capital firm, since September 2003, where he focuses on investments in enterprise IT, including security products. From April 2003 to June 2013, Mr. Chandna was a director of Imperva, Inc., a provider of cyber security solutions. From April 1996 to December 2002, Mr. Chandna was Vice President, Business Development and Product Management at Check Point Software. Mr. Chandna currently serves on the board of directors of a number of privately held companies. Mr. Chandna holds a B.S. in Electrical Engineering and an M.S. in Computer Engineering from Case Western Reserve University. Mr. Chandna was selected to serve on our board of directors because of his specific professional experience with Internet security products, his extensive background with enterprise IT companies, and his public and private company board experience.

John M. Donovan has served as a member of our board of directors since September 2012. Mr. Donovan has worked at AT&T Inc., a provider of telecommunication services, since April 2008, first as Chief Technology Officer and currently as Chief Executive Officer AT&T Communications. From November 2006 to April 2008, Mr. Donovan was Executive Vice President of Product, Sales, Marketing and Operations at Verisign. From November 2000 to November 2006, Mr. Donovan served as Chairman and CEO of inCode Telecom Group Inc., a provider of strategy and consulting services to the telecommunications industry. Prior to joining inCode, Mr. Donovan was a Partner with Deloitte Consulting where he was the Americas industry practice director for telecommunications. Mr. Donovan holds a B.S. in Electrical Engineering from the University of Notre Dame and an M.B.A. from the University of Minnesota. Mr. Donovan was selected to serve on our board of directors because of his extensive experience in the telecommunications industry.

James J. Goetz has served as a member of our board of directors since April 2005. Mr. Goetz has been a managing member of Sequoia Capital Operations, LLC, a venture capital firm, since June 2004, where he focuses on cloud, mobile, and enterprise companies. Mr. Goetz currently serves on the board of directors of several privately held companies. Mr. Goetz has previously served on the boards of directors of Barracuda Networks, Inc., a data security and storage company from 2009 to 2017, Nimble Storage, Inc., a data storage company, from 2007 to 2017, Jive Software, Inc., a provider of social business software, from 2007 until 2015, and Ruckus Wireless, Inc., a manufacturer of wireless (Wi-Fi) networking equipment, from 2012 until 2015. Mr. Goetz holds an M.S. in Electrical Engineering with a concentration in Computer Networking from Stanford University and a B.S. in Electrical Engineering with a concentration in Computer Engineering from the University of Cincinnati. Mr. Goetz was selected to serve on our board of directors because of his deep experience with the venture capital industry and providing guidance and counsel to a wide variety of Internet and technology companies.

Mary Pat McCarthy has served as a member of our board of directors since October 2016. Ms. McCarthy, now retired, served as Vice Chair of KPMG LLP, the U.S. member firm of the global audit, tax and advisory services firm, until 2011 after attaining such position in 1998. She joined KPMG LLP in 1977 and became a partner in 1987. She held numerous senior leadership positions in the firm, including Executive Director of the KPMG Audit Committee Institute from 2008 to 2011, Leader of the KPMG Client Care Program from 2007 to 2008, U.S. Leader, Industries and Markets from 2005 to 2006, and Global Leader, Information, Communication and Entertainment Practice from 1998 to 2004. Ms. McCarthy also served on KPMG s Management and Operations Committees. Ms. McCarthy earned a Bachelor of Science degree in Business Administration from Creighton University and completed the University of Pennsylvania Wharton School s KPMG International Development Program. Ms. McCarthy serves as a director of Andeavor Corporation (formerly Tesoro Corporation), a global energy corporation and Mutual of Omaha, an insurance and banking company. Ms. McCarthy was selected to serve on our board of directors due, in part, to her background as chairperson of the Audit Committee of each of Andeavor Corporation and Mutual of Omaha and her financial and accounting expertise from her prior extensive experience as the Vice Chair of KPMG LLP.

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Mark D. McLaughlin has served as our Chief Executive Officer and as a member of our board of directors since August 2011, and as the Chairman of our board of directors since April 2012. From July 2011 through August 2016, Mr. McLaughlin also served as our President. From August 2009 through July 2011, Mr. McLaughlin served as President and Chief Executive Officer and as a director at VeriSign, Inc., a provider of Internet infrastructure services, and from January 2009 to August 2009, Mr. McLaughlin served as President and Chief Operating Officer at VeriSign. From February 2000 through November 2007, Mr. McLaughlin served in several roles at VeriSign, including as Executive Vice President, Products and Marketing. Prior to joining VeriSign, Mr. McLaughlin was Vice President, Sales and Business Development at Signio Inc., an Internet payments company acquired by VeriSign in February 2000. In January 2011, President Barack Obama appointed Mr. McLaughlin to serve on the President s National Security Telecommunications Advisory Committee. Mr. McLaughlin currently serves on the board of directors of Qualcomm, Inc., a global semiconductor company that designs and markets wireless telecommunications products and services, and previously served on the board of directors of Opower, Inc., a provider of cloud based software to the utility industry. Mr. McLaughlin holds a B.S. from the U.S. Military Academy at West Point and a J.D. from Seattle University School of Law. Mr. McLaughlin was selected to serve on our board of directors because of the perspective and experience he brings as our Chief Executive Officer and his extensive background in the technology industry.

Stanley J. Meresman has served as a member of our board of directors since September 2014. Prior to that, Mr. Meresman was a Venture Partner with Technology Crossover Ventures, a private equity firm, from January 2004 to December 2004, and served as General Partner and Chief Operating Officer from November 2001 to December 2003. During the four years prior to joining Technology Crossover Ventures, Mr. Meresman was a private investor, board member and advisor to several technology companies. From May 1989 to May 1997, Mr. Meresman was the Senior Vice President and Chief Financial Officer of Silicon Graphics, Inc., a manufacturer of high-performance computing solutions. Prior to Silicon Graphics, he was Vice President of Finance and Administration and Chief Financial Officer of Cypress Semiconductor, a semiconductor company. Mr. Meresman currently serves on the board of directors of Snap, Inc., a camera and social media company, and several private companies. He previously served on the board of directors of LinkedIn Corporation, Zynga Inc., Meru Networks, Riverbed Technology, Inc. and Polycom, Inc. Mr. Meresman holds an M.B.A. from the Stanford Graduate School of Business and a B.S. in Industrial Engineering and Operations Research from the University of California, Berkeley. Mr. Meresman was selected to serve on our board of directors due, in part, to his background as chair of the audit committee of other public companies and his financial and accounting expertise from his prior extensive experience as Chief Financial Officer of two public NYSE-listed companies.

Sridhar Ramaswamy has served as a member of our board of directors since August 2017. Mr. Ramaswamy currently serves as Senior Vice President Ads & Commerce at Google, Inc., a multinational technology company that specializes in internet-related services and products, a position he has held since March 2013. From 2003 to March 2013, Mr. Ramaswamy served in various leadership roles in Google s engineering group, including as Senior Vice President Engineering. Prior to joining Google, Mr. Ramaswamy served in engineering and other technical roles at E.piphany Inc., Bell Laboratories, Inc., and Telcordia Technologies, Inc. Mr. Ramaswamy holds a B.S. in Computer Science from the India Institute of Technology, Madras India and a M.S. and PhD in Computer Science from Brown University. Mr. Ramaswamy was selected to serve on our board of directors due, in part, to the depth of his technical engineering background and his extensive cloud and infrastructure expertise.

Nir Zuk is one of our founders and has served as our Chief Technology Officer and as a member of our board of directors since March 2005. From April 2004 to March 2005, Mr. Zuk was Chief Security Technologist at Juniper Networks, Inc., a supplier of network infrastructure products and services. From September 2002 until its acquisition by Juniper in April 2004, Mr. Zuk was Chief Technology Officer at NetScreen Technologies, Inc., a provider of ASIC-based Internet security systems. In December 1999, Mr. Zuk co-founded OneSecure, Inc., a provider of prevention and detection appliances, and was Chief Technical Officer until its acquisition by NetScreen in September 2002. From 1994 to 1999, Mr. Zuk served in several technical roles, including Principal Engineer at Check Point Software Technologies Ltd., an enterprise software security company. Mr. Zuk attended

Tel Aviv University where he studied Mathematics. Mr. Zuk was selected to serve on our board of directors because of the perspective and experience he brings as one of our founders and as one of our largest stockholders, as well as his extensive experience with network security companies.

Director Independence

Our common stock is listed on the NYSE. Under the listing standards of the NYSE, independent directors must comprise a majority of a listed company s board of directors. In addition, the listing standards of the NYSE require that, subject to specified exceptions, each member of a listed company s audit, compensation, and nominating and corporate governance committees be independent. Under the listing standards of the NYSE, a director will only qualify as an independent director if, in the opinion of that listed company s board of directors, that director does not have a material relationship with the company, either directly or indirectly, that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

Audit committee members must also satisfy the additional independence criteria set forth in Rule 10A-3 under the Securities Exchange Act of 1934, as amended (the Exchange Act) and the listing standards of the NYSE. In order to be considered independent for purposes of Rule 10A-3, a member of a listed company s audit committee may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee: (1) accept, directly or indirectly, any consulting, advisory, or other compensatory fee from the listed company or any of its subsidiaries; or (2) be an affiliated person of the listed company or any of its subsidiaries.

Compensation committee members must also satisfy the additional independence criteria set forth in Rule 10C-1 under the Exchange Act and the listing standards of the NYSE. In order for a member of a listed company s compensation committee to be considered independent for purposes of the listing standards of the NYSE, the listed company s board of directors must consider all factors specifically relevant to determining whether a director has a relationship to the listed company that is material to that director s ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to: (1) the source of compensation of such director, including any consulting, advisory, or other compensatory fee paid by the listed company to such director; and (2) whether such director is affiliated with the listed company, a subsidiary of the listed company, or an affiliate of a subsidiary of the listed company.

Our board of directors has undertaken a review of the independence of each of our directors. Based on information provided by each director concerning his or her background, employment, and affiliations, our board of directors has determined that Ms. McCarthy and each of Messrs. Calderoni, Chandna, Donovan, Eschenbach, Goetz, Meresman, Ramaswamy and Warmenhoven do not have a material relationship with the company, either directly or indirectly, that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director and that each of these directors is independent as that term is defined under the applicable rules and regulations of the SEC and the listing standards of the NYSE. In making these determinations, our board of directors considered the current and prior relationships that each non-employee director has with our company and all other facts and circumstances our board of directors deemed relevant in determining their independence, including the beneficial ownership of our common stock by each non-employee director and the transactions involving them described in the section titled Certain Relationships and Related Party Transactions.

Since the beginning of our last fiscal year through October 15, 2017, both directly and through our channel partners, we have sold an aggregate of approximately $58.8 million and $0.5 million of products and services to AT&T Inc. (AT&T) and Anaplan, Inc. (Anaplan) respectively, in arm s length transactions. In addition, since the beginning of our last fiscal year through October 15, 2017, we have purchased an aggregate of approximately $0.2 million, $0.7 million and $4.5 million of AT&T, Anaplan and Google, Inc. products and services, respectively, in arm s length transactions.

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We entered into these commercial dealings in the ordinary course of our business. In making the determinations as to which members of our board of directors are independent, our board of directors considered the fact that Mr. Donovan, one of our directors, is an executive officer of AT&T, that Mr. Calderoni, one of our directors, is an executive officer at Anaplan, and that Mr. Ramaswamy, one of our directors, is an executive at Google. In reviewing these relationships, our board of directors determined these relationships do not impede the ability of Mr. Donovan, Mr. Calderoni or Mr. Ramaswamy to act independently on our behalf and on behalf of our stockholders.

Additionally, none of Messrs. Donovan, Calderoni or Ramaswamy take part in the discussion of transactions with AT&T, Anaplan, or Google, respectively, when such transactions are reviewed by our board of directors. Additionally, AT&T expects its 2017 capital expenditures to be in the $22 billion range. AT&T s purchases of our products and services, which totaled $58.8 million, are not material to either us or AT&T. All transactions with AT&T, Anaplan and Google are subject to our rigorous related party transactions review process and policy.

Leadership Structure

Mr. McLaughlin currently serves as both Chairman of our board of directors and as our Chief Executive Officer. Our board of directors believes that the current board leadership structure, coupled with a strong emphasis on board independence, provides effective independent oversight of management while allowing our board of directors and management to benefit from Mr. McLaughlin s leadership and years of experience as an executive in the technology industry. Serving on our board of directors and as Chief Executive Officer since August 2011, Mr. McLaughlin is best positioned to identify strategic priorities, lead critical discussion and execute our strategy and business plans. Mr. McLaughlin possesses detailed in-depth knowledge of the issues, opportunities, and challenges facing us. Independent directors and management sometimes have different perspectives and roles in strategy development. Our independent directors bring experience, oversight and expertise from outside of our company, while our Chief Executive Officer brings company specific experience and expertise. Our board of directors believes that Mr. McLaughlin s combined role enables strong leadership, creates clear accountability, and enhances our ability to communicate our message and strategy clearly and consistently to stockholders.

Lead Independent Director

Our corporate governance guidelines provide that one of our independent directors should serve as a Lead Independent Director at any time when our Chief Executive Officer serves as the Chairman of our board of directors or if our Chairman is not otherwise independent. Because our Chief Executive Officer, Mr. McLaughlin, is our Chairman, our board of directors has appointed Mr. Warmenhoven to serve as our Lead Independent Director. As our Lead Independent Director, Mr. Warmenhoven presides over periodic meetings of our independent directors, serves as a liaison between our Chairman and the independent directors and performs such additional duties as our board of directors may otherwise determine and delegate.

Board Effectiveness; Director Assessment; Board Education

It is important that our board of directors and its committees are performing effectively and in the best interest of Palo Alto Networks and its stockholders. Our board of directors performs an annual self-assessment, overseen by the nominating and corporate governance committee, to evaluate its effectiveness in fulfilling its obligations. Directors are sent questions by our outside legal counsel covering board of directors, committee, self and peer performance. Our outside legal counsel then interviews each director to obtain his or her assessment of the effectiveness of our board of directors and committees, as well as director performance and board of directors dynamics, summarizes these individual assessments for discussion with the board of directors and committees, and leads a discussion with the nominating and corporate governance committee and the board of directors. The board of directors then takes such further action as it deems appropriate. In addition, we encourage directors to participate in continuing education programs focused on our business and industry, committee roles and responsibilities, and legal and ethical responsibilities of directors.

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Board Meetings and Committees

During our fiscal year ended July 31, 2017, the board of directors held eight meetings (including regularly scheduled and special meetings), and no director attended fewer than 75% of the total number of meetings of the board of directors and the committees of which he was a member.

Although we do not have a formal policy regarding attendance by members of our board of directors at annual meetings of stockholders, we encourage, but do not require, our directors to attend. Eight of our ten directors at the time attended our 2016 Annual Meeting of Stockholders, either telephonically or in person.

Our board of directors has an audit committee, a compensation committee, and a nominating and corporate governance committee, each of which has the composition and responsibilities described below. Directors serve on these committees until their resignation or until otherwise determined by our board of directors. All of the directors on the standing committees of our board of directors are independent, and each of these committees is led by a committee chairperson.

Audit Committee

Our audit committee consists of Ms. McCarthy and Messrs. Calderoni, Donovan and Meresman, with Mr. Meresman serving as the chair.

The composition of our audit committee meets the requirements for independence for audit committee members under the listing standards of the NYSE and the rules and regulations of the SEC. Each member of our audit committee also meets the financial literacy and sophistication requirements of the listing standards of the NYSE. In addition, our board of directors has determined that each of Ms. McCarthy and Messrs. Calderoni and Meresman are audit committee financial experts within the meaning of the rules and regulations of the SEC. Our audit committee is responsible for, among other things:

- selecting and hiring our independent registered public accounting firm;
- evaluating the performance and independence of our independent registered public accounting firm;
- approving the audit and pre-approving any non-audit services to be performed by our independent registered public accounting firm;
- reviewing our financial statements and related disclosures and reviewing our critical accounting policies and practices;
- reviewing the adequacy and effectiveness of our internal control policies and procedures and our disclosure controls and procedures;

- reviewing and participating in the selection of our internal auditor and periodically reviewing the activities and reports of the internal audit function and any issues encountered in the course of the internal audit function s work;
- overseeing procedures for the treatment of complaints on accounting, internal accounting controls, or audit matters;
- reviewing and discussing with management and the independent registered public accounting firm the results of our annual audit, our quarterly financial statements, and our publicly filed reports;
- reviewing and approving or ratifying any proposed related person transactions; and
- preparing the audit committee report that the SEC requires in our annual proxy statement.

Our audit committee operates under a written charter that was adopted by our board of directors and satisfies the applicable rules and regulations of the SEC and the listing standards of the NYSE. A copy of the charter of our audit committee is available on our website at http://investors.paloaltonetworks.com/. During our fiscal year ended July 31, 2017, our audit committee held seven meetings.

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Compensation Committee

Our compensation committee consists of Messrs. Chandna, Eschenbach, Goetz and Warmenhoven, with Mr. Chandna serving as the chair. The composition of our compensation committee meets the requirements for independence for compensation committee members under the listing standards of the NYSE and the rules and regulations of the SEC. Each member of our compensation committee is also a non-employee director, as defined pursuant to Rule 16b-3 promulgated under the Exchange Act, and an outside director, as defined pursuant to Section 162(m) of the Internal Revenue Code (the Code). The purpose of our compensation committee is to discharge the responsibilities of our board of directors relating to compensation of our executive officers. Our compensation committee is responsible for, among other things:

- reviewing and approving our Chief Executive Officer s and other executive officers annual base salaries, incentive compensation arrangements, including the specific goals and amounts, equity compensation, employment agreements, severance arrangements and change in control agreements, and any other benefits, compensation or arrangements;

- administering our equity compensation plans;

- overseeing our overall compensation philosophy and compensation plans; and

- preparing the compensation committee report that the SEC requires to accompany the Compensation Discussion and Analysis contained in our annual proxy statement.

Our compensation committee operates under a written charter that was adopted by our board of directors and satisfies the applicable rules and regulations of the SEC and the listing standards of the NYSE. A copy of the charter of our compensation committee is available on our website at http://investors.paloaltonetworks.com. During our fiscal year ended July 31, 2017, our compensation committee held four meetings.

Nominating and Corporate Governance Committee

Our nominating and corporate governance committee consists of Messrs. Chandna, Eschenbach, Goetz, Ramaswamy and Warmenhoven, with Mr. Warmenhoven serving as the chair. The composition of our nominating and corporate governance committee meets the requirements for independence under the listing standards of the NYSE and the rules and regulations of the SEC. Our nominating and corporate governance committee is responsible for, among other things:

- evaluating and making recommendations regarding the composition, organization, and governance of our board of directors and its committees;

- evaluating and making recommendations regarding the creation of additional committees or the change in mandate or dissolution of committees;

- reviewing and making recommendations with regard to our corporate governance guidelines and compliance with laws and regulations;

- reviewing and approving conflicts of interest of our directors and corporate officers, other than related person transactions reviewed by our audit committee; and

- oversees our annual board of director and committee self-assessment process.

Our nominating and corporate governance committee operates under a written charter that was adopted by our board of directors and satisfies the applicable listing standards of the NYSE. A copy of the charter of our nominating and corporate governance committee is available on our website at http://investors.paloaltonetworks.com/. During our fiscal year ended July 31, 2017, our nominating and corporate governance committee held four meetings.

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Compensation Committee Interlocks and Insider Participation

None of the members of our compensation committee is or has been an officer or employee of our company. None of our executive officers currently serves, or in the past year has served, as a member of the board of directors or compensation committee (or other board committee performing equivalent functions) of any entity that has one or more of its executive officers serving on our board of directors or compensation committee.

Considerations in Evaluating Director Nominees

Our nominating and corporate governance committee uses a variety of methods for identifying and evaluating director nominees. In its evaluation of director candidates, our nominating and corporate governance committee will consider the current size and composition of our board of directors and the needs of our board of directors and the respective committees of our board of directors. Some of the qualifications that our nominating and corporate governance committee considers include, without limitation, issues of character, integrity, judgment, diversity (including gender and race), experience of particular relevance to us and the board of directors, independence, age, area of expertise, length of service, potential conflicts of interest and other commitments. These factors may be weighted differently depending on the individual being considered or the needs of the board of directors at the time.

Nominees must also have the ability to offer advice and guidance to our Chief Executive Officer based on past experience in positions with a high degree of responsibility and be leaders in the companies or institutions with which they are affiliated. Director candidates must have sufficient time available in the judgment of our nominating and corporate governance committee to perform all board of director and committee responsibilities. Members of our board of directors are expected to prepare for, attend, and actively participate in all board of director and applicable committee meetings. Given the significant time commitment that board membership requires, our board of directors generally believes that no director should be a member of more than three public company boards. Other than the foregoing, there are no stated minimum criteria for director nominees, although our nominating and corporate governance committee may also consider such other factors as it may deem, from time to time, are in our and our stockholders best interests. Our nominating and corporate governance committee will also seek appropriate input from our Chief Executive Officer from time to time in assessing the needs of our board of directors for relevant background, experience, diversity and skills of its members.

Our board of directors should be a diverse body, with varying perspectives and experiences. Our nominating and corporate governance committee considers diversity (whether based on broader principles such as diversity of perspective, experiences, and expertise, as well as factors commonly associated with diversity such as gender, race or national origin) in connection with its evaluation of director candidates, including the evaluation and determination of whether to re-nominate incumbent directors. Our nominating and corporate governance committee also considers these and other factors as it oversees the annual board of director and committee evaluations. The nominating and corporate governance committee is committed to seeking out qualified and diverse director candidates, including women and individuals from minority groups, to include in the pool from which director candidates are chosen. Any search firm retained by our nominating and corporate governance committee to find director candidates would be instructed to take into account all of the considerations used by our nominating and corporate governance committee including diversity. After completing its review and evaluation of director candidates, our nominating and corporate governance committee recommends to our full board of directors the director nominees for selection.

Stockholder Recommendations for Nominations to the Board of Directors

Our nominating and corporate governance committee will consider candidates for director recommended by stockholders holding at least one percent (1%) of the fully diluted capitalization of our company continuously for at least twelve (12) months prior to the date of the submission of the recommendation, so long as such recommendations comply with our certificate of incorporation and bylaws and applicable laws, rules and regulations, including those promulgated by the SEC. The nominating and corporate governance committee will evaluate such recommendations in accordance with its charter, our amended and restated bylaws, our policies and procedures for director candidates, as well as the regular director nominee criteria described above. This process is designed to ensure that our board of directors includes members with diverse backgrounds, skills and experience, including appropriate financial and other expertise relevant to our business. Eligible stockholders wishing to recommend a candidate for nomination should contact our Corporate Secretary in writing. Such recommendations must include information about the candidate, a statement of support by the recommending stockholder, evidence of the recommending stockholder s ownership of our common stock and a signed letter from the candidate confirming willingness to serve on our board of directors. Our nominating and corporate governance committee has discretion to decide which individuals to recommend for nomination as directors.

Under our bylaws, stockholders may also nominate persons for our board of directors. Any nomination must comply with the requirements set forth in our bylaws and recommendations should be sent in writing to our Corporate Secretary at Palo Alto Networks, Inc., 3000 Tannery Way, Santa Clara, California 95054.

Communications with the Board of Directors

Interested parties wishing to communicate with our board of directors or with an individual member or members of our board of directors may do so by writing to the board of directors or to the particular member or members of our board of directors, and mailing the correspondence to our General Counsel or our Legal Department, at Palo Alto Networks, Inc., 3000 Tannery Way, Santa Clara, California 95054. Our General Counsel or our Legal Department, in consultation with appropriate members of our board of directors, as necessary, will review all incoming communications and, if appropriate, all such communications will be forwarded to the appropriate member or members of our board of directors, or if none is specified, to the Chairman of our board of directors.

Corporate Governance Guidelines and Code of Business Conduct and Ethics

Our board of directors has adopted Corporate Governance Guidelines. These guidelines address items such as the qualifications and responsibilities of our directors and director candidates and corporate governance policies and standards applicable to us in general. In addition, our board of directors has adopted a Code of Business Conduct and Ethics that applies to all of our employees, officers and directors, including our Chief Executive Officer, Chief Financial Officer, and other executive and senior financial officers. The full text of our Corporate Governance Guidelines and our Code of Business Conduct and Ethics is posted on the Investor Information portion of our website at http://investors.paloaltonetworks.com/. We will post amendments to our Code of Business Conduct and Ethics or waivers of our Code of Business Conduct and Ethics for directors and executive officers on the same website.

Risk Management

Risk is inherent with every business, and we face a number of risks, including strategic, financial, business and operational, legal and compliance, and reputational. We have designed and implemented processes to manage risk in our operations. Management is responsible for the day-to-day management of risks the company faces, while our board of directors, as a whole and assisted by its committees, has responsibility for the oversight of risk management. In its risk oversight role, our board of directors has the responsibility to satisfy itself that the risk management processes designed and implemented by management are appropriate and functioning as designed.

Our board of directors believes that open communication between management and our board of directors is essential for effective risk management and oversight. Our board of directors meets with our Chief Executive Officer and other members of the senior management team at quarterly meetings of our board of directors, where, among other topics, they discuss strategy and risks facing the company, as well as at such other times as they deem appropriate.

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While our board of directors is ultimately responsible for risk oversight, our board committees assist our board of directors in fulfilling its oversight responsibilities in certain areas of risk. Our audit committee assists our board of directors in fulfilling its oversight responsibilities with respect to risk management in the areas of internal control over financial reporting and disclosure controls and procedures, legal and regulatory compliance, and discusses with management and the independent auditor guidelines and policies with respect to risk assessment and risk management. Our audit committee also reviews our major financial risk exposures and the steps management has taken to monitor and control these exposures. Our audit committee also monitors certain key risks on a regular basis throughout the fiscal year, such as risk associated with internal control over financial reporting and liquidity risk. Our nominating and corporate governance committee assists our board of directors in fulfilling its oversight responsibilities with respect to the management of risk associated with board organization, membership and structure, and corporate governance. Our compensation committee assesses risks created by the incentives inherent in our compensation programs and policies. Finally, our board of directors reviews strategic and operational risk in the context of reports from the management team, receives reports on all significant committee activities at each regular meeting, and evaluates the risks inherent in significant transactions.

Succession Planning

Our board of directors and management team recognize the importance of continually developing our talented employee base. Accordingly, our management team conducts an annual talent review of the current senior leadership positions. In addition, our CEO annually reviews a succession plan for the CEO position, using formal criteria to evaluate potential successors and also interim candidates in the event of an emergency situation. In conducting its evaluation, our board of directors considers organizational needs, competitive challenges, leadership/management potential and development, and emergency situations.

Director Stock Ownership Guidelines

Our board of directors believes that our directors and executive officers should hold a meaningful financial stake in the company in order to further align their interests with those of our stockholders and therefore adopted stock ownership guidelines in fiscal 2017. Under the guidelines, each non-employee director must own the lesser of (i) company stock with a value of three times the annual cash retainer for board service or (ii) 6,875 shares. Our non-employee directors are required to achieve ownership of our common stock within five years of the later of August 26, 2016 or such director s appointment or election date as applicable.

See the section titled Discussion of our Fiscal 2017 Executive Compensation Program Other Compensation Policies Stock Ownership and Compensation Recovery Policies for additional details on our executive ownership guidelines.

Director Compensation

In fiscal 2013, our nominating and corporate governance committee approved a policy for the compensation of the non-employee members of our board of directors (the Director Compensation Policy) to attract, retain, and reward these individuals and align their financial interests with those of our stockholders. Only non-employee directors who are not affiliated with investment funds that hold shares of our common stock are eligible for compensation under the Director Compensation Policy. The Director Compensation Policy was amended in September 2014, effective for fiscal 2015. There is no cash compensation paid under the Director Compensation Policy.

Initial Award. Under the Director Compensation Policy and prior to its recent amendment, when an eligible director initially joined our board of directors, the eligible director received an initial award of restricted stock units having a value between $750,000 to $1 million (as determined based on the average closing price of our common stock on the NYSE during the 30 calendar days prior to the date of grant). The value of this initial award has been subsequently increased to $1 million effective the beginning of fiscal 2015. This initial award will vest as to one third of the shares covered by the restricted stock unit award on the first anniversary of the

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date the eligible director joined our board of directors, and the remaining shares will vest quarterly over the following two years, subject to the director s continued service as of each such date.

Annual Award. Under the Director Compensation Policy and prior to its recent amendment, at each annual meeting of stockholders, each eligible director received an annual restricted stock unit award having a value equal to $200,000 (as determined based on the average closing price of our common stock on the NYSE during the 30 calendar days prior to the date of grant). The value of the annual award has been subsequently increased to $300,000 effective the beginning of fiscal 2015. In addition, at each annual meeting of stockholders, our Lead Independent Director will receive an additional annual restricted stock unit award having a value equal to $50,000 (as determined based on the average closing price of our common stock on the NYSE during the 30 calendar days prior to the date of grant). All annual awards, including the annual awards to the lead independent director, will vest quarterly over a period of one year, subject to the director s continued service as of each such date.

Committee Awards. At each annual meeting of stockholders, the chairpersons and members of the three standing committees of our board of directors will receive additional annual restricted stock unit awards for committee service having the following values (as determined based on the average closing price of our common stock on the NYSE during the 30 calendar days prior to the date of grant):

Board Committee	**Chairperson Retainer ($)**	**Member Retainer ($)**
Audit Committee	35,000	20,000
Compensation Committee	25,000	15,000
Nominating and Corporate Governance Committee	15,000	10,000

Any eligible director who serves as chairperson of a committee is not entitled to a member retainer for the same committee. The committee awards will vest quarterly over a period of one year, subject to the director s continued service as of each such date.

Fiscal 2017 Director Compensation Table

The following table presents summary information regarding the compensation paid to our non-employee directors for our fiscal year ended July 31, 2017.

Director	**Stock Awards ($) (1)**	**Total($)**
Frank Calderoni (2)	289,629	289,629
Asheem Chandna (3)	303,215	303,215
John M. Donovan (4)	289,629	289,629
Carl Eschenbach (5)	294,071	294,071
James J. Goetz (6)		
Mary Pat McCarthy (7)	962,539	962,539
Stanley J. Meresman (8)	303,215	303,215
Daniel J. Warmenhoven (9)	343,714	343,714
Sridhar Ramaswamy (10)		

(1) The amounts reported in this column represent the aggregate grant date fair value of these restricted stock units (RSUs) as computed in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718, Compensation Stock Compensation, or ASC Topic 718. The assumptions used in the valuation of these awards are set forth in the notes to our consolidated financial statements, which are included in our Annual Report on Form 10-K for our fiscal year ended July 31, 2017, filed with the SEC on September 7, 2017. These amounts do not necessarily correspond to the actual value that may be recognized by the director upon the vesting of such awards.

(2) As of July 31, 2017, Mr. Calderoni held 5,197 RSUs.
(3) As of July 31, 2017, Mr. Chandna held 1,160 RSUs.
(4) As of July 31, 2017, Mr. Donovan held 1,108 RSUs.
(5) As of July 31, 2017, Mr. Eschenbach held 1,125 RSUs.
(6) Mr. Goetz receives no compensation under the Director Compensation Policy.
(7) Effective as of October 20, 2016, Ms. McCarthy was elected to our board of directors. The value in the table above represents the initial stock award she received on October 20, 2016. Given the date of Ms. McCarthy s appointment to our board of directors, and pursuant to the terms of her offer letter, she will first be eligible to receive equity grants equal to the value of the annual board and audit committee stock awards set forth in our Director Compensation Policy at the Annual Meeting. As of July 31, 2017, Ms. McCarthy held 6,480 RSUs.
(8) As of July 31, 2017, Mr. Meresman held 2,103 RSUs.
(9) As of July 31, 2017, Mr. Warmenhoven held 1,315 RSUs.
(10) Effective as of August 29, 2017, Mr. Ramaswamy was elected to our board of directors. Accordingly, he did not earn any compensation in fiscal 2017.

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PROPOSAL NO. 2

RATIFICATION OF APPOINTMENT OF

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Our audit committee has appointed Ernst & Young LLP (EY), independent registered public accountants, to audit our financial statements for our fiscal year ending July 31, 2018. During our fiscal year ended July 31, 2017, EY served as our independent registered public accounting firm.

Notwithstanding the selection of EY and even if our stockholders ratify the selection, our audit committee, in its discretion, may appoint another independent registered public accounting firm at any time during our fiscal year if our audit committee believes that such a change would be in the best interests of Palo Alto Networks and its stockholders. At the Annual Meeting, our stockholders are being asked to ratify the appointment of EY as our independent registered public accounting firm for our fiscal year ending July 31, 2018. Our audit committee is submitting the selection of EY to our stockholders because we value our stockholders views on our independent registered public accounting firm and as a matter of good corporate governance. Representatives of EY will be present at the Annual Meeting, and they will have an opportunity to make statements and will be available to respond to appropriate questions from our stockholders.

If our stockholders do not ratify the appointment of EY, our board of directors may reconsider the appointment.

Fees Paid to the Independent Registered Public Accounting Firm

The following table presents fees for professional audit services and other services rendered to our company by EY for our fiscal years ended July 31, 2016 and 2017.

	2016	2017
Audit Fees (1)	$ 3,039,554	$ 3,654,504
Audit-Related Fees (2)	475,278	191,985
Tax Fees (3)	341,322	780,599
All Other Fees	0	0
	$ 3,856,154	$ 4,627,088

(1) Audit fees consist of professional services rendered in connection with the audit of our annual consolidated financial statements, including audited financial statements presented in our Annual Report on Form 10-K, and review of our quarterly consolidated financial statements presented in our Quarterly Reports on Form 10-Q. These fees also include professional services provided for new and existing statutory audits of subsidiaries or affiliates of the Company.

(2) Audit-Related fees consist of fees for professional services for assurance and related services that are reasonably related to the performance of the audit or review of our consolidated financial statements and are not reported under Audit Fees. These services include accounting consultations, services provided in connection with regulatory filings, technical accounting guidance and other attestation services.

(3)

Tax Fees consist of fees for professional services for tax compliance and tax planning. These services include assistance regarding federal, state and international tax compliance.

Auditor Independence

In our fiscal year ended July 31, 2017, there were no other professional services provided by EY that would have required our audit committee to consider their compatibility with maintaining the independence of EY.

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Audit Committee Policy on Pre-Approval of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm

Consistent with requirements of the SEC and the Public Company Oversight Board (the PCAOB) regarding auditor independence, our audit committee is responsible for the appointment, compensation and oversight of the work of our independent registered public accounting firm. In recognition of this responsibility, our audit committee has established a policy for the pre-approval of all audit and permissible non-audit services provided by our independent registered public accounting firm. These services may include audit services, audit-related services, tax services and other services.

Before engagement of the independent registered public accounting firm for the next year s audit, the independent registered public accounting firm submits a detailed description of services expected to be rendered during that year for each of the following categories of services to our audit committee for approval:

Audit services. Audit services include work performed for the audit of our financial statements and the review of financial statements included in our quarterly reports, as well as work that is normally provided by the independent registered public accounting firm in connection with statutory and regulatory filings.

Audit related services. Audit related services are for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements and are not covered above under audit services.

Tax services. Tax services include all services performed by the independent registered public accounting firm s tax personnel for tax compliance, tax advice and tax planning.

Other services. Other services are those services not described in the other categories.

Our audit committee pre-approves particular services or categories of services on a case-by-case basis. The fees are budgeted, and our audit committee requires our independent registered public accounting firm and management to report actual fees versus budgeted fees periodically throughout the year by category of service. During the year, circumstances may arise when it may become necessary to engage the independent registered public accounting firm for additional services not contemplated in the original pre-approval. In those instances, the services must be pre-approved by our audit committee before our independent registered public accounting firm is engaged. Any proposed services exceeding these levels or amounts require specific pre-approval by our audit committee. All fees paid to EY for our fiscal year ended July 31, 2017, were pre-approved by our audit committee.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE RATIFICATION

OF THE APPOINTMENT OF ERNST & YOUNG LLP.

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REPORT OF THE AUDIT COMMITTEE

The audit committee consists of Ms. McCarthy and Messrs. Calderoni, Donovan and Meresman, with Mr. Meresman serving as the chair. Each member of the committee is an independent director as required by the listing standards of the NYSE and rules and regulations of the SEC. The audit committee operates under a written charter approved by the board of directors, which is available on the Investor Information portion of our web site at www.paloaltonetworks.com. The composition of the audit committee, the attributes of its members and the responsibilities of the audit committee, as reflected in its charter, are intended to be in accordance with applicable requirements for corporate audit committees. The audit committee reviews and assesses the adequacy of its charter and the audit committee s performance on an annual basis.

The audit committee assists our board of directors in the board s oversight and monitoring of:

- our accounting and financial reporting processes and internal controls as well as the audit and integrity of our financial statements;
- the qualifications, independence and performance of our independent registered public accounting firm;
- the performance of our internal audit function;
- our compliance with applicable law; and
- risk assessment and risk management pertaining to financial, accounting and tax matters of the company.

With respect to the company s financial reporting process, the management of the company is responsible for (1) establishing and maintaining internal controls and (2) preparing the company s consolidated financial statements. Our independent registered public accounting firm, Ernst & Young LLP (EY), is responsible for auditing these financial statements. It is the responsibility of the audit committee to oversee these activities. It is not the responsibility of the audit committee to prepare or certify our financial statements or guarantee the audits or reports of the independent auditors. These are the fundamental responsibilities of management and our independent registered public accounting firm.

The audit committee is responsible for the appointment, compensation, retention, and oversight of the work performed by EY. In fulfilling its oversight responsibility, the audit committee carefully reviews the policies and procedures for the engagement of the independent registered public accounting firm, including the scope of the audit, audit fees, auditor independence matters, performance of the independent auditors, and the extent to which the independent registered public accounting firm may be retained to perform non-audit services.

In the performance of its oversight function, the audit committee has:

- reviewed and discussed the audited financial statements with management and EY;

discussed with EY the matters required to be discussed by the statement on Auditing Standards No. 16, as amended (AICPA, Professional Standards, Vol. 1. AU section 380), and as adopted by the Public Company Accounting Oversight Board in Rule 3200T; and

received the written disclosures and the letter from EY required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant s communications with the audit committee concerning independence, and has discussed with EY its independence.

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Based on the audit committee s review and discussions with management and EY, the audit committee recommended to the board of directors that the audited financial statements be included in the Annual Report on Form 10-K for the fiscal year ended July 31, 2017, for filing with the Securities and Exchange Commission.

Respectfully submitted by the members of the audit committee of the board of directors:

Stanley J. Meresman (Chair)

Mary Pat McCarthy

Frank Calderoni

John M. Donovan

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PROPOSAL NO. 3

ADVISORY VOTE ON THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS

In accordance with the rules and regulations of the SEC, pursuant to Section 14A of the Exchange Act, we are providing our stockholders with the opportunity to vote to approve, on an advisory or non-binding basis, the compensation of our named executive officers as disclosed in accordance with the rules and regulations of the SEC in the Executive Compensation section of this proxy statement. This proposal, commonly known as a say-on-pay proposal, gives our stockholders the opportunity to express their views on our named executive officers compensation as a whole. This vote is not intended to address any specific item of compensation or any specific named executive officer, but rather the overall compensation of all of our named executive officers and the philosophy, policies and practices described in this proxy statement.

The say-on-pay vote is advisory, and therefore is not binding on us, our compensation committee or our board of directors. The say-on-pay vote will, however, provide information to us regarding investor sentiment about our executive compensation philosophy, policies and practices, which our compensation committee will be able to consider when determining executive compensation for the remainder of the current fiscal year and beyond. Our board of directors and our compensation committee value the opinions of our stockholders and to the extent there is any significant vote against the compensation of our named executive officers as disclosed in this proxy statement, we will endeavor to communicate with stockholders to better understand the concerns that influenced the vote and consider our stockholders concerns and our compensation committee will evaluate whether any actions are necessary to address those concerns.

We believe that the information we have provided in the section titled Executive Compensation, and in particular the information discussed in the section titled Executive Compensation Compensation Discussion and Analysis, demonstrates that our executive compensation program has been designed appropriately and is working to ensure management s interests are aligned with our stockholders interests to support long-term value creation. Accordingly, we ask our stockholders to vote FOR the following resolution at the Annual Meeting:

RESOLVED, that Palo Alto Networks, Inc. s stockholders approve, on an advisory basis, the compensation of the named executive officers, as disclosed in Palo Alto Networks, Inc. s proxy statement for the 2017 Annual Meeting of Stockholders pursuant to the compensation disclosure rules and regulations of the SEC, including the compensation discussion and analysis, the compensation tables and narrative discussion, and other related disclosure.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE APPROVAL, ON AN ADVISORY BASIS, OF THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS.

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PROPOSAL NO. 4

APPROVAL OF THE EXECUTIVE INCENTIVE PLAN

In August 2017, our compensation committee adopted the Executive Incentive Plan (the Incentive Plan), subject to approval from our stockholders at the Annual Meeting. We are asking stockholders to approve the Incentive Plan, so that we would have the ability to grant awards that may be deductible in full for federal income tax purposes the compensation recognized by our executive officers in connection with performance-based cash bonuses and equity awards granted under the Incentive Plan.

Section 162(m) of the Internal Revenue Code (Section 162(m)) generally denies a corporate tax deduction for annual compensation exceeding $1 million paid to the chief executive officer and other covered employees as determined under Section 162(m) and applicable guidance. However, certain types of compensation, including performance-based compensation within the meaning of Section 162(m), are excluded from this deductibility limit. For performance-based cash incentives and equity awards granted under the Incentive Plan to qualify as such performance-based compensation, the material terms of the Incentive Plan must be approved by our stockholders.

The Incentive Plan will not become effective if it is not approved by our stockholders, but if that happens, we may pay bonuses or grant equity awards outside of the Incentive Plan, which may not be fully deductible by us for federal income tax purposes.

Summary of the Incentive Plan

The following paragraphs provide a summary of the principal features of the Incentive Plan and its operation. However, this summary is not a complete description of all of the provisions of the Incentive Plan and is qualified in its entirety by the specific language of the Incentive Plan. A copy of the Incentive Plan is provided as Appendix A to this Proxy Statement.

Purposes of the Incentive Plan

The purpose of the Incentive Plan is to motivate and reward eligible service providers of our company for their service by providing incentive compensation in the form of cash bonuses and equity compensation. The cash bonuses and equity awards granted under the Incentive Plan are intended to be fully deductible under Section 162(m), but we cannot guarantee they will qualify for the performance-based exemption under Section 162(m). The Incentive Plan includes a component setting forth the terms for performance-based cash awards (the cash component) and a component setting forth the terms for performance-based equity awards (the equity component).

Cash Component

Eligibility

Actual awards under the cash component may only be issued to our employees or any affiliate of our company. As of October 1, 2017, we had approximately 4,530 employees (including 2 employees who are also members of our board of directors).

Administration

The cash component will be administered by our compensation committee or any other duly authorized committee of our board of the directors consisting of two or more outside directors within the meaning of Section 162(m) (in either case, the administrator). The administrator will select which of our employees (and employees of our affiliates) will be eligible to receive awards under the cash component for an applicable performance period (the cash component participants). The actual number of cash component participants during any year cannot be determined in advance because the administrator has discretion to select the cash component participants.

Performance Periods and Performance Goals

Performance-based cash incentives may be payable to each cash component participant as a result of satisfying performance goals in a performance period. Each performance period has a length of one fiscal year or such other period as determined by the administrator. A cash component participant may be eligible for multiple and overlapping performance periods.

For each performance period, no later than the latest possible date that will not jeopardize the ability of an actual cash award to qualify as performance-based compensation under Section 162(m), the administrator will designate cash component participants for the performance period, select the performance goals applicable to the performance period, establish the methodology for calculating the maximum amount earned by satisfying such performance goals (the payout calculation methodology), and establish a target and maximum cash award for each cash component participant for the performance period.

The performance goals will be based on a specified list, as further discussed below in the section entitled Performance Goals. If a performance goal is based on or calculated with respect to shares of our common stock (Shares) and any specified corporate transaction occurs involving our company, the administrator will make equitable adjustments to the performance goal. To the extent identified in the payout calculation methodology, evaluation of performance may include or exclude certain business, financial and/or legal factors as specified by the administrator, as more fully described in the Incentive Plan.

Actual Cash Awards

Before any actual cash award is paid, the administrator must certify in writing to what extent the performance goal(s) were attained. The actual cash award payable to a cash component participant is determined using a pre-established formula that increases or decreases the cash component participant s target award based on the level of actual performance certified by the administrator. The administrator has discretion to reduce or eliminate (but not to increase) the actual cash award of any cash component participant at any time prior to payment of the actual cash award.

Additionally, the cash component limits actual cash awards to a maximum of $5,000,000 per cash component participant in any fiscal year, even if the formula otherwise indicates a larger award. If there are multiple performance periods ending in the same fiscal year, the aggregate amount paid with respect to all performance periods ending within that fiscal year cannot exceed the maximum specified in the previous sentence, and any excess will be forfeited.

Actual cash awards are paid in cash as soon as administratively practicable. If a cash component participant s employment is terminated due to the cash component participant s death or disability prior to the end of a performance period, the cash component participant (or in the event of death, the cash component participant s beneficiaries) may receive a pro-rata portion of the target award as determined by the administrator. If a cash component participant s employment is otherwise terminated during the performance period, the cash component participant will not have earned and will not be entitled to payment of any actual cash award.

Equity Component

Eligibility

Equity awards under the equity component may be issued to employees of our company or any parent or subsidiary of our company, consultants of our company or a parent or subsidiary of our company and our outside directors. As of October 1, 2017, we had approximately 4,530 employees (including 2 employees who are also members of our board of directors), 106 consultants and nine outside directors.

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Shares Available for Issuance

The equity component provides for the issuance of Shares through equity incentives in the form of stock options, restricted stock, restricted stock units, stock appreciation rights, performance units (which include any restricted stock units that may be earned in whole or in part upon attainment of performance goals or performance objectives in accordance with the same terms as applicable to performance units under the equity component) and performance shares (collectively, equity awards) as the administrator may determine. Shares underlying equity awards will be issued from the 2012 Equity Incentive Plan (2012 Plan).

Annual Limits

The equity component contains annual grant limits intended to satisfy Section 162(m). Specifically, the maximum number of Shares covered by or the maximum initial value of equity awards that can be granted to any particular employee under the equity component (each, an equity component participant) in any fiscal year is set forth below:

Award Type	**Annual Limit on Number of Shares or Initial Value**
Stock Options	Maximum of 500,000 Shares (plus an additional 500,000 Shares in connection with the equity component participant s initial service as an employee)
Restricted Stock	Maximum of 250,000 Shares (plus an additional 250,000 Shares in connection with the equity component participant s initial service as an employee)
Restricted Stock Units	Maximum of 250,000 Shares (plus an additional 250,000 Shares in connection with the equity component participant s initial service as an employee)
Stock Appreciation Rights	Maximum of 500,000 Shares (plus an additional 500,000 Shares in connection with the equity component participant s initial service as an employee)
Performance Shares	Maximum of 250,000 Shares (plus an additional 250,000 Shares in connection with the equity component participant s initial service as an employee)
Performance Units	Maximum of 250,000 Shares (plus an additional 250,000 Shares in connection with the equity component participant s initial service as an employee). In the case of any cash-settled performance units, the annual limit will be the dollar value based on the product of 250,000 Shares (or an additional 250,000 Shares for the equity component participant s initial service as an employee) multiplied by the fair market value of a Share as of the trading day prior to the Annual Meeting)

The Incentive Plan also provides that in any fiscal year, a non-employee board member may not be paid cash compensation and granted equity awards with an aggregate value (determined as fair value in accordance with United States generally accepted accounting principles (GAAP)) exceeding $2,000,000 (increased to $4,000,000 in the fiscal year his or her service as an outside director begins).

In the event of any dividend or other distribution (whether in the form of cash, Shares, other securities, or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase or exchange of Shares or other securities or other change in the corporate structure affecting our common stock, the administrator, in order to prevent diminution or enlargement of the benefits or potential benefits intended to be made available under the equity component, will adjust the number, class and price of Shares subject to outstanding equity awards, and the equity award grant limitations discussed above.

Administration

The administrator will administer the equity component. To make grants to certain officers and key employees, the members of the applicable committee must qualify as non-employee directors under Rule 16b-3 of the Exchange Act.

Subject to the terms of the Incentive Plan, the administrator has the sole discretion to determine fair market value; to select the employees who will receive equity awards; to determine the number of Shares covered by each equity award; to determine the terms and conditions of equity awards; to approve forms of equity award agreements for use under the equity component; to modify or amend each equity award; and to construe and interpret the provisions of the equity component and outstanding equity awards. The administrator may allow an equity component participant to defer the receipt of payment of cash or delivery of Shares that would otherwise be due to such equity component participant under an equity award. The administrator may make rules and regulations relating to sub-plans established for the purpose of satisfying applicable foreign laws and may make all other determinations deemed necessary or advisable for administering the equity component. The administrator will issue all equity awards pursuant to the terms and conditions of the equity component.

Notwithstanding the foregoing, the administrator may not implement a program allowing for the cancellation of equity awards in exchange for different awards, awards of the same type, and/or cash, the transfer of an outstanding equity award to a financial institution or other person or entity selected by the administrator, or the increase or reduction of the exercise price of any outstanding equity award.

Stock Options

Each option granted under the equity component will be evidenced by an equity award agreement specifying the number of Shares subject to the option and the other terms and conditions of the option, consistent with the requirements of the equity component.

The exercise price per Share of each option may not be less than the fair market value of a Share on the date of grant. However, any incentive stock option granted to a person who at the time of grant owns stock possessing more than 10% of the total combined voting power of all classes of our stock or any parent or subsidiary corporation of ours (a ten percent stockholder) must have an exercise price per share equal to at least 110% of the fair market value of a Share on the date of grant. The aggregate fair market value of the Shares (determined on the grant date) covered by incentive stock options which first become exercisable by any equity component participant during any calendar year also may not exceed $100,000. The fair market value of the common stock is generally the closing sales price of our stock as reported on the New York Stock Exchange.

Options will be exercisable at such times or under such conditions as determined by the administrator and set forth in the equity award agreement, which will include performance goals from a specified list, as further discussed below in the section entitled Performance Goals. The term of an option will be specified in the equity award agreement, but the term of an incentive stock option may not be more than ten years (or five years if granted to a ten percent stockholder).

Upon the termination of an equity component participant s active service, the unvested portion of the equity component participant s option generally expires. The vested portion of the option will remain exercisable for the period following the equity component participant s termination of active service that was determined by the administrator and specified in the equity component participant s equity award agreement, and if no such period was determined by the administrator, the vested portion of the option will remain exercisable for: (i) three months following a termination of the equity component participant s active service for reasons other than death or disability or (ii) 12 months following a termination of the equity component participant s active service due to death or disability. In no event will the option be exercisable after the end of the option s term.

The administrator will determine the acceptable form(s) of consideration for exercising an option. An option will be deemed exercised when we receive the notice of exercise and full payment for the Shares to be exercised, together with applicable tax withholdings.

Restricted Stock

Equity awards of restricted stock are rights to acquire or purchase Shares that vest in accordance with the terms and conditions established by the administrator in its sole discretion. Each equity award of restricted stock granted under the equity component will be evidenced by an equity award agreement specifying the number of Shares subject to the equity award of restricted stock and the other terms and conditions of the equity award of restricted stock, consistent with the requirements of the equity component. The administrator will determine the vesting criteria that apply to an award of restricted stock. Such vesting criteria will include performance goals from a specified list, as further discussed below in the section entitled Performance Goals.

Unless the administrator provides otherwise, participants holding Shares of restricted stock will have voting rights and rights to dividends and other distributions with respect to such Shares without regard to vesting. However, such dividends or other distributions will be subject to the same restrictions and forfeitability provisions that apply to the Shares of restricted stock with respect to which they were paid. The administrator has the discretion to reduce or waive any restrictions and to accelerate the time at which any restrictions will lapse or be removed.

An equity component participant will forfeit any Shares of restricted stock that have not vested by the termination of the equity component participant s service.

Restricted Stock Units

A restricted stock unit represents a right to receive cash or a Share if the vesting criteria set by the administrator are achieved or the restricted stock unit otherwise vests. Each award of restricted stock units granted under the equity component will be evidenced by an equity award agreement specifying the number of Shares subject to the equity award and other terms and conditions of the equity award, consistent with the requirements of the equity component.

The administrator may set vesting criteria based upon the achievement of company-wide, divisional, business unit or individual goals (such as continued employment or service), applicable federal or state securities laws, or any other basis determined by the administrator, in its discretion. Such vesting criteria will include performance goals from a specified list, as further discussed below in the section entitled Performance Goals.

After an equity award of restricted stock units has been granted, the administrator has the discretion to reduce or waive any vesting criteria that must be met to receive a payout. An equity component participant will forfeit any unearned restricted stock units upon termination of his or her service. The administrator in its sole discretion may only settle earned restricted stock units in cash, Shares, or a combination of both.

An equity component participant will forfeit any restricted stock units that have not been earned or have not vested as of the termination of his or her service with us.

Stock Appreciation Rights

A stock appreciation right gives an equity component participant the right to receive the appreciation in the fair market value of our common stock between the date the equity award is granted and the date it is exercised. Upon exercise of a stock appreciation right, the holder of the equity award will be entitled to receive an amount determined by multiplying: (i) the difference between the fair market value of a Share on the date of exercise and the exercise price by (ii) the number of exercised stock appreciation rights. We may pay the appreciation in cash, in Shares, or a combination of both. Each stock appreciation right granted under the equity component will be evidenced by an equity award agreement specifying the exercise price and the other terms and conditions of the equity award.

The exercise price per Share of each stock appreciation right may not be less than the fair market value of a Share on the date of grant. Stock appreciation rights will be exercisable at such times or under such conditions as determined by the administrator and set forth in the equity award agreement, which will include performance goals from a specified list, as further discussed below in the section entitled Performance Goals. The term of a stock appreciation right may not be more than ten years. The terms and conditions relating to the period of exercise of stock appreciation rights following the termination of an equity component participant s active service are similar to those for options described above.

Performance Units and Performance Shares

Performance units and performance shares are equity awards that will result in a payment to an equity component participant only if the performance goals, performance objectives, or other vesting provisions established by the administrator are achieved or the equity awards otherwise vest. Performance units will have an initial value established by the administrator on or before the date of grant. Each performance share will have an initial value equal to the fair market value of a Share on the grant date.

Performance units or performance shares granted under the equity component will be evidenced by an equity award agreement specifying the performance period and other terms and conditions of the equity award. The administrator may set vesting criteria based upon the achievement of company-wide, divisional, business unit or individual goals (such as continued employment or service), applicable federal or state securities laws, or any other basis determined by the administrator, in its discretion. Such vesting criteria will include performance goals from a specified list, as further discussed below in the section entitled Performance Goals.

After performance units or performance shares have been granted, the administrator has the discretion to reduce or waive any performance objectives or other vesting provisions for such performance units or performance shares, but the administrator may not increase the amount payable at a given level of performance.

The administrator has the discretion to pay earned performance units or performance shares in the form of cash, Shares (which will have an aggregate fair market value equal to the earned performance units or performance shares at the close of the applicable performance period), or a combination of both.

An equity component participant will forfeit any performance units or performance shares that have not been earned or have not vested as of the termination of his or her service with us.

Equity Award Performance Goals

The granting and/or vesting of restricted stock, restricted stock units, performance shares and performance units under the equity component shall be made subject to satisfying performance goals in a performance period. Each performance period has a length of one fiscal year or such other period as determined by the administrator. An equity component participant may be eligible for multiple and overlapping performance periods. The performance goals will be based on a specified list, as further discussed below in the section entitled Performance Goals.

To the extent necessary to comply with the performance-based compensation provisions of Section 162(m), no later than the latest possible date that will not jeopardize the ability of an equity award to qualify as performance-based compensation under Section 162(m), the administrator will in writing: (i) designate one or more equity component participants to whom an equity award will be made; (ii) select the performance goals applicable to the performance period; (iii) establish the performance goals, and amounts of such equity awards, as applicable, which may be earned for such performance period; and (iv) specify the relationship between performance goals and the amounts of such equity awards, as applicable, to be earned by each equity component participant for such performance period. Following the completion of each performance period, the administrator will certify in writing whether the applicable performance goals have been achieved for such performance period. In determining the amounts earned by an equity component participant, the administrator may reduce or eliminate (but not increase) the amount payable at a given level of performance to take into account additional factors that the administrator may deem relevant to the assessment of individual or corporate performance for the performance period. An equity component participant will be eligible to receive payment pursuant to an equity award for a performance period only if the performance goals for such period are achieved.

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Transferability of Awards

Equity awards generally are not transferable other than by will or by the laws of descent or distribution.

Dissolution or Liquidation

In the event of a proposed dissolution or liquidation of our company, the administrator will notify each equity component participant as soon as practicable prior to the effective date of such proposed transaction. An equity award will terminate immediately prior to consummation of such proposed action to the extent the equity award has not been previously exercised.

Change in Control

The equity component provides that, in the event of a merger of the Company with or into another corporation or other entity or a change in control (as defined in the Incentive Plan), each outstanding equity award will be treated as the administrator determines, including that each equity award be assumed or an equivalent option or right substituted by the successor corporation or a parent or subsidiary of the successor corporation. The administrator will not be required to treat all outstanding equity awards the same in the transaction.

If the successor corporation does not assume or substitute for the equity award, the equity component participant will fully vest in and have the right to exercise all of his or her outstanding options and stock appreciation rights, and with respect to equity awards with performance-based vesting, all performance goals or other vesting criteria will be deemed achieved at 100% of target levels and all other terms and conditions met. In addition, if an option or stock appreciation right is not assumed or substituted for, the administrator will notify the equity component participant in writing or electronically that the option or stock appreciation right will be exercisable for a period of time determined by the administrator, in its sole discretion, and the option or stock appreciation right will terminate upon the expiration of such period.

For equity awards granted to an outside director that are assumed or substituted for, if on the date of or following such assumption or substitution the outside director s status as a director of ours or of the successor corporation is terminated other than upon the outside director s voluntary resignation that is not made at the request of the acquirer, then the outside director will fully vest in and have the right to exercise options and stock appreciation rights, all restrictions on restricted stock and restricted stock units will lapse, and, with respect to performance units and performance shares, all performance goals or other vesting criteria will be deemed achieved at 100% of target levels and all other terms and conditions met.

Performance Goals

The performance goals require the achievement of objectives for one or more of the following measures: cash flow (including operating cash flow or free cash flow), revenue (on an absolute basis or adjusted for currency effects), gross margin, operating expenses or operating expenses as a percentage of revenue, earnings (which may include earnings before interest and taxes, earnings before taxes, net earnings or EBITDA), earnings per share, stock price, return on equity, total stockholder return, growth in stockholder value relative to the moving average of the S&P 500 Index or another index, return on capital, return on assets or net assets, return on investment, operating income or net operating income, operating margin, market share, overhead or other expense reduction, objective customer indicators, improvements in productivity, attainment of objective operating goals, objective employee metrics, return ratios, objective qualitative milestones, or other objective financial or other metrics relating to the progress of our company, any parent, subsidiary, or affiliate of our company, or any of their divisions or departments.

These measures may be applied to either our company or, except regarding stockholder return metrics, to a region, business unit, affiliate or business segment, and measured either on an absolute basis, a per share basis or relative to a pre-established target, to a previous period s results or to a designated comparison group, and, with respect to financial metrics, which may be determined under GAAP, under accounting principles established by the International Accounting Standards Board (IASB Principles) or which may be adjusted when established to exclude any items otherwise includable under GAAP or under IASB Principles. Each performance goal may be expressed on an absolute and/or relative basis, may be based on, or otherwise employ, comparisons based on internal targets, the past performance of our company and/or the past or current performance of other companies.

Unless the administrator provides otherwise as described in the previous paragraph, performance goals will be calculated in accordance with our company s financial statements, generally accepted accounting principles, or under a methodology established by the administrator prior to or at the time of the issuance of an equity award and which is consistently applied with respect to a performance goal in the relevant performance period.

Forfeiture Events

Each actual cash award and equity award granted under the Incentive Plan will be subject to recoupment under any clawback policy that, in the future, we are required by applicable stock exchange rules or applicable laws to adopt (including any such clawback policy that is adopted after the grant of such award), and the administrator also may impose such other clawback, recovery, or recoupment provisions in an agreement governing such award as the administrator determines necessary or appropriate. In the event of any accounting restatement, the recipient of such award will be required to repay a portion of the proceeds received in connection with the settlement of such award earned or accrued under certain circumstances.

Amendment or Termination

If approved by our stockholders, the Incentive Plan will automatically terminate five years from the date of the Annual Meeting, unless terminated at an earlier time by our board of directors or the administrator. Our board of directors or the administrator may amend, alter, suspend, or terminate the Incentive Plan at any time. However, the amendment, alteration, suspension, or termination of the Incentive Plan will not, unless mutually agreed otherwise in a signed writing between the Incentive Plan participant and the administrator, materially impair the rights of any Incentive Plan participant, except that the administrator may amend, alter, suspend or terminate the Incentive Plan if such action is done: in a manner permitted under the Incentive Plan, to avoid additional tax or income recognition under Section 409A of the Code, to comply with applicable laws, or as necessary to ensure compliance with the requirements of Section 162(m). The administrator, in its sole determination, determines whether an amendment, alteration, suspension, or termination materially impairs the rights of any participant. We will obtain stockholder approval of any amendment to the Incentive Plan to the extent such approval is necessary or desirable to comply with applicable laws.

Summary of U.S. Federal Income Tax Consequences

The following summary is intended only as a general guide to the U.S. federal income tax consequences of participation in the Incentive Plan. The summary is based on existing U.S. laws and regulations as of the record date of the Annual Meeting, and there can be no assurance that those laws and regulations will not change in the future. The summary does not purport to be complete and does not discuss the tax consequences upon an equity component participant s death, or the provisions of the income tax laws of any municipality, state or foreign country in which the equity component participant may reside. As a result, tax consequences for any particular equity component participant may vary based on individual circumstances.

Actual Cash Awards

Cash component participants will recognize ordinary income equal to the amount of the actual cash award received in the year of receipt. That income will be subject to applicable income and employment tax withholding by our company.

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Incentive Stock Options

An equity component participant recognizes no taxable income for regular income tax purposes as a result of the grant or exercise of an option that qualifies as incentive stock option under Section 422 of the Code. If an equity component participant exercises the option and then later sells or otherwise disposes of the Shares acquired through the exercise the option after both the two-year anniversary of the date the option was granted and the one-year anniversary of the exercise, the equity component participant will recognize a capital gain or loss equal to the difference between the sale price of the Shares and the exercise price, and we will not be entitled to any deduction for federal income tax purposes.

However, if the equity component participant disposes of such Shares either on or before the two-year anniversary of the date of grant or on or before the one-year anniversary of the date of exercise (a disqualifying disposition), any gain up to the excess of the fair market value of the Shares on the date of exercise over the exercise price generally will be taxed as ordinary income, unless the Shares are disposed of in a transaction in which the equity component participant would not recognize a loss (such as a gift). Any gain in excess of that amount will be a capital gain. If a loss is recognized, there will be no ordinary income, and such loss will be a capital loss. Any ordinary income recognized by the equity component participant upon the disqualifying disposition of the Shares generally should be deductible by us for federal income tax purposes, except to the extent such deduction is limited by applicable provisions of the Code.

For purposes of the alternative minimum tax, the difference between the option exercise price and the fair market value of the Shares on the exercise date is treated as an adjustment item in computing the equity component participant s alternative minimum taxable income in the year of exercise. In addition, special alternative minimum tax rules may apply to certain subsequent disqualifying dispositions of the Shares or provide certain basis adjustments or tax credits for purposes.

Nonstatutory Stock Options

An equity component participant generally recognizes no taxable income as the result of the grant of such an option. However, upon exercising the option, the equity component participant normally recognizes ordinary income equal to the amount that the fair market value of the Shares on such date exceeds the exercise price. If the equity component participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Upon the sale of the Shares acquired by the exercise of a nonstatutory stock option, any gain or loss (based on the difference between the sale price and the fair market value on the exercise date) will be taxed as capital gain or loss. No tax deduction is available to us with respect to the grant of a nonstatutory stock option or the sale of the Shares acquired through the exercise of the nonstatutory stock option.

Stock Appreciation Rights

In general, no taxable income is reportable when a stock appreciation right is granted to an equity component participant. Upon exercise, the equity component participant generally will recognize ordinary income in an amount equal to the fair market value of any Shares received. Any additional gain or loss recognized upon any later disposition of the Shares would be capital gain or loss.

Performance Shares and Performance Units

An equity component participant generally will recognize no income upon the grant of a performance share or a performance unit award. Upon the settlement of such awards, equity component participants normally will recognize ordinary income in the year of receipt in an amount equal to the cash received and the fair market value of any cash or unrestricted Shares received. If the equity component participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Upon the sale of any Shares received, any gain or loss, based on the difference between the sale price and the fair market value on the date the ordinary income tax event occurs, will be taxed as capital gain or loss.

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Section 409A

Section 409A of the Code requires that amounts that qualify as nonqualified deferred compensation satisfy requirements with respect to the timing of deferral elections, timing of payments, and certain other matters.

Section 409A provides certain requirements for non-qualified deferred compensation arrangements with respect to an individual s deferral and distribution elections and permissible distribution events. Any award granted under the Incentive Plan with a deferral feature will be subject to the requirements of Section 409A. If that award fails to satisfy such requirements, the recipient of the award may recognize ordinary income on the amounts deferred under the award to the extent the award is vested (which may be prior to when the compensation is actually or constructively received), and the recipient of the award may be subject to an additional 20% federal income tax, penalties, and interest charges on that ordinary income.

Tax Effect for Our Company

We generally will be entitled to a tax deduction in connection with actual cash awards and equity awards granted under the Incentive Plan in an amount equal to the ordinary income realized by an Incentive Plan participant when the Incentive Plan participant recognizes such income, except to the extent such deduction is limited by applicable provisions of the Code. Under Section 162(m), the annual compensation paid to any of our covered employees (which includes our chief executive officer) generally will be deductible only to the extent that it does not exceed $1,000,000. However, we can preserve the deductibility of performance-based compensation in excess of $1,000,000 if certain conditions are met, such as obtaining stockholder approval of the Incentive Plan and its material terms, setting limits on the number of actual cash awards and equity awards that any individual may receive and, except for certain stock options and stock appreciation rights, establishing performance criteria that must be met before such awards actually will vest or be paid. The Incentive Plan has been designed to permit (but not require) the administrator to grant actual cash awards and equity awards that are intended to qualify as performance-based compensation for purposes of satisfying the conditions of Section 162(m).

THE FOREGOING IS ONLY A SUMMARY OF THE EFFECT OF U.S. FEDERAL INCOME TAXATION UPON INCENTIVE PLAN PARTICIPANTS AND OUR COMPANY WITH RESPECT TO AWARDS UNDER THE INCENTIVE PLAN. IT DOES NOT PURPORT TO BE COMPLETE AND DOES NOT DISCUSS THE IMPACT OF EMPLOYMENT OR OTHER TAX REQUIREMENTS, THE TAX CONSEQUENCES OF AN INCENTIVE PLAN PARTICIPANT S DEATH, OR THE PROVISIONS OF THE INCOME TAX LAWS OF ANY MUNICIPALITY, STATE, OR FOREIGN COUNTRY.

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New Plan Benefits

The amount of the actual cash award that an employee may receive under the Incentive Plan is determined based on actual future performance, and the number of equity awards that a service provider may receive under the Incentive Plan determined by our compensation committee each year. Therefore, the amount of such actual cash awards and the number of such equity awards cannot be determined in advance. The following table sets forth: (1) the actual cash incentive paid under the applicable cash incentive compensation plan for fiscal 2017, for each of the persons and groups shown below, and (2) the aggregate number of shares of our common stock covered by restricted stock awards (including performance-based restricted stock awards, or PSAs) under the 2012 Plan during fiscal 2017, to the persons and groups shown below.

Name of Individual or Group	FY17 Cash Incentive Compensation (1)	Number of Shares Covered by Equity Awards (#) (2)	Dollar Value of Equity Awards ($) (3)
Mark D. McLaughlin, *Chief Executive Officer*	$ 0	64,804	$ 9,625,986
Steffan C. Tomlinson, *Executive Vice President, Chief Financial Officer*	$ 0	25,920	$ 3,850,157
Nir Zuk, *Executive Vice President, Chief Technology Officer*	$ 0	25,920	$ 3,850,157
René Bonvanie, *Executive Vice President, Chief Marketing Officer*	$ 0	19,440	$ 2,887,618
Mark F. Anderson, *President*	$ 0	38,882	$ 5,775,532
All current executive officers as a group (4)	$ 0	213,848	$ 31,764,982
All non-employee directors as a group (5)		20,438	$ 2,786,012
All other employees who are not executive officers, as a group	$ 363,469,533	3,889,973	$ 550,444,853

(1) As noted in the Fiscal 2017 Summary Compensation Table, our Named Executive Officers were not paid any incentive compensation with respect to fiscal 2017. The following represents each Named Executive Officer s target incentive opportunity during fiscal 2017: (i) Mark D. McLaughlin, $783,750; (ii) Steffan C. Tomlinson, $273,750; (iii) Nir Zuk, $205,625; (iv) René Bonvanie, $180,625; and (v) Mark F. Anderson, $438,000.

(2) This column represents the Shares covered by restricted stock awards (with respect to PSAs, based on the number of Shares earned at target levels of performance) granted under the 2012 Equity Incentive Plan.

(3) Reflects the aggregate grant date fair value of equity awards (with respect to PSAs, based on the number of Shares earned at target levels of performance) computed in accordance with FASB ASC Topic 718.

(4) In addition to individuals listed above, our list of current executive officers includes Lee Klarich, who became an executive officer during fiscal 2018.

(5) The individuals in this group are not eligible to participate in the cash component of the Incentive Plan.

Recommendation of Our Board of Directors

Our board of directors unanimously recommends that you vote FOR the approval of the Incentive Plan. Approval of this proposal requires the affirmative vote of a majority of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. You may vote for, against, or abstain with respect to this proposal. Abstentions are considered votes present and entitled to vote on this proposal, and thus will have the same effect as a vote against this proposal. Broker non-votes will have no effect on the outcome of this proposal.

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PROPOSAL NO. 5

STOCKHOLDER PROPOSAL RELATING TO DIVERSITY REPORT

Trillium Asset Management, LLC, located at Two Financial Center, 60 South Street, Suite 1100, Boston, MA 02111, has advised us that they plan to introduce the following resolution on behalf of William A. Gee IV. Mr. Gee is the beneficial holder of at least $2,000 in market value of the Company s common stock.

WHEREAS:

McKinsey & Company found companies with highly diverse executive teams had higher returns on equity and earnings performance than those with low diversity.

Palo Alto Network states that its commitment to women in technology is evident through our partnerships with the Anita Borg Institute and other organizations promoting diversity.

However, the Company does not disclose workforce data or share results of diversity and inclusion initiatives.

Lack of diversity among high tech workers is a central public concern according to the U.S. Equal Employment Opportunity Commission. In 2014, the Commission reported that the high-tech sector employed a larger share of whites, Asian Americans, and men, and a smaller share of African-Americans, Hispanics and women than the overall private industry.

Industry peers including Cisco and HP provide EEO-1 data. Intel discloses EEO-1 data and diversity goals. In 2015, the company set a public, time-bound goal for hiring women and underrepresented minorities and tied a portion of employee variable compensation to achieving its goal. In August 2015 Intel reported that it exceeded its target of 40 percent hires of women, blacks, Hispanics and Native Americans in the first six months of the year.

More than two dozen startups and venture capital firms, motivated by the efforts of Kapor Capital, have begun sharing strategies and setting diversity metrics.

Further, research from Mercer confirms that improving gender diversity will require attention to closing the gender pay gap. And, owing to concern about gender and racial wage disparities, the EEOC announced in January 2016 a proposed rule to stem wage discrimination by collecting pay data by gender, race and ethnicity.

Expanding workforce diversity and closing the wage gap requires policies that attract and retain diversity in the workplace. A company s family leave policies, for example, can play a role. McKinsey reports that paid parental leave and the availability of on-site child care can impact women s ability to move into higher productivity roles. The best performing companies on gender diversity have implemented gender neutral policies that improve the workplace for both men and women, according to McKinsey.

Diversity benchmarks can help ensure companies create workforces necessary to compete effectively. In our view, companies that are publicly accountable to diversity goals are most likely to make rapid progress toward achieving those goals.

RESOLVED: Shareholders request that Palo Alto Networks prepare a diversity report, at reasonable cost and omitting confidential information, available to investors including:

1. A chart identifying employees according to gender and race in major EEOC-defined job categories, listing numbers or percentages in each category;

2. A description of policies/programs focused on increasing diversity in the workplace.

Shareholder Supporting Statement: A report adequate for investors to assess strategy and performance would include a review of appropriate time-bound benchmarks for judging current and future progress, and details of practices designed to reduce unconscious bias in hiring and to build mentorship among staff of color.

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COMPANY S OPPOSITION STATEMENT

The board of directors unanimously recommends that you vote AGAINST this proposal.

We are committed to diversity in our workforce and recognize diversity as a business imperative. The board of directors continuously oversees our diversity efforts and monitors our progress toward increasing diversity.

The board of directors does not believe that preparing a report identifying employees according to standardized EEOC-defined job categories or describing our diversity efforts would enhance our efforts to encourage diversity and create a diverse workforce.

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EXECUTIVE OFFICERS

The following table identifies certain information about our executive officers as of October 23, 2017. Officers are elected by our board of directors to hold office until their successors are elected and qualified.

Name	Age	Position(s)
Mark D. McLaughlin	51	Chief Executive Officer and Chairman
Steffan C. Tomlinson	45	Chief Financial Officer
Nir Zuk	46	Chief Technology Officer and Director
René Bonvanie	56	Chief Marketing Officer
Mark F. Anderson	55	President
Lee Klarich	42	Chief Product Officer

Mark D. McLaughlin has served as our Chief Executive Officer and as a member of our board of directors since August 2011, and as the Chairman of our board of directors since April 2012. From July 2011 through August 2016, Mr. McLaughlin also served as our President. From August 2009 through July 2011, Mr. McLaughlin served as President and Chief Executive Officer and as a director at VeriSign, Inc., a provider of Internet infrastructure services, and from January 2009 to August 2009, Mr. McLaughlin served as President and Chief Operating Officer at VeriSign. From February 2000 through November 2007, Mr. McLaughlin served in several roles at VeriSign, including as Executive Vice President, Products and Marketing. Prior to joining VeriSign, Mr. McLaughlin was Vice President, Sales and Business Development at Signio Inc., an Internet payments company acquired by VeriSign in February 2000. In January 2011, President Barack Obama appointed Mr. McLaughlin to serve on the President s National Security Telecommunications Advisory Committee. Mr. McLaughlin currently serves on the board of directors of Qualcomm, Inc., a global semiconductor company that designs and markets wireless telecommunications products and services, and previously served on the board of directors of Opower, Inc., a provider of cloud based software to the utility industry. Mr. McLaughlin holds a B.S. from the U.S. Military Academy at West Point and a J.D. from Seattle University School of Law.

Steffan C. Tomlinson has served as our Chief Financial Officer since February 2012. From September 2011 to January 2012, Mr. Tomlinson was Chief Financial Officer at Arista Networks, Inc., a provider of cloud networking solutions. From April 2011 to September 2011, Mr. Tomlinson was a Partner and Chief Administrative Officer at Silver Lake Kraftwerk, a private investment firm. From September 2005 to March 2011, Mr. Tomlinson was Chief Financial Officer of Aruba Networks, Inc., a provider of intelligent wireless LAN switching systems. From 2000 until its acquisition by Juniper Networks, Inc., a supplier of network infrastructure products and services, in 2005, Mr. Tomlinson served in several roles, including Chief Financial Officer, at Peribit Networks, Inc., a provider of WAN optimization technology. Mr. Tomlinson holds an M.B.A. from Santa Clara University and a B.A. in Sociology from Trinity College.

Nir Zuk is one of our founders and has served as our Chief Technology Officer and as a member of our board of directors since March 2005. From April 2004 to March 2005, Mr. Zuk was Chief Security Technologist at Juniper Networks, Inc., a supplier of network infrastructure products and services. From September 2002 until its acquisition by Juniper in April 2004, Mr. Zuk was Chief Technology Officer at NetScreen Technologies, Inc., a provider of ASIC-based Internet security systems. In December 1999, Mr. Zuk co-founded OneSecure, Inc., a provider of prevention and detection appliances, and was Chief Technical Officer until its acquisition by NetScreen in September 2002. From 1994 to 1999, Mr. Zuk served in several technical roles, including Principal Engineer at Check Point Software Technologies Ltd., an enterprise software security company. Mr. Zuk attended Tel Aviv University where he studied Mathematics.

René Bonvanie has served as our Chief Marketing Officer since November 2011 and was our Vice President, Worldwide Marketing from September 2009 to November 2011. From June 2007 to August 2009, Mr. Bonvanie was Senior Vice President of Marketing, SaaS and Information Technology at Serena Software, Inc., a developer of information technology software. From January 2007 to June 2007, Mr. Bonvanie was Senior

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Vice President and General Manager at salesforce.com, inc., a global enterprise software company. From March 2006 to January 2007, Mr. Bonvanie was Senior Vice President of Global Marketing at SAP AG, a software company. Mr. Bonvanie holds a B.A. in Economics from Vrije Universiteit Amsterdam.

Mark F. Anderson has served as our President since August 2016. Most recently Mr. Anderson served as our Executive Vice President, Worldwide Field Operations, a position he held from May 2016 through August 2016. From June 2012 when he joined the Company until May 2016, Mr. Anderson served as our Senior Vice President, Worldwide Field Operations. From October 2004 to May 2012, Mr. Anderson served in several roles, including as Executive Vice President of Worldwide Sales, for F5 Networks, an IT infrastructure company. From March 2003 to September 2004, Mr. Anderson served as Executive Vice President of North American Sales at Lucent Technologies, a telecommunications equipment and services company. Mr. Anderson holds a B.A. in Business and Economics from York University in Toronto, Canada.

Lee Klarich has served as our Chief Product Officer since August 2017. Prior to this appointment, Mr. Klarich served as our Executive Vice President of Product Management, a role he held since November 2015. From November 2012 to November 2015, Mr. Klarich served as our Senior Vice President, Product Management and our Vice President, Product Management from May 2006 to November 2012. Prior to joining us, Mr. Klarich held various positions at NetScreen Technologies, Excite@Home, and Packard Bell-NEC. Mr. Klarich holds a B.S. in Engineering from Cornell University.

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EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Our Named Executive Officers, or NEOs, for fiscal 2017 were:

- Mark D. McLaughlin, our Chief Executive Officer, or CEO;
- Steffan C. Tomlinson, our Executive Vice President, Chief Financial Officer;
- Nir Zuk, our Executive Vice President, Chief Technology Officer;
- René Bonvanie, our Executive Vice President, Chief Marketing Officer; and
- Mark F. Anderson, our President.

Executive Summary

Our goal is to align our executive pay with the success of our business. We do this by providing short-term cash incentive compensation opportunities tied to successful achievement of our annual operating goals and by granting long-term equity awards that are intended to deliver increasing value as our stock price increases, including, for the first time in fiscal 2017, performance-based stock awards tied to our financial performance.

Since our initial public offering, or IPO, in 2012, our business has grown rapidly, and this growth requires intense focus and dedication of our executives. Accordingly, we continue to design and update our executive compensation programs to match the maturity, size, scale and growth of our business. We operate in a highly competitive and rapidly evolving market, and our ability to compete and succeed in this dynamic environment is directly correlated to our ability to recruit, incentivize and retain talented and seasoned technology leaders. The market for skilled management and personnel in the security industry is fiercely competitive, therefore our executive compensation program is critical for the growth of our business.

This executive summary provides an overview of:

(1) our fiscal 2017 business performance,

(2) a summary of our executive compensation practices,

(3) our stockholder engagement efforts, and

(4) an overview of our fiscal 2017 executive compensation program.

Fiscal 2017 Business Highlights

Our executive compensation program is designed to align the compensation of our executive officers with our operating and financial performance (both short-term and long-term) and create sustainable value for our stockholders. Our executive compensation actions and decisions should be viewed in the context of our financial and operational performance during fiscal 2017, as shown below:

Dollars in millions	**Fiscal 2016**	**Fiscal 2017**	**Change**
Total Revenue	$ 1,378.5	$ 1761.6	27.8%
Net Cash provided by Operating Activities	$ 658.1	$ 868.5	31.9%
Total Deferred Revenue	$ 1,240.8	$ 1,773.5	42.9%
Billings	$ 1,905.6	$ 2,293.4	20.4%
Approximate Number of Customers	34,000	42,500	25.0%

Although net cash provided by operating activities, deferred revenue, billings and number of customers are not measures that were used to determine awards under our incentive compensation plan, we believe that these results are important because our financial and operating performance measures are useful indicators for our compensation committee of our ability to grow our business consistent with our annual operating plan as it considers the compensation of our executives. Billings is a key financial measure and the calculation of billings to revenue is set forth in Management s Discussion and Analysis of Financial Condition and Results of Operations section on page 40 and 41 of our Annual Report on Form 10-K filed with the SEC on September 7, 2017. Note that the billings described in the table above is not the applicable billings metrics used for purposes of our performance-based stock awards. For purposes of our performance-based stock awards, we make certain adjustments to billings to exclude inorganic items such as post-acquisition billings from M&A.

Strong Revenue Growth (in millions)

Executive Compensation Practices

Our executive compensation program is designed to be heavily weighted towards compensating our executive officers based on our financial and operational performance. To that end, we have implemented executive compensation policies and practices that reinforce our pay for performance philosophy and align with sound governance principles. During fiscal 2017, the following policies and practices were in place:

What we do:

Performance-based short-term cash incentive compensation that is entirely at-risk

100% independent directors on our compensation committee

Independent compensation consultant directly engaged by and reporting to our compensation committee

Annual review and approval of our compensation strategy

Performance-based equity incentive awards that are entirely at-risk (new in fiscal 2017)

Meaningful stock ownership guidelines for our executive officers and directors (new in fiscal 2017)

Four-year vesting schedules for service-based equity awards granted in fiscal 2017 (new in fiscal 2017)

Seek the recovery of performance-based incentive compensation paid by us under a Clawback Policy (new in fiscal 2018)

What we don t do:

No single trigger change in control payments or benefits

No post-employment retirement- or pension-type benefits for our executive officers that are not available to our employees generally

No tax gross-ups for change in control payments or benefits

No hedging or pledging of shares of our common stock

Stockholder Engagement and our 2016 Say-on-Pay Vote

Our compensation committee considers a number of factors in making executive compensation decisions, including the growth and scale of the company, recent performance against financial targets, a measured analysis of our compensation peer group practices and advice and analysis of competitive market conditions by its external compensation consultant. Our compensation committee also considers the results of each annual stockholder advisory vote on the compensation of our NEOs (the Say-on-Pay vote) and stockholder feedback on our executive compensation program. As part of our regular, ongoing and transparent communications with our stockholders we engage with our stockholders on a variety of topics through quarterly earnings calls, financial conferences, non-deal road shows and other communication channels. These discussions are generally attended by a combination of our CEO, Chief Financial Officer, Lead Independent Director (who serves on our compensation committee), General Counsel and/ or Vice President of Investor Relations.

At the beginning of fiscal 2017, prior to our 2016 Annual Meeting of Stockholders, our management team reached out to our top institutional and other stockholders representing an aggregate of approximately 42% of our outstanding shares to discuss their views about our executive compensation policies and practices as well as other matters. The stockholder engagement during fiscal 2017 was more targeted and more extensive than in prior years. The feedback received was presented to our nominating and corporate governance committee, compensation committee and board of directors.

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As has been the compensation committee s normal cadence for compensation decisions, in the first quarter of fiscal 2017, the compensation committee reviewed and approved the key elements of our fiscal 2017 executive compensation program. These decisions were made prior to receiving our 2016 Say-on-Pay voting results, where we received less than majority support for our 2016 Say-on-Pay proposal. In fiscal 2017, we made significant changes to our executive compensation program as set forth in the table below and in the section entitled Fiscal 2017 Executive Compensation Program Changes and Decisions below, in part based on the feedback received from our stockholders during our 2015 engagement efforts. It is the current intent of the compensation committee to continue to engage in a dialogue with the Company s stockholders to solicit feedback regarding our executive compensation practices and programs.

Compensation Component	Our Practice Prior to Fiscal 2017	Investor Feedback	Fiscal 2017 Changes
Type of Equity Awards	As a public company, all equity awards granted to our named executive officers were time-based RSUs or RSAs.	Equity awards should include a meaningful amount of performance-based awards in addition to time-based awards.	We introduced PSAs in fiscal 2017. The fiscal 2017 long-term incentive compensation for our executive officers consists of 50% performance stock awards, or PSAs, and 50% restricted stock awards, or RSAs. The PSAs will be earned based upon achievement of billings performance. See below for additional information.
CEO Long-Term Incentive Compensation	Since joining our Company, our CEO, Mark McLaughlin, received: Pre-IPO new hire grant of stock options in fiscal 2012; and Time-based equity awards in fiscal 2014, 2015 and 2016	Our CEO s fiscal 2015 RSU award was large in comparison to those granted to CEOs at our peer companies.	In fiscal 2017, our CEO was granted equity awards within market practices in comparison to those granted to CEOs at our peer companies of which 50% were PSAs and 50% were RSAs.

Vesting Schedule	Post-IPO time-vested equity awards granted to our executive officers vested over a period of approximately three years.	All equity awards should have a four-year vesting schedule.	In fiscal 2017, we adopted a four-year vesting schedule for the fiscal 2017 equity awards granted to our executive officers. Additionally, the fiscal 2017 equity grants vesting schedules are heavily weighted towards the back end

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Compensation Component	Our Practice Prior to Fiscal 2017	Investor Feedback	Fiscal 2017 Changes
			of the service period to promote long-term incentives through the entire service period.
Stock Ownership Guidelines	We had not adopted stock ownership guidelines, in part due to the significant existing equity holdings of our executive officers.	Executive officers and non-employee members of the Board of Directors should be subject to stock ownership guidelines.	In fiscal 2017, we adopted stock ownership guidelines for our CEO, direct reports to our CEO and the non-employee members of the Board of Directors. See the section titled Other Compensation Policies Stock Ownership and Compensation Recovery Policies.

Fiscal 2017 Executive Compensation Program Changes and Decisions

Our executive compensation program continues to evolve as the company matures, gaining market share and growing, at scale, faster than the competition and the rate of the market. The changes to our executive compensation program for fiscal 2017, as further discussed below, were designed to enhance the link between executive pay and company financial performance, increase market alignment and mitigate risk, as well as respond to stockholder feedback on our compensation practices. The feedback from stockholders, along with the evolution of our fiscal planning process as we mature as a public company, and our compensation committee s ongoing discussion about the appropriate time in our growth and evolution to implement performance-based equity awards, were factors towards implementing, for the first time in fiscal 2017, performance-based stock awards, or PSAs, tied to billings performance. Previously, we had only granted restricted stock awards, or RSAs, or restricted stock units, RSUs, subject to time-based vesting to our executive officers. In 2017, we believe that we have updated our executive compensation practices and governance in a manner appropriate for a company of our size, in our industry and our stage of growth. Further, our fiscal 2017 executive compensation program was measured against a new set of peer companies that we annually select as we grow. We intend to continue reviewing our executive compensation and governance practices as the company matures.

Below is a summary of the primary features of the fiscal 2017 PSAs, along with the rationale for our approach. See the section titled Equity Compensation for more information.

PSA Feature	Our Approach	Our Rationale
Performance Measure	100% billings performance	Billings is a growth indicator and the best measure of current performance given the company s

hybrid-SaaS revenue model.

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PSA Feature	Our Approach	Our Rationale
Performance Target	Billings target set based on growth expectations at the beginning of fiscal 2017 for fiscal 2017	Align the interests of our executives with those of our stockholders through a performance target that correlates with the trajectory of our growth expectations.
		Minimum and maximum targets appropriately reward our executives for under or over-achievement of the target.
Performance Period	One-year performance period, fiscal 2017	Growth trajectory makes longer term performance projections difficult.
		Our historical financial outperformance of key operating measures.
		Risk of setting inappropriate target levels that may not align with our stockholders interests if we were to project more than one year in advance.
		Long-term focus maintained by attaching an additional 3-year vesting schedule beyond the one-year performance period (see Vesting Schedule below). This balances the difficulty in predicting long-term performance while providing a long-term horizon for earning the compensation.
Vesting Schedule	Four-year vesting schedule	Additional time-based vesting schedule beyond satisfying the performance metric provides

For CEO: Vesting heavily weighted towards last two years of the service period, so long as he continues to be a service provider through each vesting date.	additional long-term incentives A total of four-years of service is required for full vesting.
For executive officers other than CEO: Vesting heavily weighted towards the latter three years of the service period, so long as the executive officer continues to be a service provider through each vesting date.	

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As the company and the compensation program evolve and as we evaluate, including through stockholder discussions, the usefulness of performance-based stock awards in attaining our compensation objectives, our compensation committee intends to review and reconsider the mix of components in our long-term equity compensation, the appropriateness of PSA grants in future years, the metrics applicable to performance-based stock awards and the length of performance period for performance-based stock awards.

In addition to the inaugural PSA grants, in October 2016, our compensation committee approved the structure of our fiscal 2017 executive compensation, which is summarized in the chart below. In making these decisions, our compensation committee considered, among other factors, pay levels of our executive officers relative to the executives in comparable positions at the companies in our updated compensation peer group and the overall market, performance of each executive officer, the continued competition for experienced leadership in our industry and the feedback from our stockholders as discussed above.

Compensation Component	**Decision**	**Weighting of Performance Measures**
Base Salary	CEO: Base salary increased by 25%; CEO base salary was set at or around the 50th percentile of our fiscal 2017 compensation peer group.	N/A
	Other NEOs: Base salary increased by approximately 4-19%; other NEO base salary was set at or around the 50th-75th percentile of our fiscal 2017 compensation peer group.	
Target Cash Incentive as a percentage as Base Salary	All NEOs: No change to the target annual incentive compensation opportunity as a percentage of base salary.	50% revenue and 50% earnings per share, subject to certain objective adjustments determined by our compensation committee
Long-Term Equity Incentives	All NEOs: Granted equity awards consisting of mix of 50% PSAs and 50% RSAs	100% billings performance (for PSAs)
	Fiscal 2017 equity awards were targeted at or around the 60th and 75th percentile of our fiscal 2017 compensation peer group	

Fiscal 2017 Executive Compensation Highlights

The key executive compensation decisions in fiscal 2017 were as follows:

Competitive Market Analysis. Our compensation committee approved a revised compensation peer group for fiscal 2017. This compensation peer group was used to prepare a competitive market analysis that was used by our compensation committee to ensure that our executive compensation decisions for the year were positioned to be competitive with comparable peers in the market.

In fiscal 2017, our total revenue increased by $383.1 million and our non-GAAP earnings per share increased by $0.82 per share compared to fiscal 2016. While our performance in each of these metrics increased from fiscal 2016, these results did not meet the significant stretch targets we set at the beginning of fiscal 2017. Because we did not achieve our desired revenue and earnings per share goals in fiscal 2017, we did not pay our NEOs under our Fiscal 2017 Incentive Compensation Plan. This is consistent with our pay for performance philosophy and demonstrates that our compensation is truly at risk.

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In fiscal 2017, our billings increased by $387.2 million compared to fiscal 2016. This performance funded our performance-based stock awards at the 55% level.

Subsequent Events Relevant Fiscal 2018 Executive Compensation Highlights

We continued sound corporate governance practice after fiscal 2017 year end as follows:

We continued to grant equity awards to our named executive officers in the same vesting proportions as provided in fiscal 2017 (i.e., 50% solely time-based vesting and 50% performance-based vesting, with additional time-based requirements after the performance period).

We adopted a Clawback Policy pursuant to which we may seek the recovery of performance-based incentive compensation paid by us.

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DISCUSSION OF OUR FISCAL 2017 EXECUTIVE COMPENSATION PROGRAM

This section provides an overview of our executive compensation philosophy, the overall objectives of our executive compensation program and each component of our executive compensation program. In addition, we explain how and why our compensation committee arrived at the specific compensation policies and decisions involving our executive officers for fiscal 2017.

Executive Compensation Philosophy and Objectives

We operate in a highly competitive business environment, which is characterized by frequent technological advances, rapidly changing market requirements and the emergence of new market entrants. To successfully grow our business in this dynamic environment, we must continually develop and refine our products and services to stay ahead of our end-customers needs and challenges. To achieve these objectives, we need a highly talented and seasoned team of technical, sales, marketing, operations, and other business professionals.

We compete with other companies in our industry and other technology companies in the San Francisco Bay Area to attract and retain a skilled management team. To attract and retain qualified executive candidates, our compensation committee recognizes that it needs to develop competitive compensation packages to meet this challenge, we have embraced a compensation philosophy of offering our NEOs a competitive total compensation program, each of the components of which recognizes and rewards individual performance and contributions to our success, allowing us to attract, retain, and motivate talented executive officers with the skills and abilities needed to drive our desired business results. The specific objectives of our executive compensation program are to:

- reward the successful achievement of our strategic and financial growth objectives;
- drive the development of a successful and profitable business;
- attract, motivate, reward, and retain highly qualified executive officers who are important to our success and possess the skills and leadership necessary to continue to grow our business;
- recognize strong performers by offering cash performance-based incentive compensation and equity awards that have the potential to reward individual achievement as well as contributions to our overall success; and
- create value for our stockholders and align the interests of our executive officers with those of our stockholders.

Compensation Program Design

Our executive compensation program for fiscal 2017, reflected our stage of development as a growing publicly-traded company which is gaining market share and growing, at scale, faster than the competition and the rate of the market. Accordingly, we design our executive compensation program to provide market-competitive compensation in the form of base salary, a cash incentive compensation opportunity, equity awards, including both time-based RSAs and our inaugural grant of performance-based PSAs, and certain employee health and welfare benefits.

We offer cash compensation in the form of base salaries and annual cash incentive compensation opportunities (with semi-annual payouts). Typically, we have structured our cash incentive compensation opportunities to focus on the achievement of specific short-term financial and operational objectives that will further our longer-term growth objectives.

Additionally, equity awards for shares of our common stock serve as a key component of our executive compensation program. Currently, we grant full value awards, or awards without a purchase price including

RSUs, RSAs, and PSAs, to provide appropriate levels of compensation, to ensure that the recipient receives value for the shares regardless of fluctuations in the market price of our common stock, and to promote stockholder value creation (the value of a recipient s shares increases only as stockholder value increases). In the future, we may introduce other forms of equity awards, as we deem appropriate, that further our objective of providing long-term incentives to our NEOs while promoting stockholder value creation.

Finally, we offer our executive officers standard health and welfare benefits that are generally available to our other employees, including medical, dental, vision, life insurance and Section 401(k) savings plans.

We have not adopted any formal policies or guidelines for allocating compensation between current and long-term compensation or between cash and non-cash compensation, although we use competitive market data to develop a general framework for establishing the appropriate pay mix. Within this overall framework, our compensation committee reviews each component of executive compensation separately and also takes into consideration the value of each NEO s compensation package as a whole and its relative value in comparison to our other NEOs.

Our compensation committee evaluates our compensation philosophy and executive compensation program as circumstances require, and reviews executive compensation annually. As part of this review, we expect that our compensation committee will apply our philosophy and the objectives outlined above, together with consideration for the levels of compensation that we would be willing to pay to ensure that our executive compensation remains competitive and that we meet our retention objectives, as well as the cost to us if we were required to find a replacement for a key executive officer.

Compensation-Setting Process

Role of our Compensation Committee

Compensation decisions for our NEOs are made by our compensation committee. Currently, our compensation committee is responsible for reviewing, evaluating and approving the compensation arrangements, plans, policies, and practices for our NEOs and overseeing and administering our cash-based and equity-based compensation plans.

Near the beginning of each fiscal year, our compensation committee, after consulting with our management team and its compensation consultant, makes decisions with respect to any base salary adjustment, and establishes the corporate performance objectives and target annual cash incentive compensation opportunities and equity awards for our executive officers, including our NEOs, for the upcoming fiscal year. With respect to our cash incentive compensation plan, our compensation committee determines the applicable target levels for each corporate performance objective used for each applicable quarterly performance measurement period.

Our compensation committee reviews our executive compensation program from time to time, including any incentive compensation plans, to determine whether they are appropriate, properly coordinated, and achieve their intended purposes, and to make any modifications to existing plans and arrangements or to adopt new plans or arrangements.

Role of Management

In carrying out its responsibilities, our compensation committee works with members of our management team, including our CEO and our Senior Vice President of Human Resources. Typically, our management team (together with our compensation committee s compensation consultant) assists our compensation committee in the execution of its responsibilities by providing information on corporate and individual performance, market data, and management s perspective and recommendations on compensation matters.

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Typically, except with respect to his own compensation, our CEO will make recommendations to our compensation committee regarding compensation matters, including the compensation of our executive officers. Our CEO also participates in meetings of our compensation committee, except with respect to discussions involving his own compensation in which case he leaves the meeting.

While our compensation committee solicits the recommendations and proposals of our CEO with respect to compensation-related matters, these recommendations and proposals are only one factor in our compensation committee s decision-making process.

Role of Compensation Consultant

Our compensation committee has the authority to retain the services of external advisors, including compensation consultants, legal counsel and other advisors, from time to time, as it sees fit, in connection with carrying out its duties.

In fiscal 2017, our compensation committee continued to engage Compensia, Inc. (Compensia), a national compensation consulting firm, to assist us in executing our executive compensation strategy and guiding principles, assessing the current target total direct compensation opportunities of our executive officers, including comparing them against competitive market practices, developing a compensation peer group and advising on potential executive compensation decisions for fiscal 2017.

Compensia does not provide any services to us other than the services provided to our compensation committee. Our compensation committee has assessed the independence of Compensia taking into account, among other things, the factors set forth in Exchange Act Rule 10C-1 and the listing standards of the NYSE, and has concluded that no conflict of interest exists with respect to the work that Compensia performs for our compensation committee.

Use of Competitive Data

To assess the competitiveness of our executive compensation program and to assist in setting compensation levels, we refer to industry surveys, including the Radford High-Technology Executive Compensation Survey. In addition, during fiscal 2017, Compensia conducted an analysis of market data on the compensation peer group as approved by our compensation committee.

Competitive Positioning

In fiscal 2017, our compensation committee continued to compare and analyze our executive compensation with that of a formal compensation peer group of companies.

In the context of our annual executive compensation review, with assistance from Compensia and input from management, our compensation committee approved a peer group of publicly-traded technology companies, which met some or all of the following criteria: (i) operated in a high-technology industry, (ii) annual revenue approximately between $1 billion and $3 billion; (iii) revenue growth greater than 20%; (iv) a market capitalization between approximately $7 billion and $25.0 billion; and (v) a market capitalization as a multiple of annual revenue that was greater than six. As a result of the application of these criteria, we removed the following companies from our 2016 compensation peer group: Aruba Networks, which was acquired, Informatica Corporation, which was taken private, and each of Ubiquitiy Networks, Inc., Qlik Technologies, Inc., Aspen Technology, Inc. and SolarWinds, Inc. because they no longer met our revenue and/or market capitalization requirements and were not sufficiently relevant comparables. In addition, we added Akamai Technologies, Inc., Autodesk, Inc., Checkpoint Software, Inc. LinkedIn, Inc., Red Hat, Inc., Paychex, Inc., and VeriSign, Inc., which satisfied the above described criteria. The remainder of the peer group is unchanged.

The following publicly-traded companies made up our compensation peer group for the compensatory decisions made during fiscal 2017:

Akamai Technologies, Inc.	Fortinet Inc.	PayChex, Inc.
Arista Networks Inc.	LinkedIn, Inc.	Tableau Software, Inc.
Autodesk, Inc.	NetSuite Inc.	Splunk Inc.
Checkpoint Software, Inc.	Red Hat, Inc.	VeriSign, Inc.
F5 Networks Inc.	ServiceNow, Inc.	Workday, Inc.
FireEye, Inc.		

Compensia supplements the peer data with compensation data from surveys of similarly sized companies and uses this combination of market data to provide an analysis of compensation for executives holding positions comparable to the positions of our executives from the companies in our compensation peer group. Our compensation committee uses the market data as one reference point in determining the compensation of our executives. While our compensation committee focuses on compensation at or above the 50th percentile, our committee considers other factors in setting actual compensation. Such factors include the overall competitive market for our executives, the alignment between the market based positions and the actual responsibilities of our executives, each executive s performance, internal parity, the value of each executive s position and the value of each executive s unvested equity holdings.

Fiscal 2017 Executive Compensation Program Components

The following describes each component of our executive compensation program, the rationale for each, and how the compensation amounts and awards were determined for fiscal 2017.

Base Salary.

Base salary is the primary fixed component of our executive compensation program. We use base salary to compensate our NEOs for services rendered during the fiscal year and to ensure that we remain competitive in attracting and retaining executive talent. Generally, we establish the initial base salaries of our executive officers through arm s-length negotiation at the time we hire the individual executive officer, taking into account his or her position, qualifications, experience, prior salary level, and the base salaries of our other executive officers.

Thereafter, our compensation committee reviews the base salaries of each NEO annually and makes adjustments as it determines to be reasonable and necessary to reflect the scope of a NEO s performance, contributions, responsibilities, experience, current salary level, position (in the case of a promotion), and market positioning, as appropriate.

In October 2016, in connection with its review of our executive compensation program, our compensation committee approved adjustments to the base salary of our NEOs to be effective November 1, 2016. Based on an analysis prepared by Compensia, the then-current base salary level for each NEO (other than Mr. Anderson) was generally at or below the 50th percentile for the comparable executive in our compensation peer group. To move the target total cash compensation opportunity towards the 50th to the 75th percentile of the competitive market (as reflected by our compensation peer group) and to reward each individuals outstanding performance, our compensation committee approved base salary increases for each NEO, as set forth below.

Named Executive Officer	Base Salary at End of Fiscal 2016 ($)	Base Salary Effective November 1, 2016 ($)	Percentage Increase
Mr. McLaughlin	600,000	750,000	25%
Mr. Tomlinson	400,000	475,000	18.8%
Mr. Zuk	400,000	415,000	3.8%
Mr. Bonvanie	350,000	365,000	4.3%
Mr. Anderson	700,000	740,000	5.7%

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The relatively larger increases for Mr. McLaughlin and Mr. Tomlinson reflect (x) existing base salaries that were on the lower end with respect to our compensation peer group, (y) the significance of their responsibilities expected in fiscal 2017 and beyond and (z) their strong performance that warranted more competitive base salary relative to our compensation peer group.

The total base salaries of our NEOs paid for fiscal 2017, are set forth in the Fiscal 2017 Summary Compensation Table below.

Short-Term Cash Incentive Compensation

We use short-term cash incentive compensation to motivate our NEOs to achieve our annual financial and operational objectives, while making progress towards our longer-term strategic and growth goals. Typically, near the beginning of each fiscal year, our compensation committee adopts an incentive compensation plan for that fiscal year, which identifies the plan participants and establishes the target annual incentive compensation opportunity for each participant, the performance measures to be used to determine whether to make payouts for the fiscal year and the associated target levels for each measure, and the potential payouts based on actual performance for the fiscal year. Typically, cash incentive compensation payouts have been determined after the end of the applicable performance period based on our performance against one or more financial and/or operational performance objectives for the performance period as set forth in our annual operating plan.

Fiscal 2017 Incentive Compensation Plan. In October 2016, our compensation committee adopted and approved a sub-plan under our omnibus Employee Incentive Compensation Plan for fiscal 2017 (the Fiscal 2017 Incentive Compensation Plan). The Fiscal 2017 Incentive Compensation Plan provided for potential performance-based incentive payouts to all employees not paid commissions, including our NEOs. Further, the Fiscal 2017 Incentive Compensation Plan provided opportunities for cash incentive compensation payouts based on our actual achievement of pre-established corporate financial objectives as set forth in our annual operating plan. The target levels for the financial objectives in our annual operating plan were set at levels determined to be challenging and requiring substantial skill and effort on the part of senior management. The Fiscal 2017 Incentive Compensation Plan included quarterly performance periods with semi-annual payouts, including a potential accelerator and discretionary over-performance pool payable at the end of the year.

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Target Annual Incentive Compensation Opportunities. As in prior years, the target annual incentive compensation opportunities for our NEOs were expressed as a percentage of their respective base salaries. In October 2016, in connection with its review of our fiscal 2017 executive compensation program, our compensation committee decided to maintain the percentage for all NEOs target annual incentive compensation opportunities. However, due to the base salary increases described above, the dollar amount of the target annual incentive compensation opportunities increased for each of our NEOs. These base salary adjustments were generally intended so that the total target cash compensation opportunity for each NEO would be at or around the 50th to the 75th percentile of the competitive market (as reflected by our compensation peer group). For clarity, the adjustments approved in October 2016 were effective as of the second quarter of fiscal 2017 and the target annual incentive compensation opportunities for the first quarter of fiscal 2017 were the same as those at the end of fiscal 2016. The target annual incentive compensation opportunities established under the Fiscal 2017 Incentive Compensation Plan for our NEOs were:

Named Executive Officer	Target Annual Incentive Compensation Opportunity (as a % of base salary) at end of Fiscal 2016	Target Annual Incentive Compensation Opportunity (as a % of base salary) effective as of 2nd quarter Fiscal 2017	Fiscal 2017 Target Annual Incentive Compensation Opportunity ($)*
Mr. McLaughlin	110%	110%	783,750
Mr. Tomlinson	60%	60%	273,750
Mr. Zuk	50%	50%	205,625
Mr. Bonvanie	50%	50%	180,625
Mr. Anderson	60%	60%	438,000

* The aggregate target annual incentive compensation opportunity for fiscal 2017, was determined with the first fiscal quarter target calculated based on the target annual incentive compensation opportunity in effect prior to the October 2016 adjustment, and the remaining three fiscal quarters calculated based on the target annual incentive compensation opportunity as adjusted for the base salary increases approved in October 2016.

Corporate Performance Measures. For purposes of funding the Fiscal 2017 Incentive Compensation Plan, our compensation committee selected revenue and earnings per share as the corporate performance measures. Our compensation committee chose revenue as a performance measure because we are currently focused on growing our business and revenue is a key metric during this stage of our growth and enhances long-term value creation for our stockholders. Our compensation committee chose earnings per share as a performance measure because it is an important profitability measure tied to management performance and how much profit we are generating for our stockholders. In order to receive a payout under the Fiscal 2017 Annual Incentive Compensation Plan both corporate performance measures needed to meet minimum pre-established achievement levels for the relevant performance period. For purposes of the Fiscal 2017 Incentive Compensation Plan, (x) revenue was defined as GAAP revenue as reflected in our quarterly and annual financial statements, consistent with our annual operating plan; and (y) earnings per share was defined as non-GAAP net income per share as reflected in our quarterly earnings press releases furnished to the SEC, adjusted to exclude the effects of incentives paid out under our Fiscal 2017 Incentive Compensation Plan. We also exclude the foreign currency gains (losses) and tax effects associated with these items in order to provide a complete picture of our recurring core business operating results.

Performance Requirements. Our NEOs were eligible for semi-annual incentive compensation payouts only to the extent, and in the amount, that we exceeded 97% of the applicable quarter s revenue target for fiscal 2017 and 88% of the applicable fiscal quarter s earnings per share target for fiscal 2017, each as set forth in the Fiscal 2017 Incentive Compensation Plan. By the formula in the Fiscal 2017 Incentive Compensation Plan,

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achievement of 100% of both performance targets would have paid out at 100%. With respect to achievement in excess of 100%, such performance could be rewarded at the end of the fiscal year using an accelerator and/or a discretionary over-performance pool that would be funded at 200% of each NEO s applicable target annual incentive compensation opportunity, less any accelerator. If the over-performance pool was funded, our compensation committee could use its discretion to adjust down the actual cash incentive compensation payout. To inform its decision whether to exercise discretion under the Fiscal 2017 Incentive Compensation Plan, our compensation committee would have considered metrics in our annual operating plan other than revenue or earnings per share to balance the focus of our short-term incentive compensation program.

For fiscal 2017, our revenue increased by $383.1 million to $1.8 billion compared to fiscal 2016 and our non-GAAP earnings per share increased by $0.82 per share compared to fiscal 2016. However, these results did not meet the significant stretch target levels our compensation committee established at the beginning of fiscal 2017. Because we did not achieve our desired revenue and earnings per share goals in fiscal 2017, we did not make any payouts to our NEOs under our Fiscal 2017 Incentive Compensation Plan.

Equity Compensation

Following our initial public offering, through fiscal 2015, we primarily granted equity awards to our NEOs in the form of RSUs. Beginning in fiscal 2016, our compensation committee determined to grant equity awards to our NEOs solely in the form of restricted stock awards for shares of our common stock. Our compensation committee made this decision in part based on the fact that restricted stock awards would provide value even if the market price of our common stock fluctuated in the future. In addition, our compensation committee took into consideration the potential dilutive effect of these awards, noting that restricted stock awards require delivering fewer shares to provide equivalent value as a stock option.

While restricted stock units and restricted stock are generally economically equivalent, restricted stock awards are eligible for a greater tax deduction to us under Section 162(m) of the Code. As a result of this better tax qualification without the loss of economic benefit to the NEO or other adverse impact on us, we shifted from restricted stock units to restricted stock in fiscal 2016.

For fiscal 2017, as mentioned above, the most significant change to our fiscal 2017 compensation program is our inaugural grants of performance-based stock awards (PSAs). In October 2016, our compensation committee granted RSAs and PSAs to each of our NEOs after reviewing the equity compensation for our NEOs to assess whether each NEO was properly incentivized and rewarded. This was done in consultation with Compensia. The fiscal 2017 equity awards consist of 50% RSAs and 50% PSAs.

For the PSAs, the target number of shares set forth in the table below represents the number of shares eligible to be earned and subsequently vest upon achievement of the target performance on the billings metric for fiscal 2017. For purposes of the PSA target billings metric, billings was defined as total revenue plus the change in total deferred revenue, net of acquired deferred revenue, during fiscal 2017, and further adjusted to exclude post acquisition related billings. The PSAs reflect our compensation committee s commitment to incorporating performance measures into our long-term equity incentive program. The actual number of PSAs earned and eligible to vest was determined after the one-year performance period, based on achievement of the pre-established billings target in fiscal 2017. Our compensation committee believed that setting a one-year performance measurement period for PSAs was appropriate in fiscal 2017 due to our growth and our historical financial outperformance. The PSAs that satisfied the target billings performance measure set forth in the table below vest on the same vesting schedule as the fiscal 2017 RSAs awarded to such executive, also noted below, with vesting heavily weighted towards the latter portion of the service period to promote long-term incentives through the entire service period. Our compensation committee also believes that a time-based vesting schedule for any earned PSAs is important to provide additional long-term incentives for our highly valuable executives. Under this approach, while the threshold performance-period was one year, the imposition of a three-year additional time-vesting period was a way to balance the difficulty of setting multi-year performance goals while providing a longer-term incentive with back-end loaded vesting schedules.

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Additionally, the number of PSAs that would be eligible for time-based vesting is determined as follows: (i) if we achieve 90% of the billings target then 50% of the PSAs are eligible for vesting, (ii) if we achieve 100% of the billings target then 100% of the PSAs are eligible for vesting, and (iii) if we achieve 110% of the billings target then 120% of the PSAs are eligible for vesting. If we achieve less than 90% of the billings target, then all of the PSAs forfeit. If performance is between the applicable tiers described above, then the payout of PSAs eligible for vesting scales linearly. In fiscal 2017, we achieved $2,292.7 million in billings. In accordance with the payout attainment scale under the fiscal 2017 PSAs, our compensation committee determined that 91% of the billings metric payout was achieved, resulting in 55% of each NEO s target PSA being earned.

The RSA grants approved by our compensation committee are set forth in the table below. Our compensation committee determined that the RSAs should vest over four years and would be heavily weighted towards the latter three years (in the case of Mr. McLaughlin only vest during the last two years) of the service period to promote greater long-term incentives. Specifically:

(1) With respect to Mr. McLaughlin s equity award, twenty-five percent of the shares subject to such award would vest on the two year anniversary of the grant date, and the remaining shares would vest in equal increments thereafter in the third and fourth years, subject to his continued employment with us. As a result of the vesting cliff, no shares vest prior to the two-year anniversary of the grant date.

(2) With respect to Mr. Anderson s equity award, twelve percent of the shares subject to such award would vest on the one year anniversary of the grant date, twelve percent of the shares would vest in equal increments each quarter in the second year, and the remaining unvested shares would vest in equal quarterly amounts in the third and fourth years, subject to his continued employment with us.

(3) With respect to Mr. Zuk s and Mr. Tomlinson s equity awards, one-eighth of the shares subject to such award would vest on the one year anniversary of the grant date, one-eighth of the shares subject to such award would vest quarterly in the second year, and the remaining unvested shares subject to such award would vest in equal quarterly in the third and fourth years, subject to their individual continued employment with the Company.

(4) With respect to Mr. Bonvanie s equity award, one-sixth of the shares subject to such award would vest on the one year anniversary of the grant date, one-sixth of the shares subject to such award would vest quarterly in the second year, and the remaining unvested shares would vest in equal quarterly amounts over the third and fourth years, subject to his continued employment with the Company.

In determining the aggregate value of each NEO s fiscal 2017 equity award, our compensation committee considered the individual achievement of the NEO, as well as his expected future contributions, the skills, tenure and experience of the NEO, the recommendations of our CEO (except with respect to his own equity award), the competitive market data prepared by its compensation consultant, the value of his unvested equity holdings, internal pay parity, the dilutive effect of our long-term incentive compensation program and the overall impact that these equity awards would have on stockholder value.

Additionally, with respect to the aggregate value of Mr. McLaughlin s fiscal 2017 equity awards split between RSAs and PSAs and the determination to significantly back-end load the awards vesting schedules (i.e., no vesting prior to the two year anniversary of the grant date), our compensation committee considered (i) the value of Mr. McLaughlin s fiscal 2015 equity grant and his unvested equity position at the end of 2016, (ii) the value of his fiscal 2016 RSA valued at approximately $5.8 million on the date of grant that approximated the 50th percentile of the equity awards granted to the chief executive officers of the companies in our fiscal 2016 compensation peer group and (iii) projected steep decline in the remaining unvested value at the end of fiscal 2018. Accordingly, our compensation committee determined to grant Mr. McLaughlin RSAs and PSAs having an aggregate value of $10.0 million on the date of grant that approximated the 75th percentile of the equity granted to the CEOs of companies in our fiscal 2017 compensation peer group, but which had a significantly back-end loaded vesting schedule such that the first vesting event for the awards would not occur until October 2018 (the second anniversary of the date of grant).

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With respect to our other NEOs, our compensation committee considered the value of each executive s unvested equity position and the applicable data for a comparable executive in our compensation peer group and made grants at or around the 60th to 75th percentile in our compensation peer group; provided, that the aggregate grants to Mr. Anderson and Mr. Bonvanie were in excess of the 75th percentile because of (x) the significance of their responsibilities expected in fiscal 2017 and beyond and (y) their strong performance that warranted exceptional payout relative to our compensation peer group.

The chart below sets forth the number of RSAs, the target number of PSAs granted in October 2016 by our compensation committee and the number of PSAs that were earned as determined by our compensation committee, as follows:

Named Executive Officer	RSAs Granted in October 2016 (number of shares)	PSAs Granted in October 2016 (number of shares)	Earned PSAs (number of shares)
Mr. McLaughlin	32,402	32,402	17,707
Mr. Tomlinson	12,960	12,960	7,082
Mr. Zuk	12,960	12,960	7,082
Mr. Bonvanie	9,720	9,720	5,311
Mr. Anderson	19,441	19,441	10,624

The equity awards granted to our NEOs during the fiscal year ended July 31, 2017, are set forth in the Fiscal 2017 Summary Compensation Table and the Fiscal 2017 Grants of Plan-Based Awards Table below.

Welfare and Other Employee Benefits. We have established a tax-qualified Section 401(k) retirement plan for all employees who satisfy certain eligibility requirements, including requirements relating to age and length of service. As of January 1, 2016, we match contributions made to the plan by our employees up to $1,000, including our NEOs. Messrs. Tomlinson, Anderson and Bonvanie participate in our Section 401(k) retirement plan. We intend for the plan to qualify under Section 401(a) of the Internal Revenue Code, or the Code, so that contributions by employees to the plan, and income earned on plan contributions, are not taxable to employees until withdrawn from the plan.

In addition, we provide other benefits to our NEOs on the same basis as all of our full-time employees in the country in which they are resident. These benefits include medical, dental, and vision benefits, medical and dependent care flexible spending accounts, short-term and long-term disability insurance, accidental death and dismemberment insurance, and basic life insurance coverage. We design our employee benefits programs to be affordable and competitive in relation to the market, as well as compliant with applicable laws and practices. We adjust our employee benefits programs as needed based upon regular monitoring of applicable laws and practices and the competitive market.

Perquisites and Other Personal Benefits. In fiscal 2017, we provided limited perquisites to Messrs. Anderson, McLaughlin and Zuk. We provided each with spousal travel and expenses to an annual vacation award for top sales performers, which we grossed-up for taxes.

In the future, we may provide perquisites or other personal benefits in limited circumstances, such as where we believe it is appropriate to assist an individual NEO in the performance of his or her duties, to make our NEOs more efficient and effective, and for recruitment, motivation, or retention purposes. All future practices with respect to perquisites or other personal benefits will be approved and subject to periodic review by our compensation committee.

Employment Agreements

While we have not historically entered into employment agreements with our NEOs, the initial terms and conditions of employment of each of the NEOs (other than Mr. Zuk) were set forth in a written employment offer

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letter. Each of these arrangements was approved by our Board of Directors or, in certain instances, our compensation committee. Each of these employment offer letters provided for at will employment and set forth the initial compensation arrangements for the NEO, including an initial base salary, an annual incentive compensation opportunity, and an equity award in the form of an option to purchase shares of our common stock. We believe that these employment offer letters were necessary to induce these individuals to forego other employment opportunities or leave their current employer for the uncertainty of a demanding position in a new and unfamiliar organization.

In December 2011, we entered into new confirmatory employment agreements and/or amendments with Messrs. McLaughlin, Zuk and Bonvanie to achieve consistency in the employment terms among our NEOs. For a summary of the material terms and conditions of these employment arrangements, see the section titled Executive Employment Agreements.

Post-Employment Compensation

The new confirmatory employment agreements with our NEOs provide each of them with protections in the event of their involuntary termination of employment following a change in control of us, and, in the case of Messrs. McLaughlin, Tomlinson and Anderson, their involuntary termination of employment not involving a change in control transaction. We believe that these protections assist us in retaining these individuals. We also believe that these protections serve our executive retention objectives by helping our NEOs maintain continued focus and dedication to their responsibilities to maximize stockholder value, including in the event that there is a potential transaction that could involve a change in control of us. The terms of these agreements were determined after our board of directors and compensation committee reviewed our retention goals for each NEO and an analysis of relevant market data.

For a summary of the material terms and conditions of these post-employment compensation arrangements, see the sections titled Executive Employment Agreements and Potential Payments Upon Termination or Change in Control.

Other Compensation Policies

Stock Ownership and Compensation Recovery Policies

Our Board of Directors believes that our executive officers and the non-employee members of our Board of Directors should hold a meaningful financial stake in the company to closely align their interests with those of our stockholders and therefore adopted stock ownership guidelines in fiscal 2017. Under these guidelines, our CEO and executive officers who report directly to our CEO are required to achieve ownership of our common stock within five years of the later of August 26, 2016 or such executive officer s hire, appointment or election date as applicable, at the following levels:

- Our CEO must own the lesser of (i) common stock with a value of five times his or her annual base salary or (ii) 22,000 shares; and

- Each executive officer must own the lesser of (i) common stock with a value of his or her annual base salary or (ii) 3,825 shares.

The base salary multiples above are consistent with current market practices, and the alternative share number thresholds are intended to provide our executive officers with certainty as to whether the guidelines are met, regardless of our then-current stock price.

After year end and during fiscal 2018, we adopted a Clawback Policy pursuant to which we may seek the recovery of performance-based incentive compensation paid by us. The Clawback Policy applies to our CEO and to all officers who report directly to the CEO, including our NEOs. The Clawback Policy provides that if (i) we restate our financial statements as a result of a material error; (ii) the amount of cash incentive compensation or performance-based equity compensation that was paid or is payable based on achievement of specific financial results paid to a participant would have been less if the financial statements had been correct; (iii) no more than two years have elapsed since the original filing date of the financial statements upon which the incentive compensation was determined; and (iv) our compensation committee unanimously concludes, in its sole discretion, that fraud or intentional misconduct by such participant caused the material error and it would be in our best interests to seek from such participant recovery of the excess compensation, then our compensation committee may, in its sole discretion, seek repayment from such participant.

Hedging and Pledging Policies

Our insider trading policy prohibits our executive officers and members of our board of directors from engaging in derivative securities transactions, including hedging, with respect to our common stock and from pledging company securities as collateral or holding company securities in a margin account.

Risk Assessment and Compensation Practices

Our management assesses and discusses with our compensation committee our compensation policies and practices for our employees as they relate to our risk management, and based upon this assessment, we believe that, for the following reasons, any risks arising from such policies and practices are not reasonably likely to have a material adverse effect on us in the future:

- our incentive compensation plan reflects a pay for performance philosophy that rewards NEOs and other eligible employees for achievement of performance targets, and historically, we reserve the payment of discretionary bonuses for extraordinary performance and achievement;

- our equity awards include multi-year vesting schedules requiring long-term employee commitment;

- we regularly monitor short- and long-term compensation practices to determine whether management s objectives are satisfied; and

- for our Fiscal 2017 Incentive Compensation Plan, we instituted a per person cap of 300% of the target incentive compensation opportunity for each quarter to manage costs and to limit any potential risks related to short-term incentives.

Tax and Accounting Considerations

Deductibility of Executive Compensation. Section 162(m) of the Code generally disallows public companies a tax deduction for federal income tax purposes of remuneration in excess of $1 million paid to the chief executive officer and each of the three other most highly compensated executive officers (other than the chief financial officer) in any taxable year. Generally, remuneration in excess of $1 million may only be deducted if it is performance-based compensation within the meaning of the Code. Our compensation committee may consider the deductibility of compensation when making decisions, but will authorize the payment of compensation that is not deductible when it believes it appropriate.

Taxation of Parachute Payments. Sections 280G and 4999 of the Code provide that executive officers and directors who hold significant equity interests and certain other service providers may be subject to significant additional taxes if they receive payments or benefits in connection with a change in control that exceeds certain prescribed limits and that we (or a successor) may forfeit a deduction on the amounts subject to this additional tax. We did not provide any of our NEOs with a gross-up or other reimbursement payment for any tax liability that the NEO might owe as a result of the application of Sections 280G or 4999 during fiscal 2017, and we have not agreed and are not otherwise obligated to provide any NEO with such a gross-up or other reimbursement.

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Accounting for Share-Based Compensation. We follow ASC Topic 718 for our share-based compensation awards. ASC Topic 718 requires companies to measure the compensation expense for all share-based compensation awards made to employees and directors, including stock options, based on the grant date fair value of these awards. This calculation is performed for accounting purposes and reported in the compensation tables below, even though our NEOs may never realize any value from their awards. ASC Topic 718 also requires companies to recognize the compensation cost of their share-based compensation awards in their income statements over the period that an executive officer is required to render service in exchange for the option or other award.

Report of the Compensation Committee

Our compensation committee has reviewed and discussed the Compensation Discussion and Analysis with management. Based on such review and discussion, our compensation committee has recommended to our Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement.

Respectfully submitted by the members of the compensation committee of our board of directors:

Asheem Chandna (Chair)

Carl Eschenbach

James J. Goetz

Daniel J. Warmenhoven

Fiscal 2017 Summary Compensation Table

The following table presents summary information regarding the compensation paid to, or earned by, our Named Executive Officers for our fiscal year ended July 31, 2017.

Name and Principal Position	Year	Salary ($)	Stock Awards ($) (1)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)	All Other Compensation ($)	Total ($)
Mark D. McLaughlin (2)	2017	712,500	9,625,986(3)			30,652(4)	10,369,138
	2016	575,000	5,799,986		302,288	1,734	6,679,009
Chief Executive Officer	2015	487,500	65,424,000		692,750	2,466	66,606,716
Nir Zuk	2017	411,250	3,850,157(3)			23,806(4)	4,285,213
	2016	387,500	31,739,384		93,684		32,220,568
Chief Technology Officer	2015	337,500	8,275,481		222,125		8,835,106
Mark Anderson (5)	2017	730,000	5,775,532(3)			25,066(6)	6,530,598
	2016	693,750	37,029,366		204,858	38,247	37,966,221
President	2015	668,749	8,275,481		530,000	32,088	9,506,318
René Bonvanie	2017	361,250	2,887,618(3)			1,914(7)	3,250,782
	2016	337,500	12,695,719		81,193		13,114,413
Chief Marketing Officer	2015	353,749	6,206,556		192,625		6,752,930

Steffan C. Tomlinson	2017	456,250	3,850,157(3)		1,914(7)	4,308,339
	2016	393,750	15,869,606	116,169		16,379,525
Chief Financial Officer	2015	360,000	6,206,556	276,750		6,843,306

(1) The amounts reported in the Stock Awards column represent the grant date fair value of the restricted stock awards/units to purchase shares of our common stock granted to our Named Executive Officers as computed in accordance with ASC Topic 718. The assumptions used in calculating the grant date fair value of the restricted stock awards/units reported in this column are set forth in the notes to our audited consolidated financial statements included in our Annual Report on Form 10-K filed with the SEC on September 7, 2017. Note that the amounts reported in this column do not correspond to the actual economic value that may be received by our Named Executive Officers from their restricted stock unit awards or stock options.

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(2) Mr. McLaughlin served as President from July 2011 until August 2016 when Mr. Anderson was promoted to the position of President.
(3) The amounts reported in the Stock Awards column for fiscal 2017 include awards that were granted 50% in time-based restricted stock awards and 50% in performance-based restricted stock awards. With respect to the performance-based restricted stock awards, the grant date fair value assumes achievement at 100% target level. Accordingly, 50% of the amounts reported represent the time-based restricted stock awards and 50% of the amounts reported represent performance-based stock awards. Assuming the highest level of the performance conditions is satisfied, the following are the values of the performance-based awards at the date of grant: Mr. McLaughlin, $5,775,592; Mr. Zuk, $2,310,094; Mr. Anderson, $3,465,319; Mr. Bonvanie, $1,732,571; and Mr. Tomlinson, $2,310,094.
(4) Represents travel expenses (including a gross-up for taxes) and life insurance payments.
(5) Mr. Anderson served as Senior Vice President, Worldwide Field Operations from June 2012 to May 2016, as Executive Vice President, Worldwide Field Operations from May 2016 until August 2016, and as President since August 2016.
(6) Represents travel expenses, including a gross-up for taxes, life insurance payments and a 401(k) plan matching contribution made by the Company.
(7) Represents life insurance payments and a 401(k) plan matching contribution made by the Company.

Fiscal 2017 Grants of Plan-Based Awards

The following table presents information regarding the amount of equity awards granted to our Named Executive Officers during our fiscal year ended July 31, 2017.

		Estimated Future Payouts Under Non-Equity Incentive Plan Awards (1)			Estimated Future Payouts Under Equity Incentive Plan Awards (2)						
Name	**Grant Date**	**Threshold ($)**	**Target ($)**	**Maximum ($)**	**Threshold (#)**	**Target (#)**	**Maximum (#)**	**All Other Stock Awards: Number of Shares of Stock or Units (#) (3)**	**All Other Option Awards: Number of Securities Underlying Options (#) (3)**	**Exercise or Base Price of Option Awards ($/Share)**	**Grant Date Fair Value of Stock and Option Awards ($) (4)**
Mr. McLaughlin			783,750	2,351,250							
	10/20/16				16,201	32,402	38,882				4,812,993
	10/20/16							32,402			4,812,993
Mr. Zuk			205,625	616,875							
	10/20/16				6,480	12,960	15,552				1,925,078
	10/20/16							12,960			1,925,078
Mr. Anderson			438,000	1,314,000							
	10/20/16				9,720	19,441	23,329				2,887,766
	10/20/16							19,441			2,887,766

Mr. Bonvanie			180,625	541,875
Income tax expense	24.5	21.1	70.3	47.5
Net earnings	$ 39.2	$ 46.1	$ 107.4	$ 60.2

See accompanying notes to condensed consolidated financial statements beginning on page 41.

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Armstrong World Industries, Inc., and Subsidiaries

Condensed Consolidated Balance Sheets

(amounts in millions, except share data)

	Unaudited September 30, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 520.6	$ 602.2
Accounts and notes receivable, net	407.5	328.8
Inventories, net	542.6	514.5
Deferred income taxes	18.2	15.4
Income tax receivable	18.2	18.2
Other current assets	60.7	82.2
Total current assets	1,567.8	1,561.3
Property, plant and equipment, less accumulated depreciation and amortization of $1,324.1 and $1,562.0, respectively	1,164.0	1,145.3
Insurance receivable for asbestos-related liabilities, noncurrent	91.5	88.8
Prepaid pension costs	510.0	476.9
Investment in affiliates	95.0	67.4
Goodwill, net	143.1	134.2
Other intangibles, net	84.5	68.1
Deferred income taxes, noncurrent	967.4	967.4
Other noncurrent assets	97.5	96.6
Total assets	$ 4,720.8	$ 4,606.0
Liabilities and Shareholder s Equity		
Current liabilities:		
Short-term debt	$ 0.4	$ 14.6
Current installments of long-term debt	0.9	5.4
Accounts payable and accrued expenses	415.9	392.5
Short term amounts due to affiliates	10.1	10.0
Income tax payable	7.5	10.0
Deferred income taxes	0.8	0.8
Total current liabilities	435.6	433.3
Liabilities subject to compromise	4,868.1	4,869.4
Long-term debt, less current installments	12.1	21.5
Postretirement and postemployment benefit liabilities	260.9	258.9
Pension benefit liabilities	230.7	223.7
Other long-term liabilities	74.6	90.0
Deferred income taxes, noncurrent	35.7	21.2
Minority interest in subsidiaries	7.3	7.9
Total noncurrent liabilities	5,489.4	5,492.6
Shareholder s equity (deficit):		
Common stock, $1 par value per share, authorized 200 million shares; issued 51,878,910 shares	51.9	51.9
Capital in excess of par value	172.6	172.6

Reduction for ESOP loan guarantee	(142.2)	(142.2)
Accumulated deficit	(803.4)	(910.8)
Accumulated other comprehensive income	45.4	37.1
Less common stock in treasury, at cost 2006 and 2005 - 11,393,170 shares	(528.5)	(528.5)
Total shareholder s (deficit)	(1,204.2)	(1,319.9)
Total liabilities and shareholder s equity	$ 4,720.8	$ 4,606.0

See accompanying notes to condensed consolidated financial statements beginning on page 41.

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Armstrong World Industries, Inc., and Subsidiaries

Condensed Consolidated Statements of Shareholder s Equity

(amounts in millions, except per share amounts)

Unaudited

	2006		2005	
Common stock, $1 par value:				
Balance at beginning of year and September 30	$ 51.9		$ 51.9	
Capital in excess of par value:				
Balance at beginning of year and September 30	$ 172.6		$ 172.6	
Reduction for ESOP loan guarantee:				
Balance at beginning of year and September 30	$ (142.2)		$ (142.2)	
Retained earnings (accumulated deficit):				
Balance at beginning of year	$ (910.8)		$ (1,021.9)	
Net earnings for period	107.4	$ 107.4	60.2	$ 60.2
Balance at September 30	$ (803.4)		$ (961.7)	
Accumulated other comprehensive income:				
Balance at beginning of year	$ 37.1		$ 42.8	
Foreign currency translation adjustments	18.5		(12.0)	
Derivative gain (loss), net	(9.5)		9.1	
Minimum pension liability adjustments	(0.7)		2.3	
Total other comprehensive income (loss)	8.3	8.3	(0.6)	(0.6)
Balance at September 30	$ 45.4		$ 42.2	
Comprehensive income		$ 115.7		$ 59.6
Less treasury stock at cost:				
Balance at beginning of year and September 30	$ (528.5)		$ (528.5)	
Total shareholder s (deficit)	$ (1,204.2)		$ (1,365.7)	

See accompanying notes to condensed consolidated financial statements beginning on page 41.

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Armstrong World Industries, Inc., and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(amounts in millions)

Unaudited

	Nine Months Ended September 30, 2006	2005
Cash flows from operating activities:		
Net earnings	$ 107.4	$ 60.2
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	101.2	106.7
Fixed asset impairments	0.6	
Deferred income taxes	16.5	(11.1)
Gain on sale of assets	(17.1)	(0.4)
Equity (earnings) from affiliates, net	(41.4)	(27.5)
Gain on sale of investment in affiliates		(3.4)
Chapter 11 reorganization costs, net	10.9	4.5
Chapter 11 reorganization costs payments	(13.1)	(9.2)
Restructuring charges, net of reversals	10.0	17.0
Restructuring payments	(3.0)	(22.0)
Asbestos-related insurance recoveries	7.0	
Cash effect of hedging activities	(2.8)	11.1
Increase (decrease) in cash from change in:		
Receivables	(66.0)	(85.9)
Inventories	(12.7)	24.0
Other current assets	2.0	5.5
Other noncurrent assets	(45.3)	(26.8)
Accounts payable and accrued expenses	11.3	11.9
Income taxes payable	(2.8)	18.1
Other long-term liabilities	(10.5)	(3.0)
Other, net	5.8	(6.2)
Net cash provided by operating activities	58.0	63.5
Cash flow from investing activities:		
Purchases of property, plant and equipment and computer software	(98.2)	(83.4)
Purchase of minority interest	(1.5)	
Acquisitions	(60.5)	
Distributions from equity affiliates	18.0	17.0
Investment in affiliates	(4.3)	
Proceeds from the sale of investment in affiliates		20.6
Loan to affiliate	(6.3)	
Proceeds from the sale of assets	39.1	4.7
Net cash (used for) investing activities	(113.7)	(41.1)
Cash flows from financing activities:		
(Decrease) increase in short-term debt, net	(15.2)	12.1
Payments of long-term debt	(15.5)	(4.3)

Dividend to minority interest	(1.1)	
Other, net	0.5	
Net cash (used for) provided by financing activities	(31.3)	7.8
Effect of exchange rate changes on cash and cash equivalents	5.4	(5.3)
Net (decrease) increase in cash and cash equivalents	(81.6)	24.9
Cash and cash equivalents at beginning of year	602.2	515.9
Cash and cash equivalents at end of period	$ 520.6	$ 540.8

See accompanying notes to condensed consolidated financial statements beginning on page 41.

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Armstrong World Industries, Inc., and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

(dollar amounts in millions)

NOTE 1. BASIS OF PRESENTATION

Armstrong World Industries, Inc. (AWI) is a Pennsylvania corporation incorporated in 1891. On December 6, 2000, AWI filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code in order to use the court-supervised reorganization process to achieve a resolution of AWI s asbestos-related liability. On October 2, 2006, AWI s plan of reorganization (the POR), as confirmed by the U.S. District Court for the District of Delaware by order dated August 18, 2006, became effective, and AWI emerged from Chapter 11.

Armstrong Holdings, Inc. is a Pennsylvania corporation and, as of September 30, 2006, was the publicly held parent holding company of AWI. Armstrong Holdings, Inc. s only operation was its indirect ownership, through Armstrong Worldwide, Inc. (a Delaware corporation), of all of the capital stock of AWI. Upon AWI s POR becoming effective on October 2, 2006, all then-current shares of AWI were cancelled, and Armstrong Holdings, Inc. was not entitled to any distribution under the POR in respect of its former equity interest in AWI. AHI and Armstrong Worldwide, Inc. have pending claims in AWI s Chapter 11 case and the potential for a tax refund. See Note 2 for additional information about AWI s Chapter 11 case and the pending claims and potential tax refund.

We include separate consolidated financial statements for Armstrong Holdings, Inc. and its subsidiaries, and AWI and its subsidiaries in this report because, as of September 30, 2006, both companies had public securities that were registered under the Securities Exchange Act of 1934. The differences between the financial statements of Armstrong Holdings, Inc. and its subsidiaries and AWI and its subsidiaries are primarily due to transactions that occurred in 2000 related to the formation of Armstrong Holdings, Inc. and subsequent employee compensation-related stock activity. When we refer to we , our and us in this report, we are referring to AHI and AWI through October 1, 2006 and reorganized Armstrong as it was reorganized under the POR thereafter. References in this report to reorganized Armstrong are to AWI as it was reorganized under the POR on October 2, 2006, and its subsidiaries collectively.

The accounting policies used in preparing these statements are the same as those used in preparing the consolidated financial statements for the year ended December 31, 2005. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Form 10-K for the fiscal year ended December 31, 2005. 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. 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 general economic conditions. In addition, in connection with AWI s emergence from Chapter 11 on October 2, 2006, reorganized Armstrong will adopt fresh-start reporting in accordance with AICPA Statement of Position 90-7, Financial Reporting by Entities in Reorganization Under the Bankruptcy Code (SOP 90-7). As a result of the application of fresh-start reporting as of October 2, 2006, reorganized Armstrong s consolidated financial statements in future periods will not be comparable to AWI s consolidated financial statements from prior periods. See Note 2 for additional information about fresh-start reporting.

These financial statements are prepared in accordance with generally accepted accounting principles and include management estimates and judgments, where appropriate. Management utilizes estimates to record many items including asbestos-related liabilities and insurance assets, allowances for bad debts, inventory obsolescence and lower of cost or market changes, warranty, workers compensation, general liability and environmental claims. When preparing an estimate, management determines the amount based upon considering relevant information, which may include conferring with outside parties where appropriate. Actual results may differ from these estimates.

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Armstrong World Industries, Inc., and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

(dollar amounts in millions)

Operating results for the third quarter and first nine months of 2006 and the corresponding periods of 2005 included in this report are unaudited. However, these condensed consolidated financial statements have been reviewed by an independent registered public accounting firm in accordance with standards of the Public Company Accounting Oversight Board (United States) for a limited review of interim financial information.

On January 1, 2006, we adopted FASB Statement No. 123 (revised 2004), Share-Based Payment (FAS 123R). Prior to January 1, 2006, we used the intrinsic value method for stock-based employee compensation. There would have been no effect on net income and earnings per share if we had applied the fair value recognition provisions of FAS 123R to share-based employee compensation in 2005. See Note 14 for additional information on FAS 123R.

NOTE 2. CHAPTER 11 REORGANIZATION

On October 2, 2006 (the Effective Date), AWI s plan of reorganization, which was confirmed by order dated August 18, 2006, became effective, and AWI emerged from Chapter 11. AWI s two wholly-owned subsidiaries that commenced Chapter 11 proceedings at the same time as AWI remain in Chapter 11. The following summarizes the events in its Chapter 11 case that led to AWI s emergence.

Proceedings under Chapter 11

On December 6, 2000, AWI, the major operating subsidiary of AHI, filed a voluntary petition for relief (the Filing) under Chapter 11 of the U.S. Bankruptcy Code (the Bankruptcy Code) in the United States Bankruptcy Court for the District of Delaware (the Bankruptcy Court) in order to use the court-supervised reorganization process to achieve a resolution of AWI s asbestos-related liability. Also filing under Chapter 11 were two of AWI s wholly-owned subsidiaries, Nitram Liquidators, Inc. (Nitram) and Desseaux Corporation of North America, Inc. (Desseaux). The Chapter 11 cases are being jointly administered under case number 00-4471 (the Chapter 11 Case). Shortly after its commencement, the Chapter 11 Case was assigned to Judge Randall J. Newsome. His appointment as a visiting judge in the District of Delaware ended on December 31, 2003. On January 6, 2004, the Chapter 11 Case was assigned to Judge Judith K. Fitzgerald.

AHI and all of AWI s other direct and indirect subsidiaries and affiliates, including Armstrong Wood Products Inc. (formerly Triangle Pacific Corp.), WAVE (AWI s ceiling grid systems joint venture with Worthington Industries, Inc.), Armstrong Canada, and Armstrong DLW AG, were not a part of the Filing and accordingly, except for any asbestos-related liability that also relates, directly or indirectly, to the pre-Filing activities of AWI, the liabilities, including asbestos-related liability if any, of such companies were not resolved in AWI s Chapter 11 Case. See below under The Asbestos Personal Injury Trust and Note 16 under Asbestos-Related Litigation .

Through October 1, 2006, AWI operated its business and managed its properties as a debtor-in-possession subject to the provisions of the Bankruptcy Code. Pursuant to the provisions of the Bankruptcy Code, AWI was not permitted to pay any claims or obligations which arose prior to the Filing date (prepetition claims) unless specifically authorized by the Bankruptcy Court. Similarly, claimants could not enforce any prepetition claims unless specifically authorized by the Bankruptcy Court. In addition, as a debtor-in-possession, AWI had the right, subject to the Bankruptcy Court s approval, to assume or reject any executory contracts and unexpired leases in existence at the date of the Filing. Some of these were specifically assumed and others were specifically rejected already in the course of the Chapter 11 Case. In the plan of reorganization, AWI identified other executory contracts and unexpired leases that it assumed or rejected effective on the Effective Date; any not specifically assumed under the plan of reorganization were rejected as of that date.

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Armstrong World Industries, Inc., and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

(dollar amounts in millions)

Three creditors committees, one representing asbestos personal injury claimants (the Asbestos Personal Injury Claimants Committee), one representing asbestos property damage claimants (the Asbestos Property Damage Committee), and the other representing other unsecured creditors (the Unsecured Creditors Committee), were appointed in the Chapter 11 Case. In addition, an individual was appointed to represent the interests of future asbestos personal injury claimants (the Future Claimants Representative). In accordance with the provisions of the Bankruptcy Code, these parties had the right to be heard on matters that came before the Bankruptcy Court in the Chapter 11 Case. Upon resolution of all asbestos property damage claims, the Asbestos Property Damage Committee was disbanded. Upon AWI s emergence from Chapter 11 on October 2, 2006, the Asbestos Personal Injury Claimants Committee and the Unsecured Creditors Committee were disbanded. The Future Claimants Representative will continue to serve, but as of October 2, 2006 his expenses will be borne by the Asbestos Personal Injury Trust established under the plan of reorganization as described below.

Plan of Reorganization and Disclosure Statement

On November 4, 2002, AWI filed a plan of reorganization with the Bankruptcy Court. Subsequently, AWI filed several amendments to the plan, along with various exhibits. The Fourth Amended Plan of Reorganization, with certain exhibits, was filed on May 23, 2003 and, as so amended and as modified by modifications filed with the Bankruptcy Court on October 17, 2003, November 10, 2003, December 3, 2004, and February 21, 2006, was confirmed by the U.S. District Court for the District of Delaware (the Court) on August 18, 2006. Such plan, as modified on May 23, 2003 and as from time to time modified through February 21, 2006 and then confirmed, is referred to in this report as the POR . Pursuant to the POR, upon emergence from Chapter 11 on October 2, 2006, AWI continued to conduct its existing lines of business with a reorganized capital structure under which, among other things, its existing shares were cancelled and new common shares of reorganized Armstrong and cash were issued to its unsecured creditors and to the Armstrong World Industries, Inc. Asbestos Personal Injury Settlement Trust (the Asbestos PI Trust), which was established under the POR, as described below, for the benefit of AWI s current and future asbestos-related personal injury claimants, in full satisfaction of their claims against AWI. The POR excludes AWI s Nitram and Desseaux subsidiaries, neither of which is material to Armstrong and which are pursuing separate resolutions of their Chapter 11 cases that are expected to result in the winding up of their affairs.

In connection with the vote of creditors on the POR, AWI prepared a disclosure statement concerning its business and the POR, including certain projected financial information assuming an effective date of the POR of July 1, 2003, intended to demonstrate to the Bankruptcy Court the feasibility of the POR and AWI s ability to continue operations upon its emergence from Chapter 11. On May 30, 2003, the Bankruptcy Court approved the disclosure statement for distribution to parties in interest in the Chapter 11 Case. The projected financial information included in the disclosure statement was updated in certain respects by information submitted to the Bankruptcy Court in connection with the Bankruptcy Court s November 2003 hearing on confirmation of the POR and was not otherwise updated for use in any submission made in the Chapter 11 Case. This projected financial information was prepared for the limited purposes of consideration by the Bankruptcy Court, creditors and other parties in interest in the Chapter 11 Case of matters pertinent to the case. The projected financial information and estimates of value were prepared by AWI and its financial advisors and were not audited or reviewed by independent accountants. At the time they were prepared in 2003, the projections reflected numerous assumptions concerning reorganized Armstrong s anticipated future performance and with respect to prevailing and anticipated market and economic conditions, which were and remain beyond our control and which may not materialize. Projections are inherently subject to significant and numerous uncertainties and to a wide variety of significant business, economic and competitive risks and the assumptions underlying the projections may be wrong in a material respect. Actual results have and may vary significantly from those contemplated by the projections.

Armstrong World Industries, Inc., and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

(dollar amounts in millions)

During 2003, the POR was submitted for a vote by AWI s creditors for its approval. It was approved by each creditor class that was entitled to vote on the POR except the class of unsecured creditors. On November 17 and 18, 2003, the Bankruptcy Court held a hearing on confirmation of the POR and on December 19, 2003, issued proposed findings of fact and conclusions of law and a proposed order confirming the POR, notwithstanding the rejection of the POR by the class of unsecured creditors. On December 29, 2003, the Unsecured Creditors Committee filed an objection to the Bankruptcy Court s proposed findings of fact and conclusions of law and the proposed order of confirmation of the POR.

In order for AWI s POR to be confirmed, the U.S. District Court had to also issue findings of fact and conclusions of law in support of confirmation of the POR, enter or affirm an order confirming the POR and issue an injunction under Section 524(g) of the Bankruptcy Code (see Asbestos Personal Injury Trust below). Following procedural delays concerning the status of the prior U.S. District Court judge presiding over AWI s Chapter 11 Case, the case was assigned to U.S. District Court Judge Eduardo C. Robreno in June 2004. A hearing was held before Judge Robreno on December 15, 2004 to consider the objections to confirmation of the POR. On February 23, 2005, Judge Robreno ruled that the POR could not be confirmed. In the court s decision, the Judge found that, because the class of unsecured creditors voted to reject the POR, the distribution of warrants to existing equity holders, as then provided under the POR violated the absolute priority rule of the Bankruptcy Code.

AWI filed a Notice of Appeal of this decision to the United States Court of Appeals for the Third Circuit. On December 29, 2005, the U.S. Court of Appeals affirmed the District Court s decision to deny confirmation of the POR.

At a status conference before Judge Robreno on February 3, 2006, AWI and the court-authorized representatives of AWI s creditors and claimants advised the Court that they had agreed on a proposed schedule for a confirmation hearing on a modified POR which would eliminate the provisions regarding distribution of warrants to AWI s existing equity holder. AWI filed the modified POR with the Court on February 21, 2006. Following the conference, Judge Robreno established a schedule for a U.S. District Court confirmation hearing on the modified POR.

The confirmation hearing commenced on May 23, 2006 and concluded with oral arguments on July 11, 2006. At that hearing, the Court heard testimony and received evidence relating to the Unsecured Creditors Committee s objection that the modified POR unfairly discriminated against the unsecured creditors, based on the size of the present and future asbestos liability implied by the modified POR.

On August 15, 2006, the Court issued its opinion overruling the Unsecured Creditors Committee s objection. On August 18, 2006, the Court entered the order confirming AWI s POR, along with its findings of facts and conclusions of law.

A description of the basic components of the POR, as it became effective on October 2, 2006, follows.

Relationship to Armstrong Holdings, Inc. (AHI)

Upon the POR becoming effective on October 2, 2006, all then-current shares of AWI were cancelled, and AHI was not entitled to any distribution on account of its equity interest in AWI. See Matters Concerning AHI in this footnote for a discussion on the pending matters between AHI and AWI.

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Asbestos Personal Injury Trust

Upon the POR becoming effective on October 2, 2006, the Asbestos PI Trust was created, pursuant to section 524(g) of the Bankruptcy Code, for the purpose of addressing AWI s personal injury (including wrongful death) asbestos-related liability. As of October 2, 2006, all present and future asbestos-related personal injury claims against AWI, including contribution claims of co-defendants, arising directly or indirectly out of AWI s pre-Filing use of or other activities involving asbestos are channeled to the Asbestos PI Trust.

As part of the POR, an injunction was issued under Section 524(g) protecting various entities from such present and future AWI asbestos-related personal injury claims. These entities include, among others, reorganized Armstrong, AHI, AWI s subsidiaries and other affiliates (as defined in the POR), and their respective officers and directors. Now that AWI has emerged from Chapter 11, reorganized Armstrong does not have any responsibility for these claims (including claims against reorganized Armstrong based solely on its ownership of a subsidiary or other affiliate), nor will it participate in the resolution of these claims.

However, although AWI s domestic and foreign subsidiaries and other affiliates have certain protection afforded by the 524(g) injunction, asbestos-related personal injury claims against them will be channeled to the Asbestos PI Trust only to the extent such claims directly or indirectly relate to the manufacturing, installation, distribution or other activities of AWI or are based solely on AWI s ownership of the subsidiaries or other affiliates (as distinguished from independent activities of the subsidiaries or affiliates). See Note 16 under Asbestos-Related Litigation.

In addition, workers compensation claims brought against AWI or its subsidiaries or other affiliates will not be channeled to the Asbestos PI Trust and will remain subject to the workers compensation process. Workers compensation law provides that the employer is responsible for evaluation, medical treatment and lost wages as a result of a job-related injury. Historically, workers compensation claims against AWI or its subsidiaries have not been significant in number or amount, and AWI honored its obligations with respect to such claims during the Chapter 11 Case. Currently, AWI has four pending workers compensation claims, and a UK subsidiary has seven employer liability claims involving alleged asbestos exposure.

There also is uncertainty as to proceedings, if any, brought in certain foreign jurisdictions with respect to the effect of the 524(g) injunction in precluding the assertion in such jurisdictions of asbestos-related personal injury claims, proceedings related thereto or the enforcement of judgments rendered in such proceedings.

Management believes that neither AWI nor any of its subsidiaries or other affiliates is subject to any asbestos-related personal injury claims that will not be channeled to the Asbestos PI Trust under the POR and that are of a magnitude that, individually or collectively, would be material in amount to reorganized Armstrong.

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Consideration to Be Distributed under the POR

The Asbestos PI Trust and the holders of allowed unsecured claims, other than convenience creditors described below, became entitled on the Effective Date to share in the following consideration to be distributed to them under the POR:

AWI s Available Cash, which, as defined in the POR, was:

Cash available as of September 30, 2006 after reserving up to $100 million (as determined by AWI) to fund ongoing operations and making provisions for the payment of allowed claims of convenience creditors and certain other required payments under the POR,

Any cash drawn, at AWI s sole discretion, under a credit facility to be established as provided by the POR for the purpose of funding distributions under the POR, and

Certain insurance proceeds related to environmental matters.

However, pursuant to the POR, proceeds received from any private offering of debt securities or secured term loan borrowings made, as permitted by, and in connection with consummation of, the POR, and certain other amounts authorized or directed by the Court, were excluded from the determination of Available Cash.

Plan Notes of AWI as further described below or net cash proceeds from any private offerings of debt securities or secured term loan borrowings made in lieu of Plan Notes, and

New common shares of reorganized Armstrong, representing all of the shares issued under, and outstanding after giving effect to, the POR, which were determined to be 56.4 million shares, except that an additional 5,349,000 shares (5% of the shares on a fully diluted basis) were reserved for issuance pursuant to a Long-Term Incentive Plan for key employees.

The POR called for AWI to use reasonable efforts to issue one or more private offerings of debt securities or arrange term loan borrowings on, or as soon as practicable after, the Effective Date, so as to yield net proceeds at least equal to the amount of the Plan Notes prescribed by the Plan, which was the greater of (i) $1.125 billion less Available Cash and (ii) $775 million. Following its emergence, AWI received commitments for, and then entered into and received the proceeds from, $800 million of secured term loan borrowings for use principally in lieu of issuance of the Plan Notes. The borrowings consist of a $300 million term loan with a 5 year maturity and a $500 million term loan with a 7 year maturity. Of the $800 million borrowed, $775 million will be distributed to the Asbestos PI Trust and holders of allowed unsecured claims, as described in the following paragraph, and the remaining $25 million will be used by AWI for operational purposes.

The POR provided that unsecured creditors, other than convenience creditors described below, receive their pro rata share of:

34.43% of the 56.4 million new common shares of reorganized Armstrong,

- 34.43% of the first $1.05 billion of all the Available Cash and net cash proceeds from the secured term loan borrowings in lieu of Plan Notes to be distributed under the POR to unsecured creditors (other than convenience creditors) and the Asbestos PI Trust, in the form of:

  - Up to $300 million of Available Cash and

  - The balance in net cash proceeds from the secured term loan borrowings.

- 60% of the next $50 million of Available Cash but, if such Available Cash is less than $50 million, then 60% of the balance of the net cash proceeds from the secured term loan borrowings made in lieu of issuing the Plan Notes, and

- 34.43% of the remaining amount of any Available Cash, and the remaining net cash proceeds from the secured term loan borrowings made in lieu of issuing the Plan Notes.

Under the POR, the remaining amount of new common shares of reorganized Armstrong, Available Cash and net cash proceeds from the secured term loan borrowings, made in lieu of issuing the Plan Notes, were distributed to the Asbestos PI Trust. Pursuant to the POR, AWI also transferred rights arising under liability insurance policies issued to AWI with respect to asbestos-related personal injury claims to the

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Asbestos PI Trust. See Note 16 for additional information regarding the asbestos-related personal injury insurance proceedings.

Under the POR, unsecured creditors whose claims (other than claims on debt securities) are less than $10 thousand or who elect to reduce their claims to $10 thousand were treated as convenience creditors and will receive payment of 75% of their allowed claim amount in cash (which payments reduced the amount of Available Cash). Payments totaling $2.3 million to-date were made to the convenience creditors, commencing on October 2, 2006, with another $0.7 million expected to be paid in future periods.

Valuation of Consideration to be Distributed under the POR

During the third quarter of 2003, AWI and its financial advisors estimated the value of reorganized Armstrong to be between $2.4 billion and $3.0 billion, with the mid-point of this range used in the financial projections that were part of the Disclosure Statement. AWI is currently working with its financial advisors to determine what point within this range is appropriate to be the reorganization value as of October 2, 2006. This value will be used as the basis for AWI s fresh-start reporting, which will be reflected in the fourth quarter 2006 financial statements.

Based upon the distribution provisions for the POR described above, the Asbestos PI Trust and holders of allowed unsecured claims became entitled on the Effective Date to receive the following distributions:

	Value Distributed To		
(reported in millions)	Asbestos PI Trust	Unsecured Creditors	Total
Shares of reorganized Armstrong	37.0	19.4	56.4
Cash proceeds from borrowings	$ 508.2	$ 266.8	$ 775.0
Available Cash	230.3	140.4	370.7
Total of cash proceeds	$ 738.5	$ 407.2	$ 1,145.7
AWI book value of insurance	$ 91.5		

Distribution to the Asbestos PI Trust of the above-mentioned new common shares was made on October 2, 2006 and distribution to it of its share of Available Cash and net cash proceeds from the secured term loan borrowings was completed by October 17, 2006. The rights arising under liability insurance policies issued to AWI with respect to asbestos related personal injury claims were transferred to the Asbestos PI Trust on October 2, 2006. The initial distribution to holders of allowed unsecured claims, of their pro rata share of the above-mentioned new common shares, Available Cash and net cash proceeds from the secured term loan borrowings, commenced on October 17,2006. Substantially all of the total unsecured creditors value was distributed in October 2006, with some of the value reserved from distribution due to a few unsecured claims that remain unresolved. The remaining amount of distribution to the unsecured creditors will be made in future periods, as the disputed claims are resolved, in accordance with the dates and procedures established under the POR.

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Matters Concerning AHI

A final federal income tax return for AHI and AWI on a consolidated basis is expected to be filed for 2006 by September 2007. AHI and reorganized Armstrong will report substantial tax losses in this final tax return. The use of the tax losses and the extent to which they result in tax refunds will be affected in part by elections to be made in the final consolidated return by AHI as agent for the Armstrong consolidated group. Some elections would be more beneficial to one company than the other. AHI will receive a substantial tax refund of current year, and possibly prior year, tax payments, a portion of which AHI would pay over to reorganized Armstrong and the balance of which it would retain. The amount of the refund of prior year tax payments will depend in part on the elections made in the tax return. How much of the tax refunds will be retained by AHI may be the subject of dispute between AHI and reorganized Armstrong. Reorganized Armstrong expects to begin shortly negotiations with AHI concerning this matter.

Regardless of the election made in the final tax return for 2006 of the Armstrong consolidated group of companies and apart from any available tax refund, reorganized Armstrong will have a substantial tax loss carryforward as a result of its contributions to the Asbestos PI Trust on and after the Effective Date pursuant to the POR. The amount of the tax loss carryforward will, however, be affected by elections made in the final tax return of the consolidated group.

Common Shares and Debt Securities

AWI s new common shares began trading on the New York Stock Exchange on October 10 under the ticker symbol AWI . AHI s common shares continue to trade in the over-the-counter (OTC) Bulletin Board under the ticker symbol ACKHQ . AWI s pre-Filing debt securities that were trading in the OTC Bulletin Board under the ticker symbol AKKWQ ceased trading upon AWI s emergence from Chapter 11.

Bar Date for Filing Claims

The Bankruptcy Court established August 31, 2001 as the bar date for all claims against AWI except for asbestos-related personal injury claims and certain other specified claims. A bar date is the date by which claims against AWI must be filed if the claimants wish to participate in any distribution in the Chapter 11 Case. A bar date for asbestos-related personal injury claims (other than claims for contribution, indemnification, or subrogation) was rendered unnecessary under the terms of the POR, which defers the filings of such claims until the Asbestos PI Trust is established to administer such claims.

Approximately 4,900 proofs of claim (including late-filed claims) totaling approximately $6.4 billion, alleging a right to payment from AWI, were filed with the Bankruptcy Court in response to the August 31, 2001 bar date. In its ongoing review of the filed claims, AWI to date has objected to approximately 2,200 claims totaling $2.7 billion. The Bankruptcy Court disallowed these claims with prejudice.

During the first six months of 2003, AWI settled all of the approximately 460 remaining asbestos property damage claims that alleged damages of $800 million, for approximately $9 million. Payments to claimants were made during the third quarter of 2003 and were funded by insurance.

As of September 30, 2006, approximately 1,100 proofs of claim totaling approximately $1.3 billion were associated with asbestos-related personal injury litigation, including direct personal injury claims, claims by co-defendants for contribution and indemnification, and claims relating to AWI s participation in the Center for Claims Resolution. As stated above, the bar date of August 31, 2001 did not apply to asbestos-related personal injury claims other than claims for contribution, indemnification, or subrogation. Pursuant to the POR, all AWI asbestos-related personal injury claims, including claims for contribution, indemnification, or subrogation, will be channeled to, and resolved by, the Asbestos PI Trust. See the further discussion regarding AWI s liability for asbestos-related matters in Note 16.

Substantially all of the remaining approximately 1,100 claims, totaling approximately $1.6 billion, alleging a right to payment for financing, environmental, trade debt and other claims have been allowed by the

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Bankruptcy Court. For these categories of claims, AWI has previously recorded approximately $1.6 billion in liabilities. A few claims remain pending, and if allowed will be entitled only to the distributions provided for such claims in accordance with the POR.

As of September 30, 2006, AWI recorded liability amounts for claims that could be reasonably estimated and which it did not contest or believed were probable of being allowed by the Bankruptcy Court. The final value of all the claims that will ultimately be allowed by the Bankruptcy Court is not known at this time. It is possible that the value of the claims ultimately allowed by the Bankruptcy Court will be different than amounts presently recorded by AWI. However, any difference in the value of the claims ultimately allowed will not change the amount of consideration to be distributed by AWI, as described above, or impact reorganized Armstrong.

Financing

Through October 1, 2006, AWI had a $75.0 million debtor-in-possession (DIP) credit facility that was limited to issuances of letters of credit. This facility was cancelled as of October 2, 2006. As of October 2, 2006, AWI had available a $300 million revolving credit facility, that is scheduled to mature in 5 years. By October 16, 2006, AWI received commitments for, and the proceeds from, $800 million of secured term loan borrowings.

Accounting Impact

AICPA Statement of Position 90-7, Financial Reporting by Entities in Reorganization under the Bankruptcy Code (SOP 90-7) provides financial reporting guidance for entities that are reorganizing under the Bankruptcy Code. This guidance is implemented in the accompanying consolidated financial statements.

Pursuant to SOP 90-7, AWI was required to segregate pre-Filing liabilities that are subject to compromise and report them separately on the balance sheet. See Note 4 for detail of the liabilities subject to compromise at September 30, 2006 and December 31, 2005. Liabilities that may be affected by a plan of reorganization are recorded at the expected amount of the allowed claims, even if they may be settled for lesser amounts. Substantially all of AWI s pre-Filing debt, in default as of the Filing Date, was recorded at face value and was classified within liabilities subject to compromise. Obligations of AWI subsidiaries not covered by the Filing remain classified on the consolidated balance sheet based upon maturity date. AWI s estimated liability for asbestos-related personal injury claims was also recorded in liabilities subject to compromise. See Note 16 for further discussion of AWI s asbestos liability.

SOP 90-7 also requires separate reporting of all revenues, expenses, realized gains and losses, and provision for losses related to the Filing as Chapter 11 reorganization costs, net. Accordingly, AWI recorded the following Chapter 11 reorganization activities through September 2006 and 2005:

	Three Months Ended September 30		**Nine Months Ended September 30**	
	2006	**2005**	**2006**	**2005**
Professional fees	$ 10.0	$ 4.7	$ 25.9	$ 11.8
Interest income, post-Filing	(5.6)	(3.2)	(15.0)	(7.5)
Adjustments to pre-Filing liabilities				0.1
Other expense directly related to bankruptcy, net				0.1
Total Chapter 11 reorganization costs, net	$ 4.4	$ 1.5	$ 10.9	$ 4.5

Professional fees represent legal and financial advisory fees and expenses directly related to the Filing.

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Interest income was earned from short-term investments subsequent to the Filing.

Because the POR became effective on October 2, 2006, reorganized Armstrong s condensed consolidated financial statements will change materially in amounts and classifications through the implementation of the fresh-start reporting rules of SOP 90-7. This will be reflected in the financial statements reported in AWI s Form 10-K for the year 2006.

NOTE 3. SEGMENT RESULTS

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
Net sales to external customers	**2006**	**2005**	**2006**	**2005**
Resilient Flooring	$ 304.8	$ 311.5	$ 893.9	$ 914.0
Wood Flooring	217.2	220.2	645.0	624.9
Textiles and Sports Flooring	86.3	79.7	222.6	211.4
Building Products	304.5	268.2	859.8	784.5
Cabinets	60.8	57.4	174.4	161.9
Total sales to external customers	$ 973.6	$ 937.0	$ 2,795.7	$ 2,696.7

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
Segment operating income (loss)	**2006**	**2005**	**2006**	**2005**
Resilient Flooring	$ (2.9)	$ 7.7	$ 11.3	$ (5.8)
Wood Flooring	16.5	25.7	46.2	54.4
Textiles and Sports Flooring	4.2	3.2	(4.9)	(3.2)
Building Products	59.7	43.1	152.9	116.0
Cabinets	3.8	(0.3)	6.1	(9.5)
Unallocated Corporate (expense)	(13.9)	(12.9)	(23.5)	(41.7)
Total consolidated operating income	$ 67.4	$ 66.5	$ 188.1	$ 110.2

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	**2005**	**2006**	**2005**
Segment operating income	$ 67.4	$ 66.5	$ 188.1	$ 110.2
Interest expense	2.1	2.2	5.8	6.4
Other non-operating expense	0.4	1.1	1.0	1.4
Other non-operating income	(3.2)	(5.5)	(7.3)	(9.8)

Chapter 11 reorganization costs, net	4.4	1.5	10.9	4.5
Earnings before income taxes	$ 63.7	$ 67.2	$ 177.7	$ 107.7

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Segment assets	**September 30, 2006**	**December 31, 2005**
Resilient Flooring	$ 675.9	$ 675.9
Wood Flooring	720.8	646.4
Textiles and Sports Flooring	231.3	196.6
Building Products	702.9	613.2
Cabinets	106.4	99.1
Total segment assets	2,437.3	2,231.2
Assets not assigned to segments	2,283.5	2,374.8
Total consolidated assets	$ 4,720.8	$ 4,606.0

NOTE 4. LIABILITIES SUBJECT TO COMPROMISE

As a result of AWI s Chapter 11 filing (see Note 2), pursuant to SOP 90-7, AWI was required to segregate prepetition liabilities that were subject to compromise and report them separately on the balance sheet. Liabilities that may be affected by a plan of reorganization were recorded at the amount of the expected allowed claims, even if they may be settled for lesser amounts. Substantially all of AWI s prepetition debt, now in default, was recorded at face value and was classified within liabilities subject to compromise. Obligations of our subsidiaries that were not covered by the Filing remain classified on the condensed consolidated balance sheet based upon maturity date. AWI s asbestos liability was also recorded in liabilities subject to compromise. See Note 2 for further discussion on how the Chapter 11 process addressed AWI s liabilities subject to compromise and Note 16 for further discussion of AWI s asbestos liability.

Liabilities subject to compromise at September 30, 2006 and December 31, 2005 are as follows:

	September 30, 2006	**December 31, 2005**
Debt (at face value)(1)	$ 1,388.6	$ 1,388.6
Asbestos-related liability	3,190.6	3,190.6
Prepetition trade payables	58.1	58.1
Prepetition other payables and accrued interest	68.4	69.7
Amounts due to affiliates	4.7	4.7
ESOP loan guarantee	157.7	157.7
Total liabilities subject to compromise	$ 4,868.1	$ 4,869.4

(1) In accordance with SOP 90-7, we did not record contractual interest expense on prepetition debt after the Chapter 11 filing date. This unrecorded interest expense was $19.3 million and $57.6 million in the third quarter and first nine months of 2006, respectively, and $20.5 million and $63.6 million in the third quarter and first nine months of 2005, respectively.

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NOTE 5. ACQUISITIONS

On April 3, 2006, we purchased certain assets and assumed certain liabilities of HomerWood, Inc., a hardwood flooring company. On May 1, 2006 we purchased certain assets and assumed certain liabilities of Capella Engineered Wood, LLC, a hardwood flooring company, and of its parent company, Capella, Inc. The combined purchase price of these acquisitions was $61.5 million. Both acquisitions were financed from existing cash balances. Both investments will expand Armstrong s wood flooring product offerings. The acquisitions were accounted for under the purchase method of accounting in the second quarter of 2006. Preliminary allocation of the purchase price to the fair value of tangible and identifiable intangible assets acquired in each transaction has been completed. Adjustments may be recorded in future periods as the allocations are finalized.

NOTE 6. INVENTORIES

	September 30, 2006	December 31, 2005
Finished goods	$ 373.5	$ 339.1
Goods in process	53.7	44.6
Raw materials and supplies	188.0	194.4
Less LIFO and other reserves	(72.6)	(63.6)
Total inventories, net	$ 542.6	$ 514.5

NOTE 7. NATURAL GAS HEDGES

We purchase natural gas for use in the manufacture of ceiling tiles and other products and to heat many of our facilities. As a result, we are exposed to movements in the price of natural gas. We have a policy of reducing short term cost volatility by purchasing natural gas forward contracts, purchased call options, and zero-cash collars. These instruments are designated as cash flow hedges. The mark-to-market gain or loss on qualifying hedges is included in other comprehensive income to the extent effective, and reclassified into cost of goods sold in the period during which the underlying products are sold. The mark-to-market gains or losses on ineffective portions of hedges are recognized in cost of goods sold immediately. The fair value of these cash flow hedges at September 30, 2006 was a $3.8 million asset compared to an $18.7 million asset at December 31, 2005, primarily due to the price of natural gas decreasing during the year.

NOTE 8. EQUITY INVESTMENTS

Investments in affiliates of $95.0 million at September 30, 2006 reflected the equity interest in our 50% investment in the WAVE joint venture and our 50% investment in a China hardwood flooring joint venture. Both joint ventures are accounted for under the equity method of accounting. The balance increased $27.6 million from December 31, 2005 primarily due to our equity interest in WAVE s earnings. Condensed income statement data for WAVE is summarized below:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Net sales	$ 82.7	$ 77.6	$ 260.2	$ 230.0
Gross profit	29.8	24.9	95.1	70.9
Net earnings	28.3	19.9	83.0	56.4

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During the third quarter of 2006 an entrustment loan of $6.3 million was made to our China hardwood flooring joint venture to cover their short term working capital requirements. As of the end of the third quarter, no monies had been drawn by the joint venture.

NOTE 9. GOODWILL AND INTANGIBLE ASSETS

As of January 1, 2006, we had goodwill of $134.2 million. Goodwill is required to be tested for impairment at least annually. We perform our annual assessment in the fourth quarter.

The following table represents the change in goodwill for the first nine months of 2006.

Goodwill by segment	**January 1, 2006**	**Goodwill acquired**	**Adjustments, net(1)**	**Impairments**	**September 30, 2006**
Wood Flooring	$ 108.2	$ 8.0			$ 116.2
Building Products	13.4		$ 0.9		14.3
Cabinets	12.6				12.6
Total consolidated goodwill	$ 134.2	$ 8.0	$ 0.9		$ 143.1

(1) Consists of the effects of foreign exchange

We recognized $8.0 million of goodwill, $11.0 million of trademarks and $10.8 million of customer relationships during 2006 related to acquisitions. See Note 5 for further discussion of the acquisitions.

The following table details amounts related to our intangible assets as of September 30, 2006 and December 31, 2005.

	September 30, 2006		**December 31, 2005**	
	Gross Carrying Amount	**Accumulated Amortization**	**Gross Carrying Amount**	**Accumulated Amortization**
Amortized intangible assets				
Computer software	$ 67.2	$ 37.0	$ 102.1	$ 66.7
Customer relationships	10.8	0.3		
Land use rights and other	4.6	1.2	4.5	1.1
Total	$ 82.6	$ 38.5	$ 106.6	$ 67.8
Unamortized intangible assets				
Trademarks and brand names	$ 40.4		$ 29.3	
Other intangible assets, gross	$ 123.0		$ 135.9	
Aggregate Amortization Expense				
For the nine months ended September 30, 2006		$ 12.0		
For the nine months ended September 30, 2005		$ 12.8		

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NOTE 10. RESTRUCTURING AND OTHER ACTIONS

Net restructuring charges of $10.0 million and $17.0 million were recorded in the first nine months of 2006 and 2005, respectively. These charges are summarized in the following table:

	Net Charge/(Reversal)				
	Three Months Ended September 30,		Nine Months Ended September 30,		
Action Title	**2006**	**2005**	**2006**	**2005**	**Segment**
Lancaster Plant	$ (0.4)	$ 0.2	$ 9.6	$ 11.3	Resilient Flooring
Hoogezand		1.1	0.5	5.1	Building Products
U.K. Lease	(0.1)		(0.1)		Unallocated Corporate
North America SG&A				(0.1)	Resilient Flooring
Morristown		0.1		0.4	Cabinets
Searcy				0.1	Wood Flooring
Oss				0.2	Textiles & Sports Flooring
Total	$ (0.5)	$ 1.4	$ 10.0	$ 17.0	

Lancaster Plant: These charges related to the fourth quarter 2004 decision to cease commercial flooring production at Lancaster in 2006. Commercial flooring production requirements are being serviced in part by our other facilities around the world. Of the $9.6 million and $11.3 million charges in 2006 and 2005, $8.5 million and $10.5 million, respectively, are non-cash charges related to termination benefits to be paid through the U.S. pension plan. The other $1.1 million in 2006 and $0.8 million in 2005 are comprised of severance and related costs. The $0.4 million reversal in the third quarter related to certain severance accruals that were no longer necessary. We have incurred $26.9 million of severance and pension related restructuring charges to-date. We do not expect to incur any additional restructuring charges for severances and pension benefits in the remainder of 2006. Additionally, we recorded $0.3 million and $5.3 million of accelerated depreciation in 2006 and 2005, respectively, in cost of goods sold. We also recorded $9.3 million and $2.7 million of other related costs in 2006 and 2005, respectively, in cost of goods sold and $7.4 million in SG&A in 2006. We expect to incur approximately $0.2 million of other related costs in cost of good sold in the remainder of 2006. Further, we realized a gain of $14.3 million in SG&A in the second quarter of 2006 from the sale of a warehouse which became available as a result of this initiative.

Hoogezand: These charges are related to the first quarter 2004 decision to close the manufacturing facility and are comprised of severance and related costs. Closure of the plant was completed in the first quarter of 2005. The production was transferred to another Building Products location in Münster, Germany and resulted in a net reduction of approximately 72 positions. We have incurred restructuring charges of $17.7 million to-date, and expect to incur an additional $0.5 million in the remainder of 2006 and in 2007. Additionally, we recorded $0.5 million of accelerated depreciation in cost of goods sold in the first nine months of 2005, and $0.1 million and $0.6 million of other related costs in cost of goods sold in the first nine months of 2006 and 2005, respectively.

U.K. Lease: In 1996, we recorded a restructuring charge to reflect future rent associated with the vacated portion of a leased building. The lease extends through 2017. In the third quarter of 2006, we signed a new sublease agreement for a portion of the unused space and, accordingly, recorded a reduction of $0.1 million in our reserve to reflect the future expected sublease income.

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North America SG&A: The net reversal of $0.1 million in 2005 comprised certain severance accruals that were no longer necessary in the remaining accruals recorded in 2004 for severance and related costs due to a restructuring of the sales force and management structure in North America in response to changing market conditions. This initiative was announced in the fourth quarter of 2004 and was completed in the second quarter of 2005. We incurred project-to-date restructuring charges of $5.2 million and do not expect to incur any additional charges.

Morristown: The charge related to the fourth quarter 2004 decision to close a plant in Tennessee in the first quarter of 2005. Manufacturing was consolidated at two existing plants in the United States. We incurred project-to-date restructuring charges of $0.4 million of severance related charges and $0.4 million of related shutdown costs and do not expect to incur additional costs. Additionally, we recorded $0.1 million of accelerated depreciation and $0.8 million of other related costs in 2005, both in cost of goods sold.

Searcy: The charge related to the fourth quarter 2004 decision to cease production at a solid hardwood flooring location in Arkansas in the first quarter of 2005 and was comprised of estimated severance benefits and related costs. We continue to manufacture solid wood flooring at other plants across the United States. We incurred $0.9 million of restructuring charges for the project-to-date and do not expect to incur any additional charges. Additionally, in the second quarter of 2006, we recorded an asset impairment charge of $0.7 million in cost of goods sold related to property, plant and equipment at this site.

Oss: The charge was recorded to reflect shutdown costs related to a plant closure in The Netherlands. The related severance charges were recorded during the third quarter of 2003 when the plant closure was announced. We continue to manufacture carpet at other plants across Europe. We incurred $4.9 million of restructuring charges to-date and do not expect to incur any additional costs in the future.

The following table summarizes activity in the restructuring accruals for the first nine months of 2006 and 2005.

	Beginning Balance	Cash Payments	Net Charges	Other	Ending Balance
2006	$ 8.8	$ (3.0)	$ 1.5	$ 0.5	$ 7.8
2005	24.8	(22.0)	6.5	(1.0)	8.3

The amount in other for 2006 and 2005 is related to the effects of foreign currency translation.

Of the September 30, 2006 and 2005 ending balances, $1.3 million is reported in liabilities subject to compromise.

Substantially all of the remaining balance of the restructuring accrual as of September 30, 2006 relates to the noncancelable U.K. operating lease, which extends through 2017, and severance for terminated employees with extended payouts, the majority of which will be paid in 2006.

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NOTE 11. INCOME TAX EXPENSE

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
Earnings from continuing operations before income taxes	$ 63.7	$ 67.2	$ 177.7	$ 107.7
Income tax expense	24.5	21.1	70.3	47.5
Effective tax rate	38.5%	31.4%	39.6%	44.1%

The primary factor for the increase in the third quarter effective tax rate was an increase in non-deductible bankruptcy reorganization fees, partially offset by the finalization of tax benefits related to the 2005 subsidiary capital restructuring. The primary reduction in the nine month effective tax rate resulted from lower unbenefited foreign losses during 2006 compared to 2005. The 2005 third quarter and nine month tax rates were favorably impacted by the conclusion of IRS audit and appeals issues and the impact of American Jobs Creation Act dividends from foreign affiliates.

NOTE 12. PENSIONS

Following are the components of net periodic benefit costs:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2006	2005	2006	2005
U.S. defined-benefit plans				
Pension Benefits				
Service cost of benefits earned	$ 4.5	$ 6.2	$ 13.6	$ 18.5
Interest cost on projected benefit obligation	23.1	24.0	69.4	71.9
Expected return on plan assets	(40.5)	(39.4)	(121.5)	(118.4)
Amortization of prior service cost	2.3	4.1	6.7	12.4
Recognized net actuarial loss	0.4	0.3	1.3	1.1
Net periodic pension (credit)	$ (10.2)	$ (4.8)	$ (30.5)	$ (14.5)
Retiree Health and Life Insurance Benefits				
Service cost of benefits earned	$ 0.6	$ 0.7	$ 1.8	$ 2.1
Interest cost on projected benefit obligation	5.0	5.2	14.9	15.5
Amortization of prior service benefit	(1.6)	(1.4)	(4.8)	(4.2)
Recognized net actuarial loss	3.2	2.9	9.4	8.9
Net periodic postretirement benefit cost	$ 7.2	$ 7.4	$ 21.3	$ 22.3

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Non-U.S. defined-benefit plans				
Pension Benefits				
Service cost of benefits earned	$ 1.9	$ 2.4	$ 7.2	$ 7.6
Interest cost on projected benefit obligation	4.4	5.3	14.7	16.5
Expected return on plan assets	(3.0)	(3.8)	(10.6)	(11.9)
Amortization of transition obligation			(0.1)	(0.1)
Amortization of prior service cost	0.1	0.1	0.5	0.2
Recognized net actuarial loss	0.8	0.4	2.2	1.4
Net periodic pension cost	$ 4.2	$ 4.4	$ 13.9	$ 13.7

In addition, we recorded a separate charge in the second quarter of 2006 of $8.5 million for a non-cash curtailment and settlement loss related to the transfer of a non-U.S. defined benefit plan to a multiemployer industry plan.

We previously disclosed in our financial statements for the year ended December 31, 2005 that we expected to contribute $23.9 million to our non-U.S. defined benefit pension plans in 2006. As of September 30, 2006, $32.2 million of contributions have been made. We presently anticipate contributing an additional $4.4 million to fund our non-U.S. pension plans in 2006 for a total of $36.6 million.

NOTE 13. PRODUCT WARRANTIES

We provide direct customer and end-user warranties for our products. These warranties cover manufacturing defects that would prevent the product from performing in line with its intended and marketed use. Generally, the terms of these warranties range up to 25 years and provide for the repair or replacement of the defective product. We collect and analyze warranty claims data with a focus on the historic amount of claims, the products involved, the amount of time between the warranty claims and their respective sales and the amount of current sales. The increase in the current year warranty accruals in 2006 compared to 2005 related primarily to a revision of certain assumptions used in prior periods when estimating the accrual for the Wood Flooring segment. The following table summarizes the activity for the accrual of product warranties for the first nine months of 2006 and 2005:

	2006	2005
Balance at January 1	$ 21.1	$ 22.6
Reductions for payments	(25.6)	(28.5)
Current year warranty accruals	30.5	29.7
Preexisting warranty accrual changes		(0.2)
Acquisitions	0.6	
Effects of foreign exchange translation	0.5	(1.0)
Balance at September 30	$ 27.1	$ 22.6

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NOTE 14. SHARE-BASED COMPENSATION PLANS

On January 1, 2006, we adopted FASB Statement No. 123 (revised 2004), Share-Based Payment (FAS 123R), which requires all share-based payment transactions to be recognized in the financial statements using a fair-value method of accounting. This statement replaced FASB Statement No. 123 and superseded APB Opinion No. 25. Prior to January 1, 2006, we used APB Opinion No. 25 s intrinsic value method for stock-based employee compensation.

We used the modified prospective method of adopting FAS 123R, which does not require restatement of prior periods. There was no impact of adoption of the new standard because all of our outstanding stock options are fully vested.

Awards under the 1993 Long-Term Stock Incentive Plan (1993 Plan) were made in the form of stock options, stock appreciation rights in conjunction with stock options, performance restricted shares and restricted stock awards. No additional awards may be issued under the 1993 Plan.

During 1999, we adopted the 1999 Long-Term Incentive Plan (1999 Plan) which replaced the 1993 Plan. Pre-1999 grants made under predecessor plans will be governed under the provisions of those plans. The 1999 Plan provides for the granting of incentive stock options, nonqualified stock options, stock appreciation rights, performance-restricted shares and restricted stock awards. The 1999 Plan also incorporates stock awards and cash incentive awards. No more than 3,250,000 shares of common stock were to be issued under the 1999 Plan, and no more than 300,000 of the shares were to be awarded in the form of performance restricted shares, restricted stock awards or stock awards.

During 2000, we adopted the Stock Award Plan (2000 Plan) to enable stock awards and restricted stock awards to officers, key employees and non-employee directors. No more than 750,000 treasury shares were to be awarded under the 2000 Plan.

All three of the plans discussed above were terminated upon AWI emerging from Chapter 11 on October 2, 2006. No equity based compensation has been granted since AWI filed for relief under Chapter 11 in December 2000 through September 30, 2006, other than commitments entered into prior to the Chapter 11 filing.

Options were granted to purchase shares at prices not less than the closing market price of the shares on the dates the options were granted. The options generally became exercisable in one to three years and expired 10 years from the date of grant. As of September 30, 2006, there were no stock options granted since 2001.

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Changes in AHI option shares outstanding (thousands except for share price and life)	**AHI Option Shares**	**Weighted-average exercise price**	**Weighted-average remaining contractual life (in years)**
Option shares outstanding at January 1, 2006	1,987.3	$ 27.97	
Options granted			
Option shares exercised			
Options cancelled	(213.6)	55.37	
Option shares outstanding at September 30, 2006	1,773.7	$ 24.67	3.26
Option shares exercisable at September 30, 2006	1,773.7	$ 24.67	3.26
Shares available for grant	5,029.0		

The intrinsic value of the AHI option shares outstanding and exercisable at September 30, 2006 was $0, as the exercise price of all AHI options exceeded the market price of the stock on that date.

Restricted stock awards were used for the purposes of recruitment, special recognition and retention of key employees. As of September 30, 2006, no award of restricted stock shares had been granted since 2000. As of September 30, 2006, there were 111,463 restricted shares of AHI common stock outstanding with 596 accumulated dividend equivalent shares.

On October 2, 2006, following the issuance by AWI of Common Shares to the Asbestos PI Trust in furtherance of the POR, the trust as the then sole shareholder of AWI acted by written consent to approve AWI s 2006 Long-Term Incentive Plan.

NOTE 15. SUPPLEMENTAL CASH FLOW INFORMATION

	Nine Months Ended September 30, 2006	**2005**
Interest paid	$ 0.7	$ 1.5
Income taxes paid, net	$ 56.6	$ 41.1

NOTE 16. LITIGATION AND RELATED MATTERS

ASBESTOS-RELATED LITIGATION

(Note: Particular documents referred to in this section are available at www.armstrongplan.com)

On October 2, 2006 (the Effective Date), AWI s plan of reorganization, which was confirmed by order dated August 18, 2006, became effective, and AWI emerged from Chapter 11. The following summarizes the asbestos-related litigation matters during the Chapter 11 Case and as of September 30, 2006, and how they were impacted by AWI s emergence.

Prior to December 6, 2000, AWI, the major operating subsidiary of AHI, had been named as a defendant in personal injury cases and property damage cases related to asbestos-containing products. On December 6, 2000, AWI filed a voluntary petition for relief (the Filing) under Chapter 11 of the U.S. Bankruptcy Code to use the court-supervised reorganization process to achieve a resolution of AWI s asbestos-related liability.

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Two of AWI s domestic subsidiaries also commenced Chapter 11 proceedings at the time of the Filing. AHI and all of AWI s other direct and indirect subsidiaries and affiliates, including Armstrong Wood Products Inc. (formerly Triangle Pacific Corp.), WAVE (Armstrong s ceiling grid systems joint venture with Worthington Industries, Inc.), Armstrong Canada and Armstrong DLW AG were not a part of the Filing and accordingly the liabilities, including asbestos-related liability if any, of such companies arising out of their own activities were not resolved in AWI s Chapter 11 Case except for any asbestos-related liability that also relates, directly or indirectly, to the pre-Filing activities of AWI.

Asbestos-Related Personal Injury Claims

Prior to the Filing, AWI was a member of the Center for Claims Resolution (the CCR), which handled the defense and settlement of asbestos-related personal injury claims on behalf of its members. The CCR pursued broad-based settlements of asbestos-related personal injury claims under the Strategic Settlement Program (SSP) and had reached agreements with law firms that covered approximately 130,000 claims that named AWI as a defendant.

Due to the Filing, holders of asbestos-related personal injury claims were stayed from continuing to prosecute pending litigation and from commencing new lawsuits against AWI. In addition, AWI ceased making payments to the CCR with respect to asbestos-related personal injury claims, including payments pursuant to the outstanding SSP agreements. A creditors committee representing the interests of asbestos-related personal injury claimants and an individual representing the interests of future claimants was appointed in the Chapter 11 Case. Upon AWI s emergence on October 2, 2006, the Asbestos Personal Injury Claimants Committee was disbanded. The Future Claimants Representative will continue to serve, but as of October 2, 2006 his expenses will be borne by the Asbestos Personal Injury Trust. See Note 2 regarding AWI s Chapter 11 proceeding and its emergence from Chapter 11.

During 2003, AWI and the other parties in its Chapter 11 Case reached agreement on a plan of reorganization that addresses how all of AWI s pre-Filing liabilities are to be settled. Several amendments to the plan of reorganization were filed, culminating in the Fourth Amended Plan of Reorganization filed with the Bankruptcy Court on May 23, 2003, which was modified by modifications filed with the Bankruptcy Court on October 17, 2003, November 10, 2003, December 3, 2004, and February 21, 2006, and which was confirmed by the U.S. District Court for the District of Delaware (the Court) on August 18, 2006. Such plan, as modified on May 23, 2003 and as from time to time modified through February 21, 2006 and then confirmed, is referred to in this report as the POR . See Note 2 for discussion on the Chapter 11 proceedings that led to AWI s emergence from Chapter 11 on October 2, 2006.

A description of the components of the POR effecting AWI s asbestos-related liability follows.

Asbestos PI Trust

Upon AWI s Plan of Reorganization becoming effective on October 2, 2006, the Asbestos PI Trust was created, pursuant to section 524(g) of the Bankruptcy Code, for the purpose of addressing and resolving AWI s personal injury (including wrongful death) asbestos-related liability. As of October 2, 2006, all present and future asbestos-related personal injury claims against AWI, including contribution claims of co-defendants, arising directly or indirectly out of AWI s pre-Filing use of or other activities involving asbestos are channeled to the Asbestos PI Trust.

As part of the POR, in accordance with an 524(g) injunction issued under Section 524(g) and entered in connection with the POR, various entities are protected from such present and future asbestos-related personal injury claims. These entities include, among others, reorganized Armstrong, AHI, AWI s subsidiaries and other affiliates (as defined in the POR), and their respective officers and directors. Now that it has emerged from Chapter 11, AWI does not have any responsibility for these claims (including claims against AWI based solely on its ownership of a subsidiary or other affiliate), nor does it participate in their resolution.

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However, although AWI s domestic and foreign subsidiaries and other affiliates have certain protection afforded by the 524(g) injunction, asbestos-related personal injury claims against them will be channeled to the Asbestos PI Trust only to the extent such claims directly or indirectly relate to the manufacturing, installation, distribution or other activities of AWI or are based solely on AWI s ownership of the subsidiaries or other affiliates (as distinguished from independent activities of the subsidiaries or affiliates). Currently, two asbestos-related personal injury litigations against subsidiaries of AWI allegedly arising out of such independent activities are pending. These claims will not be channeled to the Asbestos PI Trust under the POR inasmuch as they do not involve activities of AWI. The subsidiaries deny liability and are aggressively defending the matters. AWI has not recorded any liability for these matters. Management does not expect that any sum that may have to be paid in connection with these matters will be material to Armstrong.

In addition, workers compensation claims brought against AWI or its subsidiaries or other affiliates will not be channeled to the Asbestos PI Trust and will remain subject to the workers compensation process. Historically, workers compensation claims against AWI and its subsidiaries have not been significant in number or amount and AWI honored its obligations with respect to such claims during the Chapter 11 Case. Workers compensation law provides that the employer is responsible for evaluation, medical treatment and lost wages as a result of a job-related injury. Currently, AWI has four pending workers compensation claims, and a UK subsidiary has seven employer liability claims involving alleged asbestos exposure.

There also is uncertainty as to proceedings, if any, brought in certain foreign jurisdictions with respect to the effect of the 524(g) injunction in precluding the assertion in such jurisdictions of asbestos-related personal injury claims, proceedings related thereto or the enforcement of judgments rendered in such proceedings.

Management believes that neither AWI nor any of its subsidiaries or other affiliates is subject to any asbestos-related personal injury claims that will not be channeled to the Asbestos PI Trust under the POR and that are of a magnitude that, individually or collectively, would be material in amount to reorganized Armstrong.

Asbestos-Related Liability

Based upon events through early March 2003, specifically the parties agreement on the basic terms of the POR s treatment of AWI s asbestos-related liabilities under a plan of reorganization, management concluded that it could reasonably estimate its probable liability for AWI s current and future asbestos-related personal injury claims. Accordingly, in the fourth quarter of 2002, AWI recorded a $2.5 billion charge to increase the balance sheet liability. The recorded asbestos-related liability for personal injury claims of approximately $3.2 billion at September 30, 2006 and December 31, 2005, which was treated as subject to compromise, represents the estimated amount of liability that is implied based upon the negotiated resolution reflected in the POR, the total consideration expected to be paid to the Asbestos PI Trust pursuant to the POR and an assumption for this purpose that the recovery value percentage for the allowed claims of the Asbestos PI Trust is equal to the estimated recovery value percentage for the allowed non-asbestos unsecured claims.

As of October 2, 2006, when the POR became effective, all present and future asbestos-related personal injury claims against AWI, including contribution claims of co-defendants, arising directly or indirectly out of AWI s pre-Filing use of or other activities involving asbestos are channeled to the Asbestos PI Trust. AWI does not have any responsibility for these claims (including claims against AWI based solely on its ownership of a subsidiary or other affiliate), nor will it participate in their resolution. Accordingly, in the financial statements reported in AWI s Form 10-K for the year 2006, AWI will reflect the resolution of this liability.

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Insurance Recovery Proceedings

As of September 30, 2006, a substantial portion of AWI s primary and remaining excess insurance asset is non-products (general liability) insurance for personal injury claims. AWI had entered into settlements with a number of the carriers resolving its coverage issues. However, an alternative dispute resolution (ADR) procedure was commenced against certain carriers to determine the percentage of resolved and unresolved claims that are non-products claims, to establish the entitlement to such coverage and to determine whether and how much reinstatement of prematurely exhausted products hazard insurance is warranted. The non-products coverage potentially available is substantial and includes defense costs in addition to limits.

During 1999, AWI received preliminary decisions in the initial phases of the trial proceeding of the ADR, which were generally favorable to AWI on a number of issues related to insurance coverage. However, during the first quarter of 2001, a new trial judge was selected for the ADR. The new trial judge conducted hearings in 2001 and determined not to rehear matters decided by the previous judge. In the first quarter of 2002, the trial judge concluded the ADR trial proceeding with findings in favor of AWI on substantially all key issues. Liberty Mutual, the only insurer that is still a party to the ADR, appealed that final judgment. Appellate argument was held on March 11, 2003. On July 30, 2003, the appellate arbitrators ruled that AWI s claims against certain Liberty Mutual policies were barred by the statute of limitations. The ruling did not address the merits of any of the other issues Liberty Mutual raised in its appeal. Based on that unfavorable ruling, AWI concluded that insurance assets of $73 million were no longer probable of recovery. AWI was also ordered to reimburse Liberty Mutual for certain costs and administration fees that Liberty Mutual incurred during the ADR. The $1.6 million claimed for these costs and fees is in dispute. Based upon an AWI request, the appellate panel held a rehearing on November 21, 2003. In January 2004, the appellate panel upheld its initial ruling. On February 4, 2004, AWI filed a motion in the U.S. District Court for the Eastern District of Pennsylvania to vacate the rulings of the appellate panel.

In July 2002, AWI filed a lawsuit against Liberty Mutual in the U.S. District Court for the Eastern District of Pennsylvania seeking, among other things, a declaratory judgment with respect to certain policy issues not subject to binding ADR. In October 2006, Liberty Mutual filed counterclaims and a jury demand requesting declaratory judgment in its favor. The U.S. District Court has not yet set a schedule to hear this matter.

On June 13, 2003, the New Hampshire Insurance Department placed The Home Insurance Company (Home) under an order of liquidation. Less than $10 million of AWI s recorded insurance asset is based on policies with Home, which management believes is probable of recovery. AWI filed a proof of claim against Home during June 2004.

The issue of shared coverage with ACandS (the former AWI insulation contracting subsidiary that was sold in August 1969 and which filed for relief under Chapter 11 of the Bankruptcy Code in September 2002) was resolved through a court-approved settlement among AWI, ACandS and the insurer, andAWI received net proceeds of $7 million during the third quarter of 2006. As part of the settlement, ACandS s remaining limits for shared coverage was assigned to AWI.

On October 2, 2006, pursuant to the POR becoming effective, AWI transferred rights arising under liability insurance policies issued to AWI with respect to asbestos-related personal injury claims to the Asbestos PI Trust. As of October 2, 2006, resolution of the ADR and other asbestos-related personal injury insurance matters is the responsibility, and at the expense, of the Asbestos PI Trust.

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Insurance Asset

An insurance asset in respect of asbestos claims in the amount of $91.5 million was recorded as of September 30, 2006 and $98.6 million as of December 31, 2005. The total amount recorded these periods reflected AWI s belief that insurance proceeds will be recovered in this amount, based upon AWI s success in insurance recoveries, settlement agreements that provide such coverage, the non-products recoveries by other companies and the opinion of outside counsel. Such insurance, in our opinion, is either available through settlement or probable of recovery through negotiation or litigation. Approximately $79 million of the asset was determined from agreed coverage in place.

In the financial statements reported in AWI s Form 10-K for the year 2006, AWI will reflect the transfer, as of October 2, 2006, of rights arising under liability insurance policies issued to AWI with respect to asbestos-related personal injury claims to the Asbestos PI Trust.

Cash Flow Impact

As a result of the Chapter 11 Filing, AWI did not make any payments for asbestos-related personal injury claims since the fourth quarter of 2000 through October 1, 2006. AWI did not receive any asbestos-related insurance recoveries during 2005 or during the first six months of 2006, but did receive $7 million in the third quarter of 2006 from the court-approved settlement with ACandS and the insurer, described above.

As of October 2, 2006, upon the POR becoming effective, all present and future asbestos-related personal injury claims against AWI, including contribution claims of co-defendants, arising directly or indirectly out of AWI s pre-Filing use of or other activities involving asbestos, are channeled to the Asbestos PI Trust. Pursuant to the POR, the Asbestos PI Trust received its share of reorganized Armstrong s new common shares, Available Cash, and net cash proceeds from the secured term loan borrowings. Pursuant to the POR, on October 2, 2006, AWI also transferred rights arising under liability insurance policies issued to AWI with respect to asbestos-related personal injury claims to the Asbestos PI Trust. Now that it has emerged from Chapter 11, AWI does not have any responsibility for these claims (including claims against AWI based solely on its ownership of a subsidiary or other affiliate), nor does it participate in their resolution. Following its distribution of consideration, described above, to the Asbestos PI Trust, AWI does not expect any future cash flow impact from asbestos-related personal injury claims against AWI.

ENVIRONMENTAL MATTERS

Environmental Expenditures

Most of our manufacturing and certain of our research facilities are affected by various federal, state and local environmental requirements relating to the discharge of materials or the protection of the environment. We make expenditures necessary for compliance with applicable environmental requirements at our operating facilities.

As a result of continuous changes in regulatory requirements, we cannot predict with certainty future expenditures associated with compliance with environmental requirements. The United States Environmental Protection Agency (EPA) has promulgated a new regulation pursuant to the Clean Air Act that may impact our domestic manufacturing operations. That regulation, The National Emission Standards for Hazardous Air Pollutants for Industrial, Commercial, and Institutional Boilers and Process Heaters Act, became effective in November, 2004, and requires compliance by September 13, 2007. While we are finalizing our review of this regulation, adoption of this regulation is not expected to have a material impact on our consolidated results of operations or financial condition.

Environmental Remediation

Summary

We are actively involved in proceedings under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), and similar state Superfund laws at 30 sites. We have also

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been remediating environmental contamination resulting from past industrial activity at certain of our former plant sites. In most cases, we are one of many potentially responsible parties (PRPs) which have potential liability for the required investigation and remediation of each site. In some cases, we have agreed to jointly fund that required investigation and remediation, while at some sites, we dispute the liability, the proposed remedy or the proposed cost allocation among the PRPs. We may also have rights of contribution or reimbursement from other parties or coverage under applicable insurance policies.

Estimates of our future environmental liability at the Superfund sites and current or former plant sites are based on evaluations of currently available facts regarding each individual site and consider factors such as our activities in conjunction with the site, existing technology, presently enacted laws and regulations and prior company experience in remediating contaminated sites. Although current law imposes joint and several liability on all parties at Superfund sites, our contribution to the remediation of these sites is expected to be limited by the number of other companies also identified as potentially liable for site remediation. As a result, our estimated liability reflects only our expected share. In determining the probability of contribution, we consider the solvency of the parties, whether liability is being disputed, the terms of any existing agreements and experience with similar matters, and the impact of AWI s emergence from Chapter 11 upon the validity of the claim.

Effects of Chapter 11

Upon AWI s emergence from Chapter 11 on October 2, 2006, AWI s environmental liabilities with respect to properties that AWI does not own or operate (such as formerly owned sites, or landfills to which AWI s waste was taken) were discharged. Claims brought by a federal or state agency alleging that AWI should reimburse the claimant for money that it spent cleaning up a site which AWI does not own or operate, and claims by private parties, such as other PRPs with respect to sites with multiple PRPs, were discharged upon emergence. Now that it has emerged from Chapter 11, AWI does not have any responsibility for these claims.

Those environmental obligations that we have with respect to AWI s subsidiaries, as well as those environmental claims AWI has with respect to property that it currently owns or operates, have not been discharged. Therefore, we will be required to continue meeting our on-going environmental compliance obligations at those sites.

In addition to the right to sue for reimbursement of the money it spends, however, CERCLA also gives the federal government the right to sue for an injunction compelling a defendant to perform a cleanup. Several state statutes give similar injunctive rights to those States. While we believe such rights against AWI were also discharged upon AWI s emergence from Chapter 11, there does not appear to be controlling judicial precedent in that regard. Thus, according to some cases, while a governmental agency s right to require AWI to reimburse it for the costs of cleaning up a site may be dischargeable, the same government agency s right to compel us to spend our money cleaning up the same site may not be discharged even though the financial impact to AWI would be the same in both instances.

Specific Events

Upon emergence, AWI resolved its environmental liabilities at 21 active sites through its Chapter 11 Case. The liabilities at sixteen of these active sites have been resolved through the global environmental settlement (Global Settlement) with the Department of Justice (DOJ) and the EPA with respect to CERCLA liability. The Global Settlement also resolved AWI s liability at 21 additional sites. The Global Settlement, which was approved by the Bankruptcy Court in October 2005, provided EPA an approved proof of claim in the amount of $8.7 million, which included $7.8 million with respect to the Peterson Puritan site. At one CERCLA site, however, AWI will continue to participate in the cleanup under a previously approved Consent Decree. In addition to the federal claims resolved by the Global Settlement, AWI s emergence from Chapter 11 also resolved its environmental liabilities with respect to claims asserted by the State and/or private parties at 5 other sites.

Armstrong World Industries, Inc., and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

(dollar amounts in millions)

AWI is subject to a unilateral order by the Oregon Department of Environmental Quality (DEQ) to conduct a remedial investigation and feasibility study and any necessary remedial design and action at its St. Helens, Oregon facility, as well as the adjacent Scappoose Bay. AWI has denied liability for Scappoose Bay, but has cooperated with the DEQ regarding its owned property. Other potentially responsible parties who are not yet subject to orders by the DEQ include former site owners Owens Corning (OC) and Kaiser Gypsum Company, Inc. (Kaiser). AWI has entered into an agreement with Kaiser for the sharing of costs and responsibilities with respect to the remedial investigation, feasibility study and remedy selection at the site. OC has entered into a settlement with the DEQ, pursuant to which, OC has made a lump sum payment to the DEQ in exchange for contribution protection (including protection against common law and statutory contribution claims by AWI against OC), and a covenant not to sue. AWI has reached an agreement with the DEQ as to how these funds will be made available to reimburse AWI and Kaiser for a portion of their shared costs of investigation and remediation of the site. AWI has recorded an environmental liability with respect to the investigation and feasibility study at its St. Helen s facility, but not for Scappoose Bay because AWI continues to dispute responsibility for contamination of Scappoose Bay.

A foreign subsidiary of AWI sold a manufacturing facility in 1990, which was prior to AWI s acquisition of the subsidiary. Under the terms of the sales agreement, an environmental indemnification was provided to the buyer of the facility. During the third quarter of 2005, the facility owner discovered additional areas of soil contamination that require additional remediation. Accordingly, a $3.1 million charge was recorded within SG&A expense to increase our probable liability. As additional sampling efforts and meetings with local government authorities continue, further increases to our recorded liability are possible.

Summary of Financial Position

Liabilities of $25.6 million and $27.3 million at September 30, 2006 and December 31, 2005, respectively were for potential environmental liabilities that we consider probable and for which a reasonable estimate of the probable liability could be made. Where existing data is sufficient to estimate the liability, that estimate has been used; where only a range of probable liabilities is available and no amount within that range is more likely than any other, the lower end of the range has been used. As assessments and remediation activities progress at each site, these liabilities are reviewed to reflect additional information as it becomes available. Due to the Chapter 11 Filing, $19.5 million of the September 30, 2006 and $19.4 million of the December 31, 2005 environmental liabilities are classified as prepetition liabilities subject to compromise. As a general rule, the Chapter 11 process does not preserve company assets for such prepetition liabilities.

The estimated liabilities above do not take into account any claims for recoveries from insurance or third parties. Such recoveries, where probable, have been recorded as an asset in the consolidated financial statements and are either available through settlement or anticipated to be recovered through negotiation or litigation. The amount of the recorded asset for estimated recoveries was $2.3 million at September 30, 2006 and December 31, 2005.

Actual costs to be incurred at identified sites may vary from our estimates. Based on our current knowledge of the identified sites, we believe that any sum we may have to pay in connection with environmental matters in excess of the amounts noted above would not have a material adverse effect on our financial condition, or liquidity, although the recording of future costs may be material to earnings in such future period.

PATENT INFRINGEMENT CLAIMS

We are a defendant in two lawsuits claiming patent infringement related to some of our laminate flooring products. The plaintiffs have claimed unspecified monetary damages. We are being defended and indemnified by our supplier for costs and potential damages related to the litigation.

Armstrong World Industries, Inc., and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

(dollar amounts in millions)

During the first quarter of 2006, a favorable settlement of a patent infringement case totaling $8.6 million was recorded within SG&A. This case, in which we were the plaintiff, related to a previously divested business. We received the proceeds in the second quarter of 2006.

OTHER CLAIMS

Additionally, we are involved in various other claims and legal actions involving product liability, patent infringement, breach of contract, distributor termination, employment law issues and other actions arising in the ordinary course of business. While complete assurance cannot be given to the outcome of these claims, we do not expect that any sum that may have to be paid in connection with these matters will have a materially adverse effect on our consolidated financial position or liquidity, however it could be material to the results of operations in the particular period in which a matter is resolved.

NOTE 17. SUBSEQUENT EVENTS

On October 2, 2006, AWI s court-approved Plan of Reorganization became effective, and AWI emerged from Chapter 11. See Notes 2 and 16 for further discussion of AWI s emergence.

For the past several years, we have maintained an agreement with the lending institution of one of our flooring distributors. Under this agreement, if the distributor was to default on its obligations and the lender foreclosed on the assets, the bank could return a large portion of our products still at the distributor (subject to certain quality and roll size minimums) for a refund of original cost. In October 2006, the lending institution of the distributor notified Armstrong that the distributor had defaulted on its obligations. As of October 17, 2006, the amount of inventory held at the distributor was approximately $3 million. We are working with the distributor and its lending institution to determine the actual amount of inventory to be repurchased subject to the agreement.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders

Armstrong World Industries, Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Armstrong World Industries, Inc., and subsidiaries (the Company) as of September 30, 2006, the related condensed consolidated statements of earnings for the three and nine-month periods ended September 30, 2006 and 2005, and the related condensed consolidated statements of cash flows and shareholder s equity for the nine-month periods ended September 30, 2006 and 2005. These condensed consolidated financial statements are the responsibility of the Company s management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Armstrong World Industries, Inc., and subsidiaries as of December 31, 2005, and the related consolidated statements of earnings, cash flows and shareholder s equity for the year then ended (not presented herein); and in our report dated February 23, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2005, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Philadelphia, Pennsylvania

October 30, 2006

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Armstrong World Industries, Inc. (AWI) is a Pennsylvania corporation incorporated in 1891. Armstrong Holdings, Inc. (AHI) is a Pennsylvania corporation and, as of September 30, 2006, was the publicly held parent holding company of AWI. Armstrong Holdings, Inc. s only operation was its indirect ownership, through Armstrong Worldwide, Inc. (a Delaware corporation), of all of the capital stock of AWI. Upon AWI s Plan of Reorganization (the POR) becoming effective on October 2, 2006, all then-current shares of AWI were cancelled and AHI no longer has any ownership interest in AWI. We include separate financial statements for Armstrong Holdings, Inc. and its subsidiaries and AWI and its subsidiaries in this report because, as of September 30, 2006, both companies had public securities that were registered under the Securities Exchange Act of 1934. The differences between the financial statements of Armstrong Holdings, Inc. and its subsidiaries and AWI and its subsidiaries included in this report are primarily due to transactions that occurred in 2000 related to the formation of Armstrong Holdings, Inc. and to employee compensation-related stock activity. When we refer to we , our and us in this report, we are referring to AHI and AWI through October 1, 2006 and reorganized Armstrong as it was reorganized under the POR thereafter. References in this report to reorganized Armstrong are to AWI as it was reorganized under the POR on October 2, 2006, and its subsidiaries collectively.

This discussion should be read in conjunction with the financial statements and the accompanying notes included elsewhere in this Form 10-Q. This discussion contains forward-looking statements based on our current expectations, which are inherently subject to risks and uncertainties. Actual results and the timing of certain events may differ significantly from those referred to in such forward-looking statements. We undertake no obligation beyond what is required under applicable securities law to publicly update or revise any forward-looking statement to reflect current or future events or circumstances, including those set forth in the section entitled Uncertainties Affecting Forward-Looking Statements and elsewhere in this Form 10-Q.

References to performance excluding the translation effect of changes in foreign exchange rates are non-GAAP measures. We believe that this information improves the comparability of business performance by excluding the impacts of changes in foreign exchange rates when translating comparable foreign currency amounts. We calculate the translation effect of foreign exchange rates by applying the current year s foreign exchange rates to the equivalent period s foreign currency amounts as reported in the prior year. We believe that this non-GAAP reference provides a clearer picture of our operating performance. Furthermore, management evaluates the performance of the businesses excluding the effects of foreign exchange rates.

We maintain a website at http://www.armstrong.com. Information contained on our website is not incorporated into this document. 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 Securities and Exchange Commission (SEC).

OVERVIEW

We are a leading global producer of flooring products and ceiling systems for use primarily in the construction and renovation of residential, commercial and institutional buildings. Through our United States (U.S.) operations and U.S. and international subsidiaries, we design, manufacture and sell flooring products (resilient, wood, carpeting and sports flooring) and ceiling systems (primarily mineral fiber, fiberglass and metal) around the world. We also design, manufacture and sell kitchen and bathroom cabinets in the U.S. We own and operate 43 manufacturing plants in 12 countries, including 26 plants located throughout the United States. Through WAVE, our joint venture with Worthington Industries, Inc., we also have an interest in 7 additional plants in 5 countries that produce suspension system (grid) products for our ceiling systems.

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Management s Discussion and Analysis of Financial Condition and Results of Operations

(dollar amounts in millions)

Our business strategy focuses on product innovation, product quality and customer service. In our businesses, these factors are the primary determinants of market share gain or loss. Our objective is to ensure that anyone buying a floor or ceiling can find an Armstrong product that meets his or her needs. Our cabinet strategy is more focused on stock cabinets in select geographic markets. In these segments, we have the same objectives: high quality, good customer service and products that meet our customers needs. Our markets are very competitive, which limits our pricing flexibility. This requires that we increase our productivity each year both in our plants and in our administration of the businesses.

On December 6, 2000, AWI filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware (the Bankruptcy Court) in order to use the court-supervised reorganization process to achieve a resolution of its asbestos liability. Also filing under Chapter 11 were two of AWI s wholly-owned subsidiaries, Nitram Liquidators, Inc. and Desseaux Corporation of North America, Inc. The Chapter 11 cases are being jointly administered under case number 00-4471 (the Chapter 11 Case). Through October 1, 2006, AWI operated its business and managed its properties as a debtor-in-possession subject to the provisions of the Bankruptcy Code. On October 2, 2006, AWI s court-approved Plan of Reorganization became effective, and AWI emerged from Chapter 11. AWI s two wholly-owned subsidiaries that commenced Chapter 11 proceedings at the same time as AWI remain in Chapter 11. See Note 2 of the Condensed Consolidated Financial Statements for information on the Chapter 11 Case and Note 16 of the Condensed Consolidated Financial Statements for information on asbestos litigation.

Reportable Segments

Resilient Flooring produces a broad range of floor coverings for homes and commercial and institutional buildings. Resilient Flooring products include vinyl sheet, vinyl tile, linoleum flooring and luxury vinyl tile. In addition, our Resilient Flooring segment sources and sells laminate flooring products, ceramic tile products, adhesives, installation and maintenance materials and accessories. Resilient Flooring products are offered in a wide variety of types, designs and colors. We sell these products to wholesalers, large home centers, retailers, contractors and to the manufactured homes industry.

Wood Flooring produces and sources wood flooring products for use in new residential construction and renovation, with some commercial applications in stores, restaurants and high-end offices. The product offering includes solid wood (predominantly pre-finished), engineered wood floors in various wood species (with oak being the primary species of choice) and related accessories. Virtually all of our Wood Flooring s sales are in North America. Our Wood Flooring products are generally sold to independent wholesale flooring distributors and large home centers under the brand names Bruce®, Hartco®, Robbins®, Timberland , Armstrong , HomerWood® and Capella®.

Textiles and Sports Flooring (TSF) produces carpeting and sports flooring products that are sold mainly in Europe. Carpeting products consist principally of carpet tiles and broadloom used in commercial applications and in the leisure and travel industry. Sports flooring products include artificial turf and other sports surfaces. Our TSF products are sold primarily through retailers, contractors, distributors and other industrial businesses.

Building Products produces suspended mineral fiber, soft fiber and metal ceiling systems for use in commercial, institutional and residential settings. In addition, our Building Products segment sources complementary ceiling products. Our products are available in numerous colors, performance characteristics and designs, and offer attributes such as acoustical control, rated fire protection and aesthetic appeal. Commercial ceiling materials and accessories are sold to ceiling systems contractors and to resale distributors. Residential ceiling products are sold primarily in North America through wholesalers and retailers (including large home centers). Suspension system (grid) products manufactured by WAVE are sold by both Armstrong and our WAVE joint venture.

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Management s Discussion and Analysis of Financial Condition and Results of Operations

(dollar amounts in millions)

Cabinets produces kitchen and bathroom cabinetry and related products, which are used primarily in the U.S. residential new construction and renovation markets. Through our system of company-owned and independent distribution centers and through direct sales to builders, our Cabinets segment provides design, fabrication and installation services to single and multi-family homebuilders, remodelers and consumers under the brand names Armstrong and Bruce®.

We also report an Unallocated Corporate segment, which includes assets and expenses that have not been allocated to the business units.

See Note 3 of the Condensed Consolidated Financial Statements for additional financial information on our reportable segments.

Financial highlights for the third quarter and first nine months:

			Change is Favorable/(Unfavorable)	
	2006	2005	As Reported	Excluding Effects of Foreign Exchange Rates
Three months ended September 30				
Total Consolidated Net Sales	$ 973.6	$ 937.0	3.9%	2.4%
Operating Income	$ 67.4	$ 66.5	1.4%	0.9%
Net increase/(decrease) in cash and cash equivalents	$ (14.4)	$ 80.7	Unfavorable	Unfavorable
Nine months ended September 30				
Total Consolidated Net Sales	$ 2,795.7	$ 2,696.7	3.7%	4.1%
Operating Income	$ 188.1	$ 110.8	69.8%	66.3%
Net increase/(decrease) in cash and cash equivalents	$ (81.6)	$ 24.9	Unfavorable	Unfavorable

In the third quarter of 2006, positive trends in Building Products and Cabinets were sustained but year-to-date growth trends in our residential businesses, particularly in Wood Flooring, were tempered by the slow-down in the U.S. housing markets.

Resilient Flooring earnings declined on lower sales and increased spending related to cost reduction initiatives.

Wood Flooring had declining sales and earnings on significantly softer markets. Increased promotional spending also hurt earnings.

Textiles and Sports Flooring continued to grow sales on the strength of pricing and improved product mix.

Building Products sustained sales and earnings growth trends, with particular strength in the Americas.

Cabinets continued to reverse the prior year s operating loss to deliver operating income on increased sales and stabilized operating performance.

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Management s Discussion and Analysis of Financial Condition and Results of Operations

(dollar amounts in millions)

In the third quarter of 2006, cash decreased primarily due to debt repayments by subsidiaries not involved in our Chapter 11 case, increased capital expenditures, contributions to under-funded non-U.S. pension funds, investments in acquisitions and higher spending on cost reduction initiatives.

Factors Affecting Revenues

Markets. We compete in building material markets around the world. The majority of our sales opportunity is in the North American and European markets. During the third quarter of 2006, these markets experienced the following:

In the U.S. residential market, housing activity continued its precipitous decline with total housing starts falling sharply in the third quarter of 2006 to 1.74 million units (at seasonally adjusted and annualized rates) compared to 2.10 million units in the same period of 2005, a decrease of over 17%. Additionally, sales of existing homes declined nearly 12% year-over-year from 7.17 million homes in July and August 2005 to 6.32 million homes in the same months of 2006. Total U.S. housing completions ticked upwards by 2.1% to 1.97 million units completed in the third quarter compared to 1.93 million units in the same period of 2005.

U.S. retail sales through building materials, garden equipment and supply stores (an indicator of home renovation activity) have continued to increase, rising nearly 9% in the third quarter of 2006 over sales levels in the third quarter of 2005, according to figures from the U.S. Census Bureau. This growth has been partially due to the strong sales of existing homes last year, after allowing for the usual lag for renovation-related expenditures. Continued strength in employment conditions and job security have also sustained solid retail sales and consumer confidence.

The North American commercial market remained strong across all segments in the third quarter of 2006 in dollar terms, driven by price gains amidst construction material inflation. Construction completions in the office, healthcare, retail and education segments increased between 8.3% (education) and 17.6% (office) compared to the third quarter of 2005. Industry statistics indicate that commercial starts have improved in 2006, with emphasis on office and education and softness in the health care and retail segments. Office vacancy rates in the third quarter were the lowest since the third quarter of 2001.

In Europe, markets in Western European countries generally remained soft with pockets of modest growth, while Eastern European markets continued to grow.

Growth continued across most Pacific Rim markets.

Quality and Customer Service Issues. Our quality and customer service are critical components of our total value proposition. In the third quarter of 2006, we experienced no significant quality or customer service issues.

Pricing Initiatives. We periodically modify prices in response to changes in costs for raw materials and energy, and to market conditions and the competitive environment. The net impact of these pricing initiatives improved sales in the first nine months of 2006 compared to the first nine months of 2005. The most significant pricing actions were:

In Resilient Flooring, we announced price increases in the third quarter of 2006 in response to inflationary cost pressures. These increases were offset by price concessions on certain products due to competitive pressures.

In Wood Flooring, there have been no significant pricing actions in 2006.

Management s Discussion and Analysis of Financial Condition and Results of Operations

(dollar amounts in millions)

- In Building Products, we implemented previously announced price increases in the third quarter of 2006 in response to inflationary cost pressures.

- In Cabinets, we implemented a January 2006 price increase.

In certain cases, price increases realized are less than the announced price increases because of our response to competitive actions and changing market conditions.

Pricing actions increased consolidated net sales in the third quarter of 2006 by approximately $19 million and in the first nine months of 2006 by approximately $38 million, when compared to the same periods of 2005.

Sales Mix. Our strategy to grow earnings includes improving profitability by increasing the portion of our sales that is derived from higher value products. Conversely, competitive changes sometimes result in lower sales related to product, geographic or channel mix. The net impact of mix improved sales in every segment for the first nine months of 2006 compared to the same period in 2005. The most significant impacts were:

- In Resilient Flooring, North American sales benefited from the rapid growth of laminate flooring.

- In Wood Flooring, faster growth in engineered products and the recently acquired premium HomerWood products improved sales.

- Textile and Sports Flooring benefited from increased sales of higher value broadloom and carpet tile products.

- In Building Products, North American sales continued to benefit from the introduction of new high value products.

- Cabinets sales improved on an improved product portfolio including the addition of higher value maple and cherry products.

Impact From Major Customers Decisions. Lowe s Companies, Inc. (Lowe s), one of our largest customers, advised us in 2004 that they would reduce the number of laminate flooring products they purchase from us starting in the first quarter of 2005. We currently estimate that the Lowe s decision will incrementally reduce 2006 sales by approximately $20 million.

Factors Affecting Operating Costs

Operating Expenses. Our operating expenses consist of direct production costs (principally raw materials, labor and energy) and manufacturing overhead costs, costs to purchase sourced products and selling, general and administrative (SG&A) expenses.

Our largest individual raw material expenditures are for lumber and veneers, PVC resins, backings for various flooring products and plasticizers. Fluctuations in the prices of these raw materials are generally beyond our control and have a direct impact on our financial results. In 2006 we experienced the following:

- PVC is a widely used, oil-based raw material. We experience cost pressures on PVC when energy prices increase and when industrial demand for the material increases. Our cost to acquire PVC resin and plasticizers prices increased by approximately $3 million in the third quarter of 2006 compared to the third quarter of 2005 and increased approximately $9 million in the nine month comparative period.

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(dollar amounts in millions)

We incurred approximately $2 million of additional costs for natural gas in the third quarter of 2006 compared to the third quarter of 2005, and approximately $15 million of additional costs for natural gas in the first nine months of 2006 compared to the first nine months of 2005, due to price increases. For the remainder of 2006, we expect year-on-year increases to continue at a moderated pace.

In our normal course of business, we transfer certain products between locations to take advantage of our production capabilities and to better service our customers needs. During the third quarter of 2006 freight costs increased by approximately $1 million and grew about $8 million in the first nine months compared to the same periods in 2005. The increases were due to rising fuel costs and the need to maintain customer service levels.

Cost Reduction Initiatives. During 2004, we implemented several significant manufacturing and organizational programs to improve our cost structure and enhance our competitive position. We did not initiate any additional manufacturing or organizational programs in 2005 or the first nine months of 2006 but did incur costs in the first nine months of 2006 and 2005 related to previously announced cost reduction initiatives. The major 2004 programs were:

- We ceased production of certain products at our Resilient Flooring manufacturing plant in Lancaster, Pennsylvania, transferring production to other Resilient Flooring plants.
- We announced that we would cease production at our Building Products plant in The Netherlands. Acceptance of the closure proposal was received from the local works council in the fourth quarter of 2004. The plant ceased production in the first quarter of 2005, and production was transferred to another Building Products location.
- We ceased production at our Cabinets manufacturing plant in Morristown, Tennessee, transferring production to other Cabinets plants.
- We restructured the sales force and management structure in our North America flooring organization.
- We announced that we would cease production at our Wood Flooring manufacturing plant in Searcy, Arkansas. Production ended in the first quarter of 2005, and was transferred to other Wood Flooring plants.

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Management s Discussion and Analysis of Financial Condition and Results of Operations

(dollar amounts in millions)

We incurred the following expenses in 2006 due to implementing these initiatives:

	SG&A	Cost of Goods Sold	Restructuring Charges	Total Expenses
Three months ended September 30, 2006				
Resilient Flooring	$ 6.2	$ 1.6	$ (0.4)	$ 7.4
Wood Flooring				
Textiles & Sports Flooring				
Building Products				
Cabinets				
Unallocated Corporate			(0.1)	(0.1)
Total Consolidated	$ 6.2	$ 1.6	$ (0.5)	$ 7.3
Nine months ended September 30, 2006				
Resilient Flooring	$ 7.4	$ 9.6	$ 9.6	$ 26.6
Wood Flooring		0.7		0.7
Textiles & Sports Flooring				
Building Products		0.1	0.5	0.6
Cabinets				
Unallocated Corporate			(0.1)	(0.1)
Total Consolidated	$ 7.4	$ 10.4	$ 10.0	$ 27.8

The Resilient Flooring SG&A costs in both the third quarter and the first nine months of 2006 relate to the Lancaster Plant cost reduction initiative. Cost of goods sold includes $1.6 million of other related costs in the third quarter, and $0.7 million of fixed asset impairments, $0.3 million of accelerated depreciation and $9.4 million of other related costs in the first nine months of 2006.

In addition, we realized a gain of $14.3 million in SG&A in the second quarter of 2006 from the sale of a warehouse which became available as a result of the Resilient Flooring cost reduction initiatives.

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Management s Discussion and Analysis of Financial Condition and Results of Operations

(dollar amounts in millions)

We incurred the following expenses in 2005 due to implementing these initiatives:

	Cost of Goods Sold	Restructuring Charges	Total Expenses
Three months ended September 30, 2005			
Resilient Flooring	$ 2.5	$ 0.2	$ 2.7
Wood Flooring			
Textiles & Sports Flooring			
Building Products	0.1	1.1	1.2
Cabinets	0.2	0.1	0.3
Total Consolidated	$ 2.8	$ 1.4	$ 4.2
Nine months ended September 30, 2005			
Resilient Flooring	$ 8.0	$ 11.2	$ 19.2
Wood Flooring		0.1	0.1
Textiles & Sports Flooring		0.2	0.2
Building Products	1.1	5.1	6.2
Cabinets	1.1	0.4	1.5
Total Consolidated	$ 10.2	$ 17.0	$ 27.2

Cost of goods sold includes $1.7 million of accelerated depreciation and $1.1 million of other related costs in the third quarter, and $6.0 million of accelerated depreciation and $4.2 million of other related costs in the first nine months of 2005.

See Note 10 of the Condensed Consolidated Financial Statements for more information on restructuring charges.

On-going Cost Reduction. In addition to significant cost reduction programs we have an ongoing focus on continuously improving our cost structure.

As a result of these cost reduction initiatives and our on-going productivity improvement efforts, we have realized significant reductions in our manufacturing conversion costs.

Employee Benefits. We recorded a pre-tax charge of $16.9 million in the fourth quarter of 2005 in cost of goods sold ($11.4 million) and SG&A ($5.5 million), related to changes made to the U.S. defined benefit pension plan. The changes are considered a curtailment under SFAS No. 88 Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits (FAS 88). The changes are expected to reduce Armstrong s annual retirement-related expenses by approximately $13 million in 2006 and $15 million in 2007, based on pension assumptions for 2006.

We also recorded a non-cash charge of $8.5 million in the second quarter of 2006 in cost of goods sold ($3.7 million) and SG&A ($4.8 million) related to the transfer of a non-U.S. defined benefit pension plan to a multiemployer industry plan. The transfer is considered a curtailment and a settlement under FAS 88.

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Management s Discussion and Analysis of Financial Condition and Results of Operations

(dollar amounts in millions)

Factors Affecting Cash Flow

Historically, excluding the cash demands for asbestos-related claims in 2000 and prior years, we typically generate positive cash flow from operating activities on an annual basis. The amount of cash generated in any one period is dependent on a number of factors, including the amount of operating profit generated and the amount of working capital (such as inventory, receivables and payables) required to operate our businesses. To maintain and enhance our operating efficiencies, we typically invest in property, plant & equipment (PP&E) and computer software.

During the first nine months of 2006, our cash and cash equivalents balance decreased by $81.6 million, compared to an increase of $24.9 million during the same period of 2005. The difference was due primarily to investments in acquisitions, debt repayments by subsidiaries not involved in our Chapter 11 case, increased capital expenditures and contributions to under-funded non-U.S. pension funds partially offset by proceeds from sale of assets. See Financial Condition and Liquidity for further discussion.

Employee Relations

As of September 30, 2006, we had approximately 14,500 full-time and part-time employees worldwide, compared to approximately 14,900 employees as of December 31, 2005. The decline reflects headcount reductions in both production and staff positions as part of ongoing cost reduction efforts. As of the date of this filing, no employees are working under expired contracts.

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Management s Discussion and Analysis of Financial Condition and Results of Operations

(dollar amounts in millions)

RESULTS OF OPERATIONS

Unless otherwise indicated, net sales in these results of operations are reported based upon the location where the sale was made.

2006 COMPARED TO 2005

CONSOLIDATED RESULTS

			Change is Favorable/(Unfavorable)	
	2006	**2005**	**As Reported**	**Excluding Effects of Foreign Exchange Rates[1]**
Three months ended September 30				
Net Sales:				
Americas	$ 684.2	$ 674.8	1.4%	1.0%
Europe	255.2	231.8	10.1%	5.0%
Pacific Rim	34.2	30.4	12.5%	12.9%
Total Consolidated Net Sales	$ 973.6	$ 937.0	3.9%	2.4%
Operating Income	$ 67.4	$ 66.5	1.4%	0.9%
Nine months ended September 30				
Net Sales:				
Americas	$ 2,014.3	$ 1,936.5	4.0%	3.6%
Europe	685.0	673.5	1.7%	4.3%
Pacific Rim	96.4	86.7	11.2%	12.5%
Total Consolidated Net Sales	$ 2,795.7	$ 2,696.7	3.7%	4.1%
Operating Income	$ 188.1	$ 110.8	69.8%	66.3%

(1) Excludes a favorable foreign exchange effect in translation on net sales of $13.4 million for three months and an unfavorable effect of $10.4 million for nine months. Excludes favorable foreign exchange effect in translation on operating income of $0.3 million for three months and $2.3 million for nine months.

Net sales in the Americas increased in the third quarter primarily on the strength of Building Products. Growth in Building Products, Cabinets and Wood Flooring sales more than offset declines in Resilient Flooring for the first nine months.

Excluding the translation effect of changes in foreign exchange rates, net sales in the European markets also increased in both the third quarter and for the first nine months on sales growth in both Building Products and the European flooring segments.

Excluding the translation effect of changes in foreign exchange rates, double-digit net sales growth in the Pacific Rim in both the third quarter and for the first nine months on increased Building Products and Resilient Flooring sales.

Cost of goods sold in the third quarter of 2006 was 76.7% of net sales, compared to 76.9% in the same period of 2005. Cost of goods sold in the first nine months of 2006 was 77.6% of net sales, compared to 77.9% in the same period of 2005. Year-over-year productivity improvements benefited 2006 margins, while 2005 margins include the one-time benefit from an accrual related to a favorable decision in a breach of contract dispute and from proceeds received from a business interruption insurance claim.

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SG&A in the third quarter of 2006 was $173.7 million (17.8% of net sales) and $469.9 million (16.8% of net sales) for the first nine months of 2006, compared to $158.2 million (16.9% of net sales) and $495.6 million (18.4% of net sales) for the corresponding 2005 periods. Excluding the translation effect of changes in foreign exchange rates of $2.7 million, SG&A expenses in the third quarter of 2006 were $12.6 million higher than the 2005 SG&A expenses, primarily due to $6.2 million of expenses associated with the closure of the Lancaster plant and to a $5.0 million contribution to the Armstrong Foundation (a community giving program funded by Armstrong). Excluding the translation effect of changes in foreign exchange rates of $(4.8) million, SG&A expenses in the first nine months of 2006 were $21.1 million lower than the 2005 SG&A expenses, primarily as a result of a $17 million gain related to the sale of buildings.

We recorded net restructuring charges of $(0.5) million in the third quarter and $10.0 million in the first nine months of 2006 compared to $1.4 million in the third quarter and $17.0 million in the first nine months of 2005. See Note 10 of the Condensed Consolidated Financial Statements for a description of the restructuring actions.

Equity earnings, primarily from our WAVE joint venture, were $14.1 million in the third quarter of 2006 compared to $9.9 million for the third quarter of 2005, and $41.4 million in the first nine months of 2006 compared to $28.2 million for the first nine months of 2005. See Note 8 for further information.

Operating income of $67.4 million in the third quarter and $188.1 million in the first nine months of 2006 compared to operating income of $66.5 million and $110.8 million in the same periods of 2005.

Interest expense was $2.1 million in the third quarter of 2006, compared to $2.2 million in the third quarter of 2005. Interest expense was $5.9 million in the first nine months of 2006, compared to $6.5 million in the first nine months of 2005. In accordance with SOP 90-7, we did not record contractual interest expense on prepetition debt after the Chapter 11 filing date. This unrecorded interest expense was $19.3 million in the third quarter and $57.6 million in the first nine months of 2006 and $20.5 million in the third quarter and $63.6 million in the first nine months of 2005. Unrecorded interest expense reflects the amount of interest expense we would have incurred under the original maturities of prepetition debt.

Income tax expense of $24.5 million and $70.3 million for the third quarter and first nine months of 2006 compared to $21.1 million and $47.5 million in the comparable 2005 periods. We reported an effective income tax rate of 38.5% for the third quarter compared to a tax rate of 31.4% for the same period in 2005. The primary factor for the increase in the third quarter effective tax rate was an increase in non-deductible bankruptcy reorganization fees, partially offset by the finalization of tax benefits related to the 2005 subsidiary capital restructuring. We reported an effective income tax rate of 39.6% for the nine months compared to a tax rate of 43.9% for the same period in 2005. The primary reduction in the nine month effective tax rate resulted from lower unbenefited foreign losses during 2006 compared to 2005. The 2005 third quarter and nine month tax rates were favorably impacted by the conclusion of IRS audit and appeals issues and the impact of American Jobs Creation Act dividends from foreign affiliates.

Net earnings of $39.2 million for the third quarter and $107.4 million for the first nine months of 2006 compared to net earnings of $46.1 million for the third quarter and $60.8 million for the first nine months of 2005.

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REPORTABLE SEGMENT RESULTS

Resilient Flooring

	2006	2005	Change is Favorable/(Unfavorable) As Reported	Change is Favorable/(Unfavorable) Excluding Effects of Foreign Exchange Rates[1]
Three months ended September 30				
Net Sales:				
Americas	$ 224.0	$ 233.5	(4.1)%	(4.7)%
Europe	66.0	64.6	2.2%	(2.7)%
Pacific Rim	14.8	13.4	10.4%	11.3%
Total Segment Net Sales	$ 304.8	$ 311.5	(2.2)%	(3.6)%
Operating Income/(Loss)	$ (2.9)	$ 7.7	Unfavorable	Unfavorable
Nine months ended September 30				
Net Sales:				
Americas	$ 662.7	$ 677.5	(2.2)%	(2.8)%
Europe	187.7	197.7	(5.1)%	(2.5)%
Pacific Rim	43.5	38.8	12.1%	14.2%
Total Segment Net Sales	$ 893.9	$ 914.0	(2.2)%	(2.0)%
Operating Income/(Loss)	$ 11.3	$ (5.8)	Favorable	Favorable

(1) Excludes favorable foreign exchange rate effect in translation on net sales of $4.6 million for three months and unfavorable $1.7 million for nine months. Excludes favorable foreign exchange rate effect in translation on operating income of $0.1 million for three months and $1.4 million for nine months.

Net sales in the Americas in the third quarter and first nine months declined $9.5 million and $14.8 million respectively on volume declines in vinyl products and lower selling prices for laminate. These were partially offset by growth in laminate volume and for the nine month period, growth in sales of commercial vinyl products.

Excluding the translation effect of changes in foreign exchange rates, net sales in the European markets in the third quarter and first nine months declined $1.8 million and $4.8 million respectively as lower volumes more than offset improvements in price realization and product/geographic mix.

Excluding the translation effect of changes in foreign exchange rates, net sales in the Pacific Rim in the third quarter and first nine months increased $1.5 million and $5.4 million respectively on improved product mix, and higher volume for the nine month period.

Operating income for the third quarter declined $10.6 million as sales declines, increased spending on cost reduction initiatives and raw material inflation more than offset benefits from previously implemented cost reductions. In addition, operating income in the third quarter of 2005 included a $5.2 million gain from the settlement of a breach of contract dispute and $2.4 million of proceeds received from a business interruption insurance claim. Through nine months operating income improved by $17.1 million, which includes $17 million in net gains from the sale of buildings in 2006. The operating loss in the first nine months of 2005 included the gain from the settlement of a breach of contract dispute and proceeds received from a business interruption insurance claim, as described previously.

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Wood Flooring

	2006	2005	Change is Favorable/ (Unfavorable)
Three months ended September 30			
Total Segment Net Sales[(1)]	$ 217.2	$ 220.2	(1.4)%
Operating Income	$ 16.5	$ 25.7	(35.8)%
Nine months ended September 30			
Total Segment Net Sales[(1)]	$ 645.0	$ 624.9	3.2%
Operating Income	$ 46.2	$ 54.4	(15.1)%

(1) Virtually all Wood Flooring products are sold in the Americas, primarily in the U.S.

Net sales for the third quarter decreased by $3.0 million. The decrease was primarily due to volume declines from the residential housing market slowdown in both engineered and solid wood floors which more than offset the benefit from previously announced acquisitions. Through the first nine months net sales increased by $20.1 million on the benefit from previously announced acquisitions and volume growth in both engineered and solid wood floors, which were only partially offset by price declines.

Operating income for the third quarter and first nine months decreased by $9.2 million and $8.2 million respectively. For the quarter, operating income decreased primarily due to volume declines, raw material inflation and increased investment in promotional efforts. The 2005 quarter also included the benefit from the settlement of a breach of contract dispute. Through nine months, increased sales volume and production efficiencies offset price declines and approximately $4 million in charges related to warranty reserves and a fixed asset write-down.

Textiles and Sports Flooring

			Change is Favorable/(Unfavorable)	
	2006	2005	As Reported	Excluding Effects of Foreign Exchange Rates[(1)]
Three months ended September 30				
Total Segment Net Sales	$ 86.3	$ 79.7	8.3%	3.2%
Operating Income	$ 4.2	$ 3.2	31.3%	23.5%
Nine months ended September 30				
Total Segment Net Sales	$ 222.6	$ 211.4	5.3%	7.4%
Operating (Loss)	$ (4.9)	$ (3.2)	(53.1)%	Unfavorable

(1) Excludes favorable foreign exchange rate effect in translation on net sales of $3.9 million for three months and an unfavorable $4.1 million for nine months. Excludes favorable foreign exchange rate effect in translation on operating income of $0.2 million for three months and $0.9 million for nine months.

Excluding the translation effects of changes in foreign exchange rates, net sales for the third quarter and first nine months increased by $2.7 million and $15.3 million respectively. In the third quarter, net sales benefited from higher volume and improved pricing in carpet tiles and improved pricing and product mix in broadloom carpet. For the first nine months, higher volume in broadloom carpet and carpet tiles combined with improved product mix to drive the sales growth.

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Operating income for the third quarter improved $1.0 million, primarily due to sales growth. Through nine months, operating losses increased by $1.7 million, primarily due to an $8.5 million non-cash charge related to the transfer or a defined benefit pension plan to a multiemployer industry plan, partially offset by sales growth.

Building Products

	2006	2005	Change is Favorable As Reported	Excluding Effects of Foreign Exchange Rates[(1)]
Three months ended September 30				
Net Sales:				
Americas	$ 182.2	$ 163.7	11.3%	10.7%
Europe	102.9	87.5	17.6%	12.3%
Pacific Rim	19.4	17.0	14.1%	14.1%
Total Segment Net Sales	$ 304.5	$ 268.2	13.5%	11.5%
Operating Income	$ 59.7	$ 43.1	38.5%	37.2%
Nine months ended September 30				
Net Sales:				
Americas	$ 532.2	$ 472.2	12.7%	12.0%
Europe	274.7	264.4	3.9%	6.8%
Pacific Rim	52.9	47.9	10.4%	11.1%
Total Segment Net Sales	$ 859.8	$ 784.5	9.6%	10.2%
Operating Income	$ 152.9	$ 116.0	31.8%	31.9%

(1) Excludes favorable foreign exchange rate effect in translation on net sales of $5.0 million for three months and unfavorable $4.6 million for nine months. Excludes favorable foreign exchange rate effect in translation on operating income of $0.4 million for three months and unfavorable $0.1 million for nine months.

Net sales in the Americas for the third quarter and first nine months increased by $18.5 million and $60.0 million respectively. The growth in sales over both periods was driven by price increases made to offset inflationary pressures and by improved product mix. Through nine months increased volume in the strong U.S. Commercial markets also contributed to growth. This year-over-year volume growth moderated in the third quarter as we began to lap the market improvement that began in the second half of 2005.

Excluding the translation effect of changes in foreign exchange rates, net sales in Europe for the third quarter and first nine months increased by $11.3 million and $17.6 million respectively. Over both periods, increased sales of metal ceilings and improved price and product mix offset volume declines in mineral fiber ceilings across weak Western European markets.

Excluding the translation effect of changes in foreign exchange rates, net sales in the Pacific Rim for the third quarter and first nine months increased by $2.4 million and $5.3 million respectively on strong sales in Australia and India.

Operating income for the third quarter and first nine months increased by $16.6 million and $36.9 million respectively on improved price realization, better product mix and increased equity earnings in WAVE, only partially offset by inflation in raw materials, energy and freight.

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Cabinets

	2006	2005	Change is Favorable
Three months ended September 30			
Total Segment Net Sales[1]	$ 60.8	$ 57.4	5.9%
Operating Income/(Loss)	$ 3.8	$ (0.3)	Favorable
Nine months ended September 30			
Total Segment Net Sales[1]	$ 174.4	$ 161.9	7.7%
Operating Income/(Loss)	$ 6.1	$ (9.5)	Favorable

(1) Substantially all Cabinets products are sold in the U.S.

Net sales for the third quarter and first nine months increased by $3.4 million and $12.5 million respectively on higher selling prices and improved product mix, which more than offset lower volume due to declines in the residential market.

Operating income for the third quarter and first nine months increased by $4.1 million and $15.6 million respectively, primarily driven by the sales growth. In addition, the 2005 operating loss included higher SG&A expense and costs related to the shutdown of the Morristown, Tennessee manufacturing plant which were not repeated in 2006.

Unallocated Corporate

Unallocated corporate expense of $13.9 million in the third quarter increased from $12.9 million in the prior year due to a $5 million increased U.S. pension credit related to plan changes and favorable asset performance, offset by a $5.0 million contribution to the Armstrong Foundation, the settlement of a liability related to a previously divested business and increased incentive compensation. For the first nine months of 2006 expense of $23.5 million decreased from $41.1 million in the comparable period of 2005 primarily due to a $16 million increased U.S. pension credit related to plan changes and favorable asset performance, partially offset by a $5.0 million contribution to the Armstrong Foundation, the settlement of a liability related to a previously divested business and increased incentive compensation. In addition, the first nine months of 2006 included a gain related to an $8.6 million settlement of a patent infringement case.

FINANCIAL CONDITION AND LIQUIDITY

Cash Flow

As shown on the Condensed Consolidated Statements of Cash Flows, our cash and cash equivalents balance decreased by $81.6 million in the first nine months of 2006, compared to a $24.9 million increase in the first nine months of 2005.

Operating activities in the first nine months of 2006 provided $58.0 million of net cash, compared to $63.5 million provided in the same period of 2005. The $5.5 million change was primarily due to a relative increase in inventories and contributions to non-U.S. under-funded pension plans, partially offset by higher earnings and a lower increase in receivables.

Net cash used for investing activities was $113.7 million in the first nine months of 2006, compared to $41.1 million in 2005. The increase was due to investments in acquisitions partially offset by proceeds received from the sale of assets. In addition, in the first nine months of 2005 we received proceeds of $20.6 million from the sale of our equity interest in Interface Solutions, Inc.

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Net cash of $31.3 million was used by our financing activities in the first nine months of 2006, compared to $7.8 million provided in the same period of 2005. The change is due to higher debt repayments by subsidiaries not involved in our Chapter 11 case.

Balance Sheet and Liquidity

Changes in significant balance sheet accounts and groups of accounts from December 31, 2005 to September 30, 2006 are as follows:

	September 30, 2006	December 31, 2005	Increase/ (Decrease)
Cash and cash equivalents	$ 520.6	$ 602.2	$ (81.6)
Current assets, excluding cash and cash equivalents	1,047.2	959.1	88.1
Current assets	$ 1,567.8	$ 1,561.3	$ 6.5

The decrease in cash and cash equivalents was described previously (see Cash Flow). The increase in current assets, excluding cash and cash equivalents, was primarily due to an increase in receivables due to higher sales in September of 2006 compared to December of 2005, and to an increase in inventory to sustain customer service levels, partially offset by a reduction in prepaid expenses.

	September 30, 2006	December 31, 2005	Increase
Property, plant and equipment, net	$ 1,164.0	$ 1,145.3	$ 18.7

The change was due to capital expenditures of $93.0 million, acquired fixed assets of $26.2 million and foreign currency translation. This was mostly offset by scheduled depreciation of $88.8 million and the sale of certain assets.

Credit Facilities

Through October 1, 2006, AWI had a $75 million debtor-in-possession credit facility that was limited to issuances of letters of credit. As of September 30, 2006 and December 31, 2005, AWI had $43.4 million and $43.3 million, respectively, in letters of credit outstanding pursuant to the DIP credit facility. The DIP credit facility also contained several covenants including, among other things, limits on asset sales and capital expenditures and a required ratio of debt to cash flow. We were in compliance with all of the DIP facility covenants. The covenants did not impair our operating ability.

Pursuant to AWI emerging from Chapter 11 on October 2, 2006, the DIP facility was cancelled as of that date. As of October 2, 2006, reorganized Armstrong had available a $300 million revolving credit facility. By October 16, 2006, reorganized Armstrong received commitments for, and the proceeds from, $800 million of secured term loan borrowings. See Note 2 for additional information about this financing.

Liquidity

Our liquidity needs for operations vary throughout the year. We retain lines of credit to facilitate our seasonal needs, if required. For certain international operations that were not participating in our Chapter 11 Case, we had lines of credit of $47.8 million at September 30, 2006, of which $5.1 million was used and $42.7 million was available. However, these lines of credit are uncommitted, and poor operating results or credit concerns at the related foreign subsidiaries could result in the lines being withdrawn by the lenders. We have been able to maintain and, as needed, replace credit facilities to support our operations. Additionally, we had letter of credit issuance capabilities under the DIP Facility which, as of our emergence date, was replaced with a revolving credit facility (described above). We believe that cash on hand and generated from operations, together with lines of credit and the revolving credit facility, will be adequate to address reorganized Armstrong s foreseeable liquidity needs in the normal course of business operations and to meet scheduled debt obligations consisting of principal and debt repayments.

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As of September 30, 2006, AHI s only operation was its indirect ownership of all the capital stock of AWI. As a result of AWI emerging from Chapter 11 on October 2, 2006 and all-then current shares of AWI being cancelled, AHI does not have any current operational activities but certain AWI Chapter 11 related matters concerning AHI remain unresolved (see Note 2 for additional information). Pursuant to the POR, AWI is required to bear certain costs and expenses that are incurred by AHI over a reasonable period to effect an orderly transition in its affairs following AWI s emergence from Chapter 11, including the costs and expenses of preparing, submitting to AHI s shareholders and, if approved by AHI s shareholders, implementing a plan of dissolution and liquidation. Accordingly, as a result of such obligations of AWI, AHI currently expects to have adequate liquidity to satisfy its anticipated administrative costs during such transition period. If AHI determines not to pursue its dissolution, there can be no assurance that AWI will continue to bear the costs and expenses of AHI.

New Accounting Pronouncements

In connection with AWI s emergence from Chapter 11 on October 2, 2006, reorganized Armstrong will adopt fresh-start reporting in accordance with AICPA Statement of Position 90-7, Financial Reporting by Entities in Reorganization Under the Bankruptcy Code (SOP 90-7). As a result of the application of fresh-start reporting as of October 2, 2006, changes in accounting principles that will be required in reorganized Armstrong s financial statements within the twelve months following our emergence date must be adopted at the time fresh-start reporting is adopted.

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, which clarifies the accounting for uncertain tax positions and adds new required annual disclosures. FIN 48 is effective for fiscal years beginning after December 15, 2006. However, due to the requirements of fresh-start reporting, reorganized Armstrong was required to adopt FIN 48 effective October 2, 2006. We continue to evaluate the effects of this pronouncement and expect to complete this analysis during the fourth quarter of 2006.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (FAS 157), Fair Value Measurements, which establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007. We do not expect any material impact on reorganized Armstrong or AHI from adopting FAS 157.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158 (FAS 158), Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, which establishes recognition and disclosure provisions for sponsors of defined benefit pension and other postretirement benefit plans. FAS 158 is effective for fiscal years ending after December 15, 2006. Due to the requirements of fresh-start reporting, reorganized Armstrong is required to adopt FAS 158 effective October 2, 2006. As part of fresh-start reporting, AWI will recognize all unrecognized gains, losses, and prior service cost existing at October 2, 2006. The equity adjustment for FAS 158 in reorganized Armstrong s December 31, 2006 balance sheet will therefore represent only gains and losses incurred in the fourth quarter of 2006. FAS 158 will have no impact on AHI, as AHI does not have any pension or postretirement benefit plans after October 2, 2006.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 (SAB 108), Quantification of Misstatements, which provides guidance to public companies related to quantifying prior period misstatements. SAB 108 is effective for fiscal years ending after November 15, 2006. Due to the requirements of fresh-start reporting, reorganized Armstrong is required to adopt SAB 108 effective October 2, 2006. We do not expect any material impact on reorganized Armstrong or AHI from adopting SAB 108.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

For information regarding our exposure to certain market risks, see Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our 2005 Form 10-K filing. There have been no significant changes in our financial instruments or market risk exposures from the amounts and descriptions disclosed therein.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. The Securities and Exchange Commission defines the term disclosure controls and procedures to mean a company s controls and other procedures that are designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission s rules and forms. Based on the evaluation of the effectiveness of our disclosure controls and procedures by our management, with the participation of our chief executive officer and our chief financial officer, as of the end of the period covered by this report, our chief executive officer and our chief financial officer have concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Commission s rules and forms.

(b) Changes in Internal Control Over Financial Reporting. No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended September 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II   OTHER INFORMATION

Item 1. Legal Proceedings

See Note 16 of the Condensed Consolidated Financial Statements for a full description of our legal proceedings.

Item 1A. Risk Factors

See page 4 for our   Risk Factors   discussion which has been updated from the risk factors previously disclosed in Part I, Item 1A of our 2005 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

In connection with the consummation of AWI   s Fourth Amended Plan of Reorganization, as modified, dated February 21, 2006 (the   POR   ), AWI issued on October 2, 2006 and October 17, 2006 a total of approximately 55,862,000 Common Shares to the Armstrong World Industries, Inc. Asbestos Personal Injury Settlement Trust (the   Asbestos PI Trust   ) and to holders of allowed general unsecured creditor claims against AWI, in discharge as provided by the POR of claims against AWI. An additional 538,000 Common Shares were reserved for issuance under the POR pending the resolution of unresolved unsecured creditor claims. The issuance of such shares was reported in AWI   s Current Reports on Form 8-K filed with the Commission on October 2, 2006 and October 10, 2006 and the nature of the claims in consideration of which such shares were or are to be issued is discussed further in Note 2 to our financial statements for the quarter ended September 30, 2006 included in this report. The issuance of such shares was exempt from registration under the Securities Act of 1933, as amended, pursuant to Section 1145 of the Bankruptcy Code.

Item 4. Submission of Matters to a Vote of Security Holders.

On October 2, 2006, following the issuance by AWI of Common Shares to the Asbestos PI Trust in furtherance of the POR, the trust as the then sole shareholder of AWI acted by written consent to approve AWI   s 2006 Long-Term Incentive Plan.

Item 6. Exhibits

The following exhibits are filed as part of this Quarterly Report on Form 10-Q:

Exhibit No.	Description
No. 3.1	Amended and Restated Certificate of Incorporation of Armstrong World Industries, Inc. is incorporated by reference from the Current Report on Form 8-K dated October 2, 2006, wherein it appeared as Exhibit 3.1.
No. 3.2	Armstrong World Industries, Inc. s Bylaws are incorporated by reference from the Current Report on Form 8-K dated October 2, 2006, wherein they appeared as Exhibit 3.2.
No. 3.3	Armstrong Holdings, Inc. s Bylaws, as amended, effective October 2, 2006, are filed herewith.
No. 3.4	Armstrong Holdings, Inc. s Amended and Restated Articles of Incorporation are incorporated by reference from the Current Report on Form 8-K dated May 9, 2000, wherein it appeared as Exhibit 3.1(i). (SEC File No. 000-50408)
No. 4.1	Armstrong Holdings, Inc. s Shareholder Summary of Rights to Purchase Preferred Stock as amended and restated as of February 20, 2006 is incorporated by reference from the 2005 Annual Report on Form 10-K wherein it appeared as Exhibit 4.1.
No. 4.2	Armstrong World Industries, Inc. s Retirement Savings and Stock Ownership Plan effective as of October 1, 1996, as amended April 12, 2001 is incorporated by reference from the Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, wherein it appeared as Exhibit 4. * (SEC File No. 1-2116)
No. 4.3	Armstrong World Industries, Inc. s $450,000,000 Credit Agreement (5-year) dated as of October 29, 1998, among Armstrong World Industries, Inc., The Chase Manhattan Bank, as administrative agent, and the banks listed therein, is incorporated by reference from the 1998 Annual Report on Form 10-K, wherein it appeared as Exhibit 4(f). (SEC File No. 1-2116)
No. 4.4	Armstrong World Industries, Inc. s Indenture, dated as of August 6, 1996, between Armstrong World Industries, Inc. and The Chase Manhattan Bank, formerly known as Chemical Bank, as successor to Mellon Bank, N.A., as Trustee, is incorporated by reference from Armstrong World Industries, Inc. s registration statement on Form S-3/A dated August 14, 1996, wherein it appeared as Exhibit 4.1. (SEC File No. 1-2116)
No 4.5	Instrument of Resignation, Appointment and Acceptance dated as of December 1, 2000 among Armstrong World Industries, Inc., The Chase Manhattan Bank and Wells Fargo Bank Minnesota, National Association, regarding Armstrong World Industries, Inc. s Indenture, dated as of August 6, 1996, between Armstrong World Industries, Inc. and The Chase Manhattan Bank, formerly known as Chemical Bank, as successor to Mellon Bank, N.A., as Trustee, is incorporated by reference from the 2000 Annual Report on Form 10-K wherein they appear as Exhibit 4(e). (SEC File No. 1-2116)

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No. 4.6 Copy of portions of Armstrong World Industries, Inc. s Board of Directors Pricing Committee s resolutions establishing the terms and conditions of $200,000,000 of 6.35% Senior Notes Due 2003 and $150,000,000 of 6 1/2% Senior Notes Due 2005, is incorporated by reference from the 1998 Annual Report on Form 10-K, wherein it appeared as Exhibit 4(h). (SEC File No. 1-2116)

No. 4.7 Copy of portions of Armstrong World Industries, Inc. s Board of Directors Pricing Committee s resolutions establishing the terms and conditions of $180,000,000 of 7.45% Senior Quarterly Interest Bonds Due 2038, is incorporated by reference from the 1998 Annual Report on Form 10-K, wherein it appeared as Exhibit 4(i). (SEC File No. 1-2116)

No. 4.8 Note Purchase Agreement dated June 19, 1989 for 8.43% Series A Guaranteed Serial ESOP Notes due 1989 2001 and 9.00% Series B Guaranteed Serial ESOP Notes due 2000-2004 for the Armstrong World Industries, Inc. Employee Stock Ownership Plan (Share in Success Plan) Trust, with Armstrong World Industries, Inc. as guarantor is incorporated by reference from Armstrong Holdings, Inc. and Armstrong World Industries, Inc. s registration statement on Form 10-Q for the quarter ended September 30, 2000, wherein it appeared as Exhibit 4(a). (SEC File No. 1-2116)

No. 4.9 Armstrong World Industries, Inc. s $300,000,000 Revolving Credit and Guarantee Agreement dated December 6, 2000, between Armstrong World Industries, Inc. and The Chase Manhattan Bank and the banks referenced therein; the First Amendment to this Agreement, dated February 2, 2001; and the Amendment Letter to this Agreement, dated February 28, 2001, are incorporated by reference from the 2000 Annual Report on Form 10-K wherein they appear as Exhibit 4(i). (SEC File No. 1-2116)

No. 4.10 Second, Third, Fourth, Fifth, Sixth and Seventh Amendments to Armstrong World Industries, Inc. s December 6, 2000 Debtor in Possession Credit Facility dated May 29, 2001; June 4, 2001; October 30, 2002; October 31, 2003; October 14, 2004; and October 27, 2005, respectively, are incorporated by reference from the Quarterly Report on Form 10-Q for the quarter ended September 30, 2005, wherein they appeared as Exhibit 4.10.

No. 4.11 Instrument of Resignation, Appointment and Acceptance dated June 14, 2005, among Armstrong World Industries, Inc., J. P. Morgan Trust Company, National Association, successor-in-interest to Bank One Trust Company, N.A. (J. P. Morgan) and Law Debenture Trust Company of New York (Law Debenture), whereby J. P. Morgan resigned as trustee and Law Debenture accepted the appointment as successor trustee under the Indenture dated March 15, 1988 between Armstrong World Industries, Inc. and Morgan Guaranty Trust Company of New York, as supplemented by the supplemental indenture dated as of October 19, 1990 between Armstrong World Industries, Inc. and First National Bank of Chicago, J. P. Morgan Trust Company, National Association successor-in-interest to Bank One Trust Company (relating to Armstrong World Industries, Inc. s $125 million 9-3/4% Debentures due 2008 and Series A Medium Term Notes which is incorporated by reference from the 1995 Annual Report on Form 10-K wherein it appeared as Exhibit 4(c) (SEC File No. 1-2116)) is incorporated by reference from the Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, wherein it appeared as Exhibit 4.11.

No. 4.12	Senior Indenture dated as of December 23, 1998 between Armstrong World Industries, Inc. and First National Bank of Chicago, as Trustee, is incorporated by reference from Armstrong World Industries, Inc. s Registration Statement on Form S-3 (File No. 333- 74501) dated March 16, 1999, wherein it appeared as Exhibit 4.3. (SEC File No. 1-2116)
No. 4.13	Global Note representing $200 million of 7.45% Senior Notes due 2029 is incorporated by reference from the Current Report on Form 8-K filed on May 29, 1999, wherein it appeared as Exhibit 4.2. (SEC File No. 1-2116)
	Armstrong Holdings, Inc. and Armstrong World Industries, Inc. agree to furnish to the Commission upon request copies of instruments defining the rights of holders of long-term debt of the registrants and their subsidiaries which are not filed herewith in accordance with applicable rules of the Commission because the total amount of securities authorized thereunder does not exceed 10% of the total assets of the registrants and their subsidiaries on a consolidated basis.
No. 10.1	Armstrong World Industries, Inc. s Agreement Concerning Asbestos-Related Claims dated June 19, 1985, (the Wellington Agreement) among Armstrong World Industries, Inc. and other companies is incorporated by reference from the 1997 Annual Report on Form 10-K wherein it appeared as Exhibit 10(i)(a). (SEC File No. 1-2116)
No. 10.2	Producer Agreement concerning Center for Claims Resolution, as amended, among Armstrong World Industries, Inc. and other companies is incorporated by reference from the 1999 Annual Report on Form 10-K wherein it appeared as Exhibit 10(i)(b). (SEC File No. 1-2116)
No. 10.3	Armstrong World Industries, Inc. s 1993 Long-Term Stock Incentive Plan is incorporated by reference from the 1993 Proxy Statement wherein it appeared as Exhibit A. * (SEC File No. 1-2116)
No. 10.4	Armstrong World Industries, Inc. s Directors Retirement Income Plan, as amended, is incorporated by reference from the 1996 Annual Report on Form 10-K wherein it appeared as Exhibit 10(iii)(c). * (SEC File No. 1-2116)
No. 10.5	Armstrong World Industries, Inc. and Armstrong Holdings, Inc. s Management Achievement Plan for Key Executives, as amended August 1, 2005, is incorporated by reference from the Current Report on Form 8-K filed on September 30, 2005, wherein it appeared as Exhibit 10.1.*
No. 10.6	Armstrong World Industries, Inc. s Retirement Benefit Equity Plan (formerly known as the Excess Benefit Plan), as amended January 1, 2000 is incorporated by reference from the 1999 Annual Report on Form 10-K wherein it appeared as Exhibit 10(iii)(e). * (SEC File No. 1-2116)
No. 10.7	Armstrong Holdings, Inc. s Deferred Compensation Plan, as amended May 1, 2000, is incorporated by reference from the 2000 Annual Report on Form 10-K wherein it appeared as Exhibit 10(iii)(f). * (SEC File No. 000-50408)
No. 10.8	Armstrong World Industries, Inc. s Severance Pay Plan for Salaried Employees, as amended January 1, 2003 and March 15, 2005 in incorporated by reference from the 2004 Annual Report on Form 10-K wherein it appeared as Exhibit 10.8.*

No. 10.9	Armstrong World Industries, Inc. s 1999 Long-Term Incentive Plan and Supplement dated August 1, 2005, are incorporated by reference from the Current Report on Form 8-K filed on September 30, 2005, wherein they appeared as Exhibit 10.2 and Exhibit 10.3.*
No. 10.10	Form of Change in Control Agreement between Armstrong World Industries, Inc. and certain officers is incorporated by reference from the 2000 Annual Report on Form 10-K wherein it appears as Exhibit 10(iii)(k). * (SEC File No. 1-2116)
No. 10.11	Change in Control Agreement between Armstrong Holdings, Inc. and Michael D. Lockhart, dated August 7, 2000 is incorporated by reference from the Quarterly Report on Form 10-Q for the quarter ended September 30, 2000, wherein it appeared as Exhibit 10(e). * (SEC File No. 000-50408)
No. 10.12	Form of Indemnification Agreement among Armstrong Holdings, Inc., Armstrong World Industries, Inc. and certain directors and officers is incorporated by reference from the Quarterly Report on Form 10-Q for the quarter ended June 30, 2000, wherein it appeared as Exhibit 10(iii)(a). * (SEC File No. 000-50408)
No. 10.13	Form of Indemnification Agreement among Armstrong Holdings, Inc., Armstrong World Industries, Inc. and certain directors is incorporated by reference from the 2003 Annual Report on Form 10-K wherein it appeared as Exhibit 10(iii)(q). * (SEC File No. 000-50408)
No. 10.14	Form of Indemnification Agreement among Armstrong Holdings, Inc., Armstrong World Industries, Inc. and certain directors is incorporated by reference from the 2001 Annual Report on Form 10-K wherein it appeared as Exhibit 10(iii)(s). * (SEC File No. 000-50406)
No. 10.15	Armstrong World Industries, Inc. s Bonus Replacement Retirement Plan, dated as of January 1, 1998, as amended, is incorporated by reference from the 1998 Annual Report on Form 10-K wherein it appeared as Exhibit 10(iii)(m). * (SEC File No. 1-2116)
No. 10.16	Employment Agreement between Armstrong Holdings, Inc. and Michael D. Lockhart dated August 7, 2000 is incorporated by reference from the Quarterly Report on Form 10-Q for the quarter ended September 30, 2000 wherein it appeared as Exhibit 10(a). * (SEC File No. 000-50408)
No. 10.17	Amendment to August 7, 2000 Employment Agreement between Armstrong Holdings, Inc. and Michael D. Lockhart is incorporated by reference from the Quarterly Report on Form 10-Q for the quarter ended March 31, 2001, wherein it appeared as Exhibit 10. * (SEC File No. 000-50408)
No. 10.18	Armstrong Holdings, Inc. s Stock Award Plan is incorporated by reference from Armstrong Holdings, Inc. s registration statement on Form S-8 filed August 16, 2000, wherein it appeared as Exhibit 4.1. * (SEC File No. 000-50408)
No. 10.19	Management Services Agreement between Armstrong Holdings, Inc. and Armstrong World Industries, Inc., dated August 7, 2000 is incorporated by reference from the Quarterly Report on Form 10-Q for the quarter ended September 30, 2000 wherein it appeared as Exhibit 10(g). * (SEC File No. 000-50408)

No. 10.20	Form of Amendment of Restricted Stock Award Agreements between Armstrong Holdings, Inc. and the following executive officers: M.D. Lockhart, S.J. Senkowski and W.C. Rodruan dated July 22, 2002 is incorporated by reference from the Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 wherein it appeared as Exhibit 10. *
No. 10.21	Hiring Agreement between Armstrong World Industries, Inc. and F. Nicholas Grasberger III dated January 6, 2005 is incorporated by reference from the Current Report filed on Form 8-K on January 6, 2005, wherein it appeared as Exhibit 10.1. *
No. 10.22	Change in Control Agreement between Armstrong World Industries, Inc. and F. Nicholas Grasberger III dated January 6, 2005 is incorporated by reference from the Current Report filed on Form 8-K on January 6, 2005, wherein it appeared as Exhibit 10.2. *
No. 10.23	Indemnification Agreement between Armstrong World Industries, Inc. and F. Nicholas Grasberger III dated January 6, 2005 is incorporated by reference from the Current Report filed on Form 8-K on January 6, 2005, wherein it appeared as Exhibit 10.3. *
No. 10.24	Order of the U.S. District Court Authorizing and Approving Continued Cash Retention Program for Key Employees dated December 9, 2004, is incorporated by reference from the Current Report filed on Form 8-K on February 3, 2005, wherein it appeared as Exhibit 99.1.*
No. 10.25	Executive Officer Compensation Arrangements between Armstrong World Industries Inc. and certain executive officers are incorporated by reference from the 2004 Annual Report on Form 10-K wherein they appeared as Exhibit 10.29. *
No. 10.26	Form of Long-Term Incentive Plan 2005 award letter regarding executive participation in the 1999 Long-Term Incentive Plan is incorporated by reference from the 2004 Annual Report on Form 10-K wherein it appeared as Exhibit 10.30. *
No. 10.27	Armstrong World Industries, Inc. s Nonqualified Deferred Compensation Plan effective January 2005 is incorporated by reference from the 2005 Annual Report on Form 10-K wherein it appeared as Exhibit 10.29. *
No. 10.28	Summary of Armstrong Nonemployee Director Compensation is incorporated by reference from the 2004 Annual Report on Form 10-K wherein it appeared as Exhibit 10.32. *
No. 10.29	Agreement of Purchase and Sale between S-J Realty Management, LLC and Armstrong World Industries, Inc. dated December 5, 2005, is incorporated by reference from the Current Report filed on Form 8-K on January 30, 2006, wherein it appeared as Exhibit 10.1.
No. 10.30	Form of grant letter regarding executive officer participation in Armstrong World Industries, Inc. s 2006 retention payment program is incorporated by reference from the Current Report filed on Form 8-K on January 30, 2006, wherein it appeared as Exhibit 10.1.*
No. 10.31	Order of the U.S. District Court dated January 26, 2006, and related Armstrong World Industries, Inc. s Motion for an Order Authorizing and Approving Continued Cash Retention Program for Key Employees, is incorporated by reference from the Current Report filed on Form 8-K/A on February 2, 2006, wherein it appeared as Exhibit 99.1 *

No. 10.32	Form of Long-Term Incentive Plan 2006 award letter regarding executive participation in the 2006 Long-Term Incentive Plan is incorporated by reference from the 2005 Annual Report on Form 10-K wherein it appeared as Exhibit 10.37. *
No. 10.33	Change in Control Agreement between Armstrong World Industries, Inc. and Donald A. McCunniff dated March 13, 2006 is incorporated by reference from the Current Report filed on Form 8-K on March 14, 2006, wherein it appeared as Exhibit 10.1. *
No. 10.34	Indemnification Agreement between Armstrong World Industries, Inc. and Donald A. McCunniff dated March 13, 2006 is incorporated by reference from the Current Report filed on Form 8-K on March 14, 2006, wherein it appeared as Exhibit 10.2. *
No. 10.35	Credit Agreement, dated as of October 2, 2006, by and among the Company, certain subsidiaries of the Company as guarantors, Bank of America, N.A., as Administrative Agent, the other lenders party thereto, JP Morgan Chase Bank, N.A. and Barclays Bank PLC, as Co-Syndication Agents and LaSalle Bank National Association and the Bank of Nova Scotia, as Co-Documentation Agents, is incorporated by reference from the Current Report on Form 8-K dated October 2, 2006, wherein it appeared as Exhibit 10.1.
No. 10.36	The Armstrong World Industries, Inc. Asbestos Personal Injury Settlement Trust Agreement dated as of October 2, 2006, by and among Armstrong World Industries, Inc. and, as trustees, Anne M. Ferazzi, Harry Huge, Paul A. Knuti, Lewis R. Sifford and Thomas M. Tully is incorporated by reference from the Current Report on Form 8-K dated October 2, 2006, wherein it appeared as Exhibit 10.2.
No. 10.37	Stockholder and Registration Rights Agreement, dated as of October 2, 2006, by and between Armstrong World Industries, Inc. and the Armstrong World Industries, Inc. Asbestos Personal Injury Asbestos Trust is incorporated by reference from the Current Report on Form 8-K dated October 2, 2006, wherein it appeared as Exhibit 10.3.
No. 10.38	Armstrong World Industries, Inc. 2006 Long-Term Incentive Plan is incorporated by reference from the Current Report on Form 8-K dated October 2, 2006, wherein it appeared as Exhibit 10.4.*
No. 10.39	Form of Armstrong World Industries, Inc. 2006 Long-Term Incentive Plan Stock Option Agreement is incorporated by reference from the Current Report on Form 8-K dated October 2, 2006, wherein it appeared as Exhibit 10.5.*
No. 10.40	Form of Armstrong World Industries, Inc. 2006 Long-Term Incentive Plan Restricted Stock Award Agreement is incorporated by reference from the Current Report on Form 8-K dated October 2, 2006, wherein it appeared as Exhibit 10.6.*
No. 10.41	Form of Armstrong World Industries, Inc. 2006 Long-Term Incentive Plan notice of restricted stock and/or option award is incorporated by reference from the Current Report on Form 8-K dated October 2, 2006, wherein it appeared as Exhibit 10.7.*
No. 10.42	Form of Indemnification Agreement for directors and officers of Armstrong World Industries, Inc. is incorporated by reference from the Current Report on Form 8-K dated October 2, 2006, wherein it appeared as Exhibit 10.8.*
No. 10.43	2006 Director Phantom Stock Unit Plan is incorporated by reference from the Current Report on Form 8-K dated October 23, 2006, wherein it appeared as Exhibit 10.1.*

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No. 10.44	2006 Director Phantom Stock Unit Agreement is incorporated by reference from the Current Report on Form 8-K dated October 23, 2006, wherein it appeared as Exhibit 10.2.*
No. 10.45	2006 Director Phantom Stock Unit Agreement is incorporated by reference from the Current Report on Form 8-K dated October 23, 2006, wherein it appeared as Exhibit 10.3.*
No. 15.1	Awareness Letter from Independent Registered Public Accounting Firm.
No. 15.2	Awareness Letter from Independent Registered Public Accounting Firm.
No. 31.1	Certification of Principal Executive Officer of Armstrong Holdings, Inc. required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act.
No. 31.2	Certification of Principal Financial Officer of Armstrong Holdings, Inc. required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act.
No. 31.3	Certification of Principal Executive Officer of Armstrong World Industries, Inc. required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act.
No. 31.4	Certification of Principal Financial Officer of Armstrong World Industries, Inc. required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act.
No. 32.1	Certification of Chief Executive Officer of Armstrong Holdings, Inc. required by Rule 13a-14(b) and 18 U.S.C. Section 1350 (furnished herewith).
No. 32.2	Certification of Chief Financial Officer of Armstrong Holdings, Inc. required by Rule 13a-14(b) and 18 U.S.C. Section 1350 (furnished herewith).
No. 32.3	Certification of Chief Executive Officer of Armstrong World Industries, Inc. required by Rule 13a-14(b) and 18 U.S.C. Section 1350 (furnished herewith).
No. 32.4	Certification of Chief Financial Officer of Armstrong World Industries, Inc. required by Rule 13a-14(b) and 18 U.S.C. Section 1350 (furnished herewith).

* Management Contract or Compensatory Plan.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Armstrong Holdings, Inc.
Armstrong World Industries, Inc.

By: /s/ F. Nicholas Grasberger III
F. Nicholas Grasberger III, Senior Vice President and Chief Financial Officer

By: /s/ John N. Rigas
John N. Rigas, Senior Vice President, Secretary and General Counsel

By: /s/ William C. Rodruan
William C. Rodruan, Vice President and

Controller (Principal Accounting Officer)

Date: October 30, 2006

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EXHIBIT INDEX

No. 3.1	Armstrong Holdings, Inc. Bylaws, as amended effective October 2, 2006.
No. 15.1	Awareness Letter from Independent Registered Public Accounting Firm.
No. 15.2	Awareness Letter from Independent Registered Public Accounting Firm.
No. 31.1	Certification of Principal Executive Officer of Armstrong Holdings, Inc. required by Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act.
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