

ADVANCED DRAINAGE SYSTEMS, INC.
Form 10-Q
August 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

OR

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

Commission file number: 001-36557

ADVANCED DRAINAGE SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware 51-0105665
(State or Other Jurisdiction of (I.R.S. Employer

Incorporation or Organization) Identification No.)

4640 Trueman Boulevard, Hilliard, Ohio 43026

(Address of Principal Executive Offices, Including Zip Code)

(614) 658-0050

(Registrant's Telephone Number, Including Area Code)

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

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

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

Large Accelerated Filer Accelerated Filer
Non-Accelerated Filer Smaller Reporting Company
Emerging Growth Company

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

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

As of July 31, 2018, the registrant had 56,929,194 shares of common stock outstanding. The shares of common stock trade on the New York Stock Exchange under the ticker symbol "WMS." In addition, as of July 31, 2018, 320,474 shares of unvested restricted common stock were outstanding and 22,985,628 shares of ESOP, preferred stock, convertible into 17,680,545 shares of common stock, were outstanding. As of July 31, 2018, 74,930,213 shares of common stock were outstanding, inclusive of outstanding shares of unvested restricted common stock and on an as-converted basis with respect to the outstanding shares of ESOP preferred stock.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

| | | |
|---------|---|------|
| Item 1. | Condensed Consolidated Financial Statements (Unaudited) | Page |
| | <u>Condensed Consolidated Balance Sheets as of June 30, 2018 and March 31, 2018</u> | 1 |
| | <u>Condensed Consolidated Statements of Operations for the three months ended June 30, 2018 and 2017</u> | 2 |
| | <u>Condensed Consolidated Statements of Comprehensive Income for the three months ended June 30, 2018 and 2017</u> | 3 |
| | <u>Condensed Consolidated Statements of Cash Flows for the three months ended June 30, 2018 and 2017</u> | 4 |
| | <u>Condensed Consolidated Statements of Stockholders' Equity and Mezzanine Equity for the three months ended June 30, 2018 and 2017</u> | 5 |
| | <u>Notes to the Condensed Consolidated Financial Statements</u> | 6 |
| Item 2. | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 21 |
| Item 3. | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 32 |
| Item 4. | <u>Controls and Procedures</u> | 32 |

PART II. OTHER INFORMATION

| | | |
|----------|---|----|
| Item 1. | <u>Legal Proceedings</u> | 34 |
| Item 1A. | <u>Risk Factors</u> | 34 |
| Item 2. | <u>Unregistered Sale of Equity Securities</u> | 35 |
| Item 3. | <u>Defaults Upon Senior Securities</u> | 35 |
| Item 4. | <u>Mine Safety Disclosures</u> | 35 |
| Item 5. | <u>Other Information</u> | 35 |
| Item 6. | <u>Exhibits</u> | 36 |
| | <u>Signatures</u> | 37 |

Table of Contents

PART I. FINANCIAL INFORMATION

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited) (In thousands, except par value)

| | June 30, | March 31, |
|---|--------------|--------------|
| | 2018 | 2018 |
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 18,394 | \$ 17,587 |
| Receivables (less allowance for doubtful accounts of \$6,968 and \$6,826, respectively) | 228,905 | 171,961 |
| Inventories | 261,721 | 263,792 |
| Other current assets | 8,740 | 5,113 |
| Total current assets | 517,760 | 458,453 |
| Property, plant and equipment, net | 391,710 | 399,381 |
| Other assets: | | |
| Goodwill | 102,792 | 103,017 |
| Intangible assets, net | 42,486 | 44,437 |
| Other assets | 36,158 | 37,954 |
| Total assets | \$ 1,090,906 | \$ 1,043,242 |
| LIABILITIES, MEZZANINE EQUITY AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current maturities of debt obligations | \$ 26,623 | \$ 26,848 |
| Current maturities of capital lease obligations | 21,787 | 22,007 |
| Accounts payable | 102,884 | 105,521 |
| Other accrued liabilities | 66,037 | 60,560 |
| Accrued income taxes | 16,090 | 6,307 |
| Total current liabilities | 233,421 | 221,243 |
| Long-term debt obligations (less unamortized debt issuance costs of \$2,837 and \$3,028, respectively) | 278,561 | 270,900 |
| Long-term capital lease obligations | 57,388 | 59,963 |
| Deferred tax liabilities | 34,008 | 32,304 |
| Other liabilities | 22,950 | 25,023 |
| Total liabilities | 626,328 | 609,433 |
| Commitments and contingencies (see Note 10) | | |
| Mezzanine equity: | | |
| Redeemable convertible preferred stock: \$0.01 par value; 47,070 shares authorized; | 287,337 | 291,247 |

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| | | |
|--|-------------|-------------|
| 44,170 shares issued; 22,987 and 23,300 shares outstanding, respectively | | |
| Deferred compensation – unearned ESOP shares | (187,772) | (190,168) |
| Redeemable noncontrolling interest in subsidiaries | 8,474 | 8,471 |
| Total mezzanine equity | 108,039 | 109,550 |
| Stockholders' equity: | | |
| Common stock; \$0.01 par value: 1,000,000 shares authorized; 57,366 shares issued; | | |
| 56,925 and 56,476 shares outstanding, respectively | 11,431 | 11,426 |
| Paid-in capital | 375,215 | 364,908 |
| Common stock in treasury, at cost | (9,033) | (8,277) |
| Accumulated other comprehensive loss | (24,684) | (21,247) |
| Retained deficit | (11,976) | (39,214) |
| Total ADS stockholders' equity | 340,953 | 307,596 |
| Noncontrolling interest in subsidiaries | 15,586 | 16,663 |
| Total stockholders' equity | 356,539 | 324,259 |
| Total liabilities, mezzanine equity and stockholders' equity | \$1,090,906 | \$1,043,242 |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited) (In thousands, except per share data)

| | Three Months Ended | |
|--|--------------------|-----------|
| | June 30, | |
| | 2018 | 2017 |
| Net sales | \$387,847 | \$358,359 |
| Cost of goods sold | 288,156 | 271,620 |
| Gross profit | 99,691 | 86,739 |
| Operating expenses: | | |
| Selling | 24,165 | 23,099 |
| General and administrative | 21,382 | 26,676 |
| Loss on disposal of assets and costs from exit and disposal activities | 1,104 | 3,423 |
| Intangible amortization | 1,984 | 2,044 |
| Income from operations | 51,056 | 31,497 |
| Other expense: | | |
| Interest expense | 3,802 | 4,479 |
| Derivative gains and other income, net | (814) | (954) |
| Income before income taxes | 48,068 | 27,972 |
| Income tax expense | 14,284 | 9,746 |
| Equity in net loss (income) of unconsolidated affiliates | 133 | (248) |
| Net income | 33,651 | 18,474 |
| Less: net income attributable to noncontrolling interest | 1,371 | 732 |
| Net income attributable to ADS | 32,280 | 17,742 |
| Weighted average common shares outstanding: | | |
| Basic | 56,594 | 55,303 |
| Diluted | 57,158 | 56,010 |
| Net income per share: | | |
| Basic | \$0.51 | \$0.29 |
| Diluted | \$0.51 | \$0.28 |
| Cash dividends declared per share | \$0.08 | \$0.07 |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited) (In thousands)

| | Three Months Ended | |
|--|-----------------------|----------|
| | June 30, | |
| | 2018 | 2017 |
| Net income | \$33,651 | \$18,474 |
| Currency translation (loss) gain | (4,812) | 3,427 |
| Comprehensive income | 28,839 | 21,901 |
| Less: other comprehensive (loss) gain attributable to | | |
| noncontrolling interest | (1,375) | 851 |
| Less: net income attributable to noncontrolling interest | 1,371 | 732 |
| Total comprehensive income attributable to ADS | \$28,843 | \$20,318 |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) (In thousands)

| | Three Months Ended | |
|---|--------------------|-----------|
| | June 30, 2018 | 2017 |
| Cash Flows from Operating Activities | | |
| Net income | \$33,651 | \$18,474 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 17,827 | 18,221 |
| Deferred income taxes | 1,729 | (281) |
| Loss on disposal of assets and costs from exit and disposal activities | 1,104 | 3,423 |
| ESOP and stock-based compensation | 5,580 | 4,304 |
| Amortization of deferred financing charges | 191 | 353 |
| Fair market value adjustments to derivatives | (625) | 191 |
| Equity in net loss (income) of unconsolidated affiliates | 133 | (248) |
| Other operating activities | (1,030) | (1,656) |
| Changes in working capital: | | |
| Receivables | (54,910) | (47,469) |
| Inventories | 1,040 | (2,445) |
| Prepaid expenses and other current assets | (3,665) | (2,547) |
| Accounts payable, accrued expenses, and other liabilities | 8,806 | (6,857) |
| Net cash provided by (used in) operating activities | 9,831 | (16,537) |
| Cash Flows from Investing Activities | | |
| Capital expenditures | (6,874) | (17,949) |
| Other investing activities | (109) | (254) |
| Net cash used in investing activities | (6,983) | (18,203) |
| Cash Flows from Financing Activities | | |
| Proceeds from Revolving Credit Facility | 101,400 | 212,950 |
| Payments on Revolving Credit Facility | (93,700) | (155,750) |
| Payments on Term Loan | — | (72,500) |
| Proceeds from Senior Notes | — | 75,000 |
| Debt issuance costs | — | (2,268) |
| Payments of notes, mortgages and other debt | (230) | (1,225) |
| Payments on capital lease obligations | (5,885) | (6,066) |
| Cash dividends paid | (6,141) | (4,353) |
| Proceeds from exercise of stock options | 3,215 | 6 |
| Repurchase of common stock | — | (7,947) |
| Other financing activities | (257) | (652) |
| Net cash (used in) provided by financing activities | (1,598) | 37,195 |
| Effect of exchange rate changes on cash | (443) | (188) |

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| | | |
|--|-----------|----------|
| Net change in cash | 807 | 2,267 |
| Cash at beginning of period | 17,587 | 6,450 |
| Cash at end of period | \$ 18,394 | \$ 8,717 |
| SUPPLEMENTAL CASH FLOW INFORMATION | | |
| Cash paid for income taxes | \$ 952 | \$ 5,899 |
| Cash paid for interest | 4,000 | 4,498 |
| Non-cash operating, investing and financing activities: | | |
| Acquisition of property, plant and equipment under capital lease and incurred | | |
| lease obligations | 3,171 | 9,588 |
| Balance in accounts payable for the acquisition of property, plant and equipment | 1,851 | 2,593 |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND MEZZANINE EQUITY

(Unaudited) (In thousands)

| | | | Common | | Accumulated | | Total | | Non- | Total | Redeemable | | Deferred |
|----|----------|-----------|--------|-------------|-------------|------------|-----------|-----------|-------------|----------|-----------------|-------------|----------------|
| | Paid | Stock in | | Other | Compreh- | Retain | ADS | holders' | controlling | Stock- | Convertible | ESOP Shares | Compensation - |
| | -In | Treasury | Amount | Loss | ended | ed | Stock- | in | Interest | holders' | Preferred Stock | Shares | Unearned |
| | Capital | Shares | | | Deficit | | Equity | Subsidiar | in | Equity | Shares | Amount | Shares |
| | Amount | Amount | Amount | Amount | Amount | Amount | Amount | Amount | Amount | Amount | Amount | Amount | Amount |
| 60 | \$12,393 | \$755,787 | 98,222 | \$(436,984) | \$(24,815) | \$(83,678) | \$222,703 | \$14,907 | \$237,610 | 24,225 | \$302,814 | 15,863 | \$(198,210) |
| | — | — | — | — | — | 17,742 | 17,742 | 528 | 18,270 | — | — | — | — |
| | — | — | — | — | 2,576 | — | 2,576 | 851 | 3,427 | — | — | — | — |
| | — | — | — | — | — | (458) | (458) | — | (458) | — | — | — | — |
| | — | — | — | — | — | (3,895) | (3,895) | — | (3,895) | — | — | — | — |
| | — | 602 | — | — | — | — | 602 | — | 602 | — | — | (161) | 2,012 |
| | — | 3 | (1) | 3 | — | — | 6 | — | 6 | — | — | — | — |
| | — | 447 | (33) | 147 | — | — | 594 | — | 594 | — | — | — | — |
| | — | 13,714 | — | — | — | — | 13,714 | — | 13,714 | — | — | — | — |

| | | | | | | | | | | | | | |
|----|----------|-----------|----------|-------------|------------|------------|-----------|----------|-----------|----------|-----------|--------|-------------|
| — | 1,084 | — | — | — | — | 1,084 | — | 1,084 | — | — | — | — | |
| — | 3,237 | (274) | 1,220 | — | — | 4,457 | — | 4,457 | (357) | (4,457) | — | — | |
| — | — | 400 | (7,947) | — | — | (7,947) | — | (7,947) | — | — | — | — | |
| 60 | \$12,393 | \$774,874 | 98,314 | \$(443,561) | \$(22,239) | \$(70,289) | \$251,178 | \$16,286 | \$267,464 | 23,868 | \$298,357 | 15,702 | \$(196,200) |
| 9 | \$11,426 | \$364,908 | 413 | \$(8,277) | \$(21,247) | \$(39,214) | \$307,596 | \$16,663 | \$324,259 | 23,300 | \$291,247 | 15,219 | \$(190,100) |
| — | — | — | — | — | — | 32,280 | 32,280 | 1,033 | 33,313 | — | — | — | — |
| — | — | — | — | (3,437) | — | (3,437) | (1,375) | (4,812) | — | — | — | — | |
| — | — | — | — | — | — | (497) | (497) | — | (497) | — | — | — | — |
| — | — | — | — | — | — | (4,545) | (4,545) | — | (4,545) | — | — | — | — |
| — | — | — | — | — | — | — | — | (735) | (735) | — | — | — | — |
| — | 1,625 | — | — | — | — | 1,625 | — | 1,625 | — | — | (192) | 2,396 | |

| | | | | | | | | | | | | | |
|---|----------|-----------|--------|------------|------------|------------|-----------|----------|-----------|----------|-----------|--------|-----------|
| 2 | 3,215 | 26 | (704) | — | — | 2,513 | — | 2,513 | — | — | — | — | |
| 1 | 786 | 2 | (52) | — | — | 735 | — | 735 | — | — | — | — | |
| — | 773 | — | — | — | — | 773 | — | 773 | — | — | — | — | |
| 2 | 3,908 | — | — | — | — | 3,910 | — | 3,910 | (313) | (3,910) | — | — | |
| 6 | \$11,431 | \$375,215 | 441 | \$(9,033) | \$(24,684) | \$(11,976) | \$340,953 | \$15,586 | \$356,539 | 22,987 | \$287,337 | 15,027 | \$(187,77 |

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

Advanced Drainage Systems, Inc.

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business - Advanced Drainage Systems, Inc. and subsidiaries (collectively referred to as “ADS” or the “Company”), incorporated in Delaware, designs, manufactures and markets high performance thermoplastic corrugated pipe and related water management products, primarily in North and South America and Europe. ADS’s broad product line includes corrugated high density polyethylene (or “HDPE”) pipe, polypropylene (or “PP”) pipe and related water management products.

The Company is managed based primarily on the geographies in which it operates and reports results of operations in two reportable segments: Domestic and International.

Historically, sales of the Company’s products have been higher in the first and second quarters of each fiscal year due to favorable weather and longer daylight conditions accelerating construction activity during these periods. Seasonal variations in operating results may also be impacted by inclement weather conditions, such as cold or wet weather, which can delay projects.

Basis of Presentation - The Company prepares its Condensed Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The Condensed Consolidated Balance Sheet as of March 31, 2018 was derived from audited financial statements included in the Annual Report on Form 10-K for the year ended March 31, 2018 (“Fiscal 2018 Form 10-K”). The accompanying unaudited Condensed Consolidated Financial Statements contain all adjustments, of a normal recurring nature, necessary to present fairly its financial position as of June 30, 2018 and the results of operations and cash flows for the three months ended June 30, 2018. The interim Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements, including the notes thereto, filed in the Company’s Fiscal 2018 Form 10-K.

Principles of Consolidation - The Condensed Consolidated Financial Statements include the Company, its wholly-owned subsidiaries, its majority-owned subsidiaries and variable interest entities (“VIEs”) of which the Company is the primary beneficiary. The Company uses the equity method of accounting for equity investments where it exercises significant influence but does not hold a controlling financial interest. Such investments are recorded in Other assets in the Condensed Consolidated Balance Sheets and the related equity earnings from these investments are included in Equity in net loss (income) of unconsolidated affiliates in the Condensed Consolidated Statements of Operations. All intercompany balances and transactions have been eliminated in consolidation.

Recent Accounting Guidance

Recently Adopted Accounting Guidance

Revenue Recognition - In May 2014, the FASB issued an accounting standards update (“ASU”) which amends the guidance for revenue recognition. This amendment contains principles that will require an entity to recognize revenue to depict the transfer of goods and services to customers at an amount that an entity expects to be entitled to in exchange for goods or services. The amendment sets forth a new revenue recognition model that requires identifying the contract, identifying the performance obligations and recognizing the revenue upon satisfaction of performance obligations. In August 2015, the FASB issued an additional accounting standards update that deferred the effective date of the new revenue standard for public entities to periods beginning after December 15, 2017, with early adoption permitted but not earlier than the original effective date of periods beginning after December 15, 2016. There have also been various additional accounting standards updates issued by the FASB in 2016 that further amend this new revenue standard. The updated standard permits the use of either the retrospective or cumulative effect transition method. The Company adopted these standards on April 1, 2018 using the modified retrospective transition method. See “Note 3. Revenue Recognition” for further information on the adoption of the revenue recognition ASU.

- 6 -

Table of Contents

Advanced Drainage Systems, Inc.

Cash Flow Classification - In August 2016, the FASB issued an ASU which provides amended guidance on the classification of certain cash receipts and cash payments in the statement of cash flows, including related to debt prepayment or debt extinguishment costs, contingent consideration payments made after a business combination, proceeds from the settlement of insurance claims, proceeds from the settlement of corporate-owned life insurance and distributions received from equity method investees. This update is effective for fiscal years beginning after December 15, 2017, including interim periods within those years, and early adoption is permitted. This amended guidance must be applied retrospectively to all periods presented, but may be applied prospectively if retrospective application would be impracticable. The Company adopted this update effective April 1, 2018 using the retrospective method. The new standard did not have a material impact on the Condensed Consolidated Financial Statements.

Goodwill Impairment - In January 2017, the FASB issued an ASU which removes the requirement to compare the implied fair value of goodwill with its carrying amount as part of step 2 of the goodwill impairment test. As a result, under the standards update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. The amendments are effective for annual periods beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company adopted this update effective April 1, 2018. The new standard did not have an impact on the Condensed Consolidated Financial Statements.

Definition of a Business - In January 2017, the FASB issued an ASU to clarify the definition of a business. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. The amendments are intended to help companies and other organizations evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments provide a more robust framework to use in determining when a set of assets and activities is a business. The amendments are effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The Company adopted this update effective April 1, 2018. The new standard did not have an impact on the Condensed Consolidated Financial Statements.

Stock-Based Compensation - In May 2017, the FASB issued an ASU to clarify when modification accounting should be applied for changes to the terms or conditions of share-based payment awards. The amendments clarify that modification accounting guidance should only be applied if there is a change to the value, vesting conditions, or award classification and would not be required if the changes are considered non-substantive. The amendments are effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The Company adopted this update effective April 1, 2018. The new standard did not have an impact on the Condensed Consolidated Financial Statements.

Recent Accounting Guidance Not Yet Adopted

Leases - In February 2016, the FASB issued an ASU which amends the guidance for leases. This standard contains principles that will require an entity to recognize most leases on the balance sheet by recording a right-of-use asset and a lease liability, unless the lease is a short-term lease that has an accounting lease term of twelve months or less. The standard also contains other changes to the current lease guidance that may result in changes to how entities determine

which contractual arrangements qualify as a lease, the accounting for executory costs such as property taxes and insurance, as well as which lease origination costs will be capitalizable. The new standard also requires expanded quantitative and qualitative disclosures. This standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those years, and early adoption is permitted. The standard requires the use of the modified retrospective transition method, whereby the new guidance will be applied at the beginning of the earliest period presented in the financial statements of the period of adoption. The modified retrospective transition approach includes certain practical expedients that entities may elect to apply in transition. The Company expects to adopt this standard effective April 1, 2019. The Company has implemented a new software solution to improve the process of tracking and accounting for leases under the current and new standards. The Company has not yet determined whether to

- 7 -

Table of Contents

Advanced Drainage Systems, Inc.

apply any of the available practical expedients. The Company is in the process of reviewing contracts under the new standard to determine the impact the new standard will have on the Condensed Consolidated Financial Statements.

Measurement of Credit Losses - In June 2016, the FASB issued an ASU which provides amended guidance on the measurement of credit losses on financial instruments, including trade receivables. This standard requires the use of an impairment model referred to as the current expected credit loss model. This standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those years, and early adoption is permitted for fiscal years beginning after December 15, 2018. The Company expects to adopt this standard effective April 1, 2020. The Company is currently evaluating the impact of this standard on the Condensed Consolidated Financial Statements.

Hedge Accounting – In August 2017, the FASB issued an ASU which expands an entity’s ability to apply hedge accounting for non-financial and financial risk components and provides a simplified approach for fair value hedging of interest rate risk. The standard also refines how entities assess hedge effectiveness. This standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those years, and early adoption is permitted. The Company expects to adopt this standard effective April 1, 2019. The Company is currently evaluating the impact of this standard on the Condensed Consolidated Financial Statements.

With the exception of the pronouncements described above, there have been no new accounting pronouncements issued or adopted since the filing of the Fiscal 2018 Form 10-K that have significance, or potential significance, to the Condensed Consolidated Financial Statements.

2. LOSS ON DISPOSAL OF ASSETS AND COSTS FROM EXIT AND DISPOSAL ACTIVITIES

In fiscal 2018, the Company initiated restructuring activities (the “2018 Restructuring Plan”), including closing two underutilized manufacturing facilities, reducing headcount, optimizing product offerings and eliminating nonessential costs, designed to improve the Company’s cost structure. As additional restructuring opportunities may be identified, the Company does not have an estimated completion date or expected total cost estimate for the 2018 Restructuring Plan. The following table summarizes the activity included in Loss on disposal of assets and costs from exit and disposal activities recorded during the three months ended June 30, 2018 and 2017:

| | Three Months Ended | |
|---|--------------------|----------------|
| | June 30, 2018 | 2017 |
| | (in thousands) | |
| Accelerated depreciation | \$— | \$2,041 |
| Plant severance | (35) | 641 |
| Corporate severance | — | — |
| Other restructuring activities | 31 | — |
| Total 2018 Restructuring Plan activities | \$(4) | \$2,682 |

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| | | |
|--|---------|---------|
| Loss on other disposals and partial disposals of property, plant and equipment | 1,108 | 741 |
| Total loss on disposal of assets and costs from exit and disposal activities | \$1,104 | \$3,423 |

Approximately \$2.7 million of the Total 2018 Restructuring Plan activities related to the Domestic reporting segment for the three months ended June 30, 2017, respectively. There were no 2018 Restructuring Plan activities related to the International reporting segment for the three months ended June 30, 2018 and 2017, respectively.

- 8 -

Table of Contents

Advanced Drainage Systems, Inc.

A reconciliation of the beginning and ending amounts of restructuring liability related to the 2018 Restructuring Plan at June 30, 2018 and 2017 is as follows:

| | Three Months Ended | |
|--|-----------------------|------|
| | June 30, 2018 | 2017 |
| (Amounts in thousands) | (In thousands) | |
| Balance at the beginning of the period | \$3,901 | \$ — |
| Expenses | 55 | — |
| Non-cash expenses | (59) | — |
| Payments | (1,074) | — |
| Balance at the end of the period | \$2,823 | \$ — |

As of June 30, 2018 and March 31, 2018, the Company had \$0.4 million and \$0.5 million of long-term severance liability related to the restructuring activities recorded in Other liabilities in the Condensed Consolidated Balance Sheet.

3. REVENUE RECOGNITION

On April 1, 2018, the Company adopted Accounting Standards Codification Topic 606, Revenue from Contracts with Customers (“ASC 606”), and all related amendments using the modified retrospective transition method. The adoption of ASC 606 did not impact the opening retained earnings balance or cause a material shift in the amount or timing of revenue recognition. Results for reporting periods beginning after April 1, 2018 are presented under ASC 606, while prior period amounts were not adjusted and continue to be reported in a consistent manner with historical accounting policies.

The Company generates revenue by selling pipe and related water management products primarily to distributors, retailers, buying groups and co-operative buying groups. Products are shipped predominately by the Company’s internal fleet, and the Company does not provide any additional revenue generating services after product delivery. Payment terms and conditions vary by contract.

Revenue is recognized at the point in-time obligations under the terms of a contract with a customer are satisfied; generally upon the transfer of control of the promised goods. In substantially all of the Company’s contracts with customers, control is transferred to the customer upon delivery. The Company recognizes revenue in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. Revenue is presented in the Condensed Consolidated Statements of Operations net of allowances for returns, rebates, discounts, and taxes collected concurrently with revenue-producing activities.

Refer to “Note 13. Business Segments Information” for the Company’s disaggregation of Net sales by reportable segment. The disclosure of Net sales by reportable segment is aligned by geographical region and product type and best depicts how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

Significant Judgments - The Company's performance obligation under contracts with customers is to sell and deliver pipe and related water products. The Company's contracts with customers may contain multiple performance obligations by promising to deliver multiple products to the customer. For these contracts, the Company accounts for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis.

The Company's products are generally sold with a right of return, and the Company may provide credits or incentives, which are accounted for as variable consideration when estimating the amount of revenue to recognize. Variable consideration is estimated at contract inception and updated at the end of each reporting period as additional information becomes available and only to the extent that it is probable that a significant reversal of any incremental revenue will not occur.

Table of Contents

Advanced Drainage Systems, Inc.

Contract Balances - The Company recognizes a contract asset representing the Company's right to recover products upon the receipt of returned products and a contract liability for the customer refund. The adoption of this standard resulted in the Company recording a contract asset for estimated inventory returns. On April 1, 2018, the estimated inventory returns resulted in a \$0.6 million decrease in Receivables, net and a \$0.6 million increase in Other current assets on the Company's Consolidated Balance Sheets. The following table presents the balance of the Company's contract asset and liability as of June 30, 2018 and April 1, 2018:

| | June 30, 2018 | April 1, 2018 |
|----------------------------------|---------------------|---------------------|
| | (In thousands) | |
| Contract asset - product returns | \$674 | \$577 |
| Refund liability | 1,610 | 1,468 |

Practical Expedients and Exemptions - The Company expenses incremental costs to obtain a contract (e.g. sales commissions) when incurred as the amortization period would have been one year or less. These costs are recorded within selling expenses on the Condensed Consolidated Statements of Operations.

The Company has elected the accounting policy election permitted by ASC 606 to account for shipping and handling costs as activities to fulfill the promise to transfer the goods when these activities are performed after a customer obtains control of the goods. Revenue will be recognized at the point of shipment.

The Company has elected the accounting policy to exclude from the transaction price all sales taxes that are assessed by a governmental authority and that are imposed on and concurrent with a specific revenue-producing transaction and collected by the Company from a customer, for example, sales, use, value added, and some excise taxes.

Further, the Company does not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less.

4. INVENTORIES

Inventories as of the periods presented consisted of the following:

| | June 30, 2018 | March 31, 2018 |
|--|------------------|----------------------|
| | (In thousands) | |

| | | |
|-------------------|-----------|-----------|
| Raw materials | \$54,591 | \$54,909 |
| Finished goods | 207,130 | 208,883 |
| Total inventories | \$261,721 | \$263,792 |

There were no work-in-process inventories as of the periods presented.

5. FAIR VALUE MEASUREMENT

When applying fair value principles in the valuation of assets and liabilities, the Company is required to maximize the use of quoted market prices and minimize the use of unobservable inputs. The Company has not changed its valuation techniques used in measuring the fair value of any financial assets or liabilities during the fiscal years presented. The fair value estimates take into consideration the credit risk of both the Company and its counterparties.

When active market quotes are not available for financial assets and liabilities, ADS uses industry standard valuation models. Where applicable, these models project future cash flows and discount the future amounts to a present value using market-based observable inputs including credit risk, interest rate curves, foreign currency rates and forward and spot prices for currencies. In circumstances where market-based observable inputs are not available, management judgment is used to develop assumptions to estimate fair value.

- 10 -

Table of Contents

Advanced Drainage Systems, Inc.

Generally, the fair value of Level 3 instruments is estimated as the net present value of expected future cash flows based on internal and external inputs.

Recurring Fair Value Measurements - The assets and liabilities carried at fair value as of the periods presented were as follows:

| | June 30, 2018 | | | |
|--|----------------|---------|---------|---------|
| | Total | Level 1 | Level 2 | Level 3 |
| | (In thousands) | | | |
| Assets: | | | | |
| Derivative assets – diesel fuel contracts | \$818 | \$ — | \$818 | \$— |
| Interest rate swaps | 3,414 | — | 3,414 | — |
| Total assets at fair value on a recurring basis | \$4,232 | \$ — | \$4,232 | \$— |
| Liabilities: | | | | |
| Derivative liabilities – diesel fuel contracts | \$326 | \$ — | \$326 | \$— |
| Contingent consideration for acquisitions | 460 | — | — | 460 |
| Total liabilities at fair value on a recurring basis | \$786 | \$ — | \$326 | \$460 |

| | March 31, 2018 | | | |
|--|----------------|---------|---------|---------|
| | Total | Level 1 | Level 2 | Level 3 |
| | (In thousands) | | | |
| Assets: | | | | |
| Derivative assets – diesel fuel contracts | \$596 | \$ — | \$596 | \$— |
| Interest rate swaps | 2,801 | — | 2,801 | — |
| Total assets at fair value on a recurring basis | \$3,397 | \$ — | \$3,397 | \$— |
| Liabilities: | | | | |
| Derivative liability - diesel fuel contracts | \$116 | \$ — | \$116 | \$— |
| Contingent consideration for acquisitions | 578 | — | — | 578 |
| Total liabilities at fair value on a recurring basis | \$694 | \$ — | \$116 | \$578 |

For the three months ended June 30, 2018 and 2017, respectively, there were no transfers in or out of Levels 1, 2 or 3.

Valuation of Contingent Consideration for Acquisitions - The fair values of the contingent consideration payables for acquisitions were calculated based on a discounted cash flow model, whereby the probability-weighted future payment value is discounted to the present value using a market discount rate. The method used to price these liabilities is considered Level 3, due to the subjective nature of the unobservable inputs used to determine the fair value. Changes in the fair value of recurring fair value measurements using significant unobservable inputs (Level 3)

for the periods presented were as follows:

| | Three Months Ended | |
|--|-----------------------|---------|
| | June 30, 2018 | 2017 |
| | (In thousands) | |
| Balance at the beginning of the period | \$578 | \$1,348 |
| Change in fair value | 2 | 26 |
| Payments of contingent consideration liability | (120) | (516) |
| Balance at the end of the period | \$460 | \$858 |

Valuation of Debt - The carrying amounts of current financial assets and liabilities approximate fair value because of the immediate or short-term maturity of these items, or in the case of derivative instruments, because they are recorded at fair value. The carrying and fair value of the Company's Senior Notes (discussed

Table of Contents

Advanced Drainage Systems, Inc.

in “Note 12. Debt” in the Company’s Fiscal 2018 Form 10-K) were \$125.0 million and \$121.8 million, respectively, as of June 30, 2018 and \$125.0 million and \$122.3 million, respectively, at March 31, 2018. The fair value of the Senior Notes was determined based on a comparison of the interest rate and terms of such borrowings to the rates and terms of similar debt available for the period. The Company believes the carrying amount on the remaining long-term debt, including the Secured Bank Term Loans, is not materially different from its fair value as the interest rates and terms of the borrowings are similar to currently available borrowings. The categorization of the framework used to evaluate this debt is considered Level 2.

6. DERIVATIVE TRANSACTIONS

The Company uses interest rate swaps, commodity options in the form of collars and swaps, and foreign currency forward contracts to manage its various exposures to interest rate, commodity price fluctuations and foreign currency exchange rate fluctuations. For the interest rate swap executed on June 28, 2017, gains and losses resulting from the difference between the spot rate and applicable base rate is recorded in Interest expense. For collars, commodity swaps and foreign currency forward contracts, contract settlement gains and losses are recorded in the Condensed Consolidated Statements of Operations in Derivative gains and other income, net. Gains and losses related to mark-to-market adjustments for changes in fair value of the derivative contracts are also recorded in the Condensed Consolidated Statements of Operations in Derivative gains and other income, net.

The Company recorded net losses and net (gains) on mark-to-market adjustments for changes in the fair value of derivatives contracts as well as net losses and net (gains) on the settlement of derivative contracts as follows:

| | Three Months Ended | |
|--|--------------------------|-------|
| | June 30, 2018 | 2017 |
| | (in thousands) | |
| Diesel fuel option collars | \$(12) | \$276 |
| Interest rate swaps | (613) | (85) |
| Total net unrealized mark-to-market (gains) losses | \$(625) | \$191 |
| Diesel fuel option collars | (308) | 52 |
| Foreign exchange forward contracts | (51) | — |
| Interest rate swaps | (25) | — |
| Total net realized (gains) losses | \$(384) | \$52 |

A summary of the fair value of derivatives is included in “Note 5. Fair Value Measurement.”

7.NET INCOME PER SHARE AND STOCKHOLDERS’ EQUITY

The Company is required to apply the two-class method to compute both basic and diluted net income per share. The two-class method is an earnings allocation formula that treats participating securities as having rights to earnings that would otherwise have been available to common stockholders.

- 12 -

Table of Contents

Advanced Drainage Systems, Inc.

The following table presents information necessary to calculate net income per share for the periods presented, as well as potentially dilutive securities excluded from the weighted average number of diluted common shares outstanding because their inclusion would have been anti-dilutive:

| | Three Months Ended | |
|--|-----------------------|----------|
| | June 30, | |
| (In thousands, except per share data) | 2018 | 2017 |
| NET INCOME PER SHARE—BASIC: | | |
| Net income attributable to ADS | \$32,280 | \$17,742 |
| Adjustments for: | | |
| Dividends to redeemable convertible preferred | | |
| stockholders | (497) | (489) |
| Dividends paid to unvested restricted stockholders | (15) | (19) |
| Net income available to common stockholders and | | |
| participating securities | 31,768 | 17,234 |
| Undistributed income allocated to participating | | |
| securities | (2,712) | (1,429) |
| Net income available to common stockholders – | | |
| Basic | \$29,056 | \$15,805 |
| Weighted average number of common shares | | |
| outstanding – Basic | 56,594 | 55,303 |
| Net income per common share – Basic | \$0.51 | \$0.29 |
| NET INCOME PER SHARE—DILUTED: | | |
| Net income available to common stockholders – | | |
| Diluted | \$29,056 | \$15,805 |
| Weighted average number of common shares | | |
| outstanding – Basic | 56,594 | 55,303 |
| Assumed exercise of stock options | 564 | 707 |
| Weighted average number of common shares | | |
| outstanding – Diluted | 57,158 | 56,010 |
| Net income per common share – Diluted | \$0.51 | \$0.28 |
| Potentially dilutive securities excluded as | 6,166 | 6,459 |

anti-dilutive

Stockholders' Equity –During the three months ended June 30, 2017, the Company repurchased 0.4 million shares of common stock at a cost of \$7.9 million. The Company did not repurchase any shares of common stock during the three months ended June 30, 2018. The repurchases were made under the Board of Directors' authorization in February 2017 to repurchase up to \$50 million of ADS common stock in accordance with applicable securities laws. As of June 30, 2018, approximately \$42.1 million of common stock may be repurchased under the authorization. The repurchase program does not obligate the Company to acquire any particular amount of common stock, and may be suspended or terminated at any time at the Company's discretion.

8. RELATED PARTY TRANSACTIONS

ADS Mexicana - ADS conducts business in Mexico and Central America through its joint venture ADS Mexicana, S.A. de C.V. (together with its affiliate ADS Corporativo, S.A. de C.V., "ADS Mexicana"). ADS owns 51% of the outstanding stock of ADS Mexicana and consolidates ADS Mexicana for financial reporting purposes.

ADS Mexicana's Revolving Credit Facility expired on June 22, 2018 and was replaced by an Intercompany Revolving Credit Promissory Note (the "Intercompany Note") with a borrowing capacity of \$12.0 million. The Intercompany Note matures on June 22, 2022. The other joint venture partner indemnifies the Company for 49% of any unpaid borrowing. The interest rates under the Intercompany Note are determined by certain

- 13 -

Table of Contents

Advanced Drainage Systems, Inc.

base rates or London Interbank Offered Rate (“LIBOR”) plus an applicable margin based on the Leverage Ratio. As of June 30, 2018 there were no borrowings under the Intercompany Note.

South American Joint Venture - The Tuberias Tigre – ADS Limitada joint venture (the “South American Joint Venture”) manufactures and sells HDPE corrugated pipe in certain South American markets. ADS owns 50% of the South American Joint Venture. ADS is the guarantor of 50% of the South American Joint Venture’s credit facility, and the debt guarantee is shared equally with the joint venture partner. The Company’s maximum potential obligation under this guarantee is \$11.0 million as of June 30, 2018. The maximum borrowings permitted under the South American Joint Venture’s credit facility are \$22.0 million. This credit facility allows borrowings in either Chilean pesos or US dollars at a fixed interest rate determined at inception of each draw on the facility. The guarantee of the South American Joint Venture’s debt expires on December 31, 2020. ADS does not anticipate any required contributions related to the balance of this credit facility. As of June 30, 2018 and March 31, 2018, the outstanding principal balances of the credit facility including letters of credit were \$13.4 million and \$14.5 million, respectively. As of June 30, 2018, there were no U.S. dollar denominated loans. The weighted average interest rate as of June 30, 2018 was 5.7% on Chilean peso denominated loans.

ADS and the South American Joint Venture have shared services arrangements in order to execute the joint venture services. In addition, the South American Joint Venture has entered into agreements for pipe sales with ADS and its other related parties, which totaled \$0.6 million and \$0.6 million for the three months ended June 30, 2018 and 2017, respectively. ADS pipe sales to the South American Joint Venture were \$0.2 million and \$0.1 million for the three months ended June 30, 2018 and 2017, respectively.

BaySaver - BaySaver Technologies LLC (“BaySaver”) is a joint venture that was established to produce and distribute water quality filters and separators used in the removal of sediment and pollution from storm water. ADS owns 65% of the outstanding stock of BaySaver and consolidates its interest in BaySaver.

ADS and BaySaver have entered into shared services arrangements in order to execute the joint venture services. Included within these arrangements are the lease of a plant and adjacent yard used to conduct business and operating expenses related to the leased facility.

Tigre-ADS USA - Tigre-ADS USA was a joint venture established to manufacture and sell PVC fittings for waterworks, plumbing, and HVAC applications primarily in the United States and Canadian markets. In April 2018, the Company and the joint venture partner agreed to exchange the Company’s shares of Tigre-ADS USA for a release from the existing debt guarantees. Following the exchange, the Company no longer has an ownership interest in Tigre-ADS USA.

As of June 30, 2018, ADS is the guarantor of 49% of a specific Tigre-ADS USA credit facility. The Company’s maximum potential obligation under this guarantee was \$1.2 million as of June 30, 2018. The Company was released from the guarantee of Tigre-ADS USA’s debt on July 12, 2018.

ADS purchased \$0.5 million and \$0.6 million of Tigre-ADS USA manufactured products for use in the production of ADS products during the three months ended June 30, 2018 and 2017.

Table of Contents

Advanced Drainage Systems, Inc.

9. DEBT

Long-term debt as of the periods presented consisted of the following:

| | June 30, | March 31, |
|--|----------------|----------------|
| | 2018 | 2018 |
| | (In thousands) | |
| Secured Bank Term Loans: | | |
| Revolving Credit Facility — ADS | \$ 179,200 | \$ 171,500 |
| Revolving Credit Facility — ADS Mexicana | — | — |
| Senior Notes payable | 125,000 | 125,000 |
| Industrial revenue bonds | 710 | 940 |
| Equipment financing | 3,111 | 3,336 |
| Total | 308,021 | 300,776 |
| Unamortized debt issuance costs | (2,837) | (3,028) |
| Current maturities | (26,623) | (26,848) |
| Long-term debt obligation | \$ 278,561 | \$ 270,900 |

Events Related to the Secured Bank Term Loans - On June 22, 2018, the Company's \$12.0 million Revolving Credit Facility – ADS Mexicana matured. At June 22, 2018, there were no borrowings under the Revolving Credit Facility – ADS Mexicana.

Fiscal 2019 Amendment to the Secured Bank Term Loans – On July 9, 2018, the Company amended the Second Amended and Restated Credit (the “Credit Agreement”) and the Second Amended and Restated Private Shelf Agreement (the “Private Shelf Agreement”) to amend the definition of Consolidated EBITDA and changed the timing of the quarterly rate adjustments. In addition, the amendment to the Credit Agreement clarified the process of a transition to replace LIBOR which is being phased out.

10. COMMITMENTS AND CONTINGENCIES

Purchase Commitments – The Company secures supplies of resin raw material by agreeing to purchase quantities during a future given period at a fixed price. These purchase contracts typically range from 1 to 12 months and occur in the ordinary course of business. Under such noncancelable purchase contracts in place at June 30, 2018, the Company has agreed to purchase resin over the period July 2018 through December 2018 at a committed purchase cost of \$8.9 million.

Litigation and Other Proceedings – As previously disclosed in the Company's Fiscal 2018 Form 10-K, the Company's historical accounting practices were the subject of an investigation by SEC's Division of Enforcement (the “Enforcement Division”), which began in August 2015. That matter was resolved on July 10, 2018 via a settlement between the Company and the SEC. Pursuant to the settlement, the Company consented to the entry of an administrative order without admitting or denying the findings therein. The order required the Company to cease and desist from committing or causing any violations and any future violations of certain provisions of the federal

securities laws and the rules promulgated thereunder and to pay a civil monetary penalty of \$1.0 million, which payment has been made. The Company previously accrued an expense for the penalty amount during Fiscal 2018.

The Company is involved from time to time in various legal proceedings that arise in the ordinary course of business, including but not limited to commercial disputes, environmental matters, employee related claims, intellectual property disputes and litigation in connection with transactions including acquisitions and divestitures. The Company does not believe that such litigation, claims, and administrative proceedings will have a material adverse impact on the Company's financial position or results of operations. The Company records a liability when a loss is considered probable, and the amount can be reasonably estimated.

- 15 -

Table of Contents

Advanced Drainage Systems, Inc.

11. INCOME TAXES

The Tax Cuts and Jobs Act (the “Tax Act”) was enacted on December 22, 2017. The Tax Act significantly revises the future ongoing U.S. corporate income tax by, among other things, lowering the U.S. corporate income tax rate from 35% to 21%, full expensing on qualified property, eliminates the domestic manufacturing deduction and implements a territorial tax system. The 21% U.S. corporate income tax rate was effective January 1, 2018.

The Company has recognized the provisional tax impacts related to revaluation of deferred tax assets and liabilities and deemed repatriated earnings and included these amounts in its financial statements for the year ended March 31, 2018. The ultimate impact may differ from these provisional amounts, possibly materially, due to, among other things, additional analysis, changes in interpretations and assumptions the Company has made, additional regulatory guidance that may be issued, and actions the Company may take as a result of the Tax Act. During the three months ended June 30, 2018, the Company did not make any adjustments to its provisional amounts included in its Consolidated Financial Statements for the year ended March 31, 2018. The accounting is expected to be finalized in conjunction with the filing of the fiscal 2018 U.S. corporate income tax return, no later than the close of third quarter fiscal 2019.

The Company’s effective tax rate will vary based on a variety of factors, including overall profitability, the geographical mix of income before taxes and related tax rates in jurisdictions where it operates and other onetime charges, as well as discrete events. For the three months ended June 30, 2018 and 2017, the Company utilized an effective tax rate of 29.7% and 34.8%, respectively, to calculate its provision for income taxes. These rates are higher than the federal statutory rate primarily due to state and local income taxes and the Company’s Employee Stock Ownership Plan (“ESOP”). In addition, the effective tax rate for the three months ended June 30, 2017 differed from the federal statutory rate due to the impact of a \$1.0 million discrete income tax benefit related to the release of tax reserves.

12. STOCK-BASED COMPENSATION

ADS has several programs for stock-based payments to employees and non-employee members of its Board of Directors, including stock options and restricted stock. Equity-classified restricted stock awards are measured based on the grant-date estimated fair value of each award. The Company accounts for all restricted stock granted to Directors as equity-classified awards. The Company recognized stock-based compensation expense in the following line items of the Condensed Consolidated Statements of Operations for the three months ended June 30, 2018 and 2017:

| | Three Months Ended | |
|--|-----------------------|------|
| | June 30, 2018 | 2017 |
| | (in thousands) | |
| Component of income before income taxes: | | |
| Cost of goods sold | \$62 | \$45 |
| Selling expenses | 36 | 25 |

| | | |
|--|---------|---------|
| General and administrative expenses | 1,461 | 1,620 |
| Total stock-based compensation expense | \$1,559 | \$1,690 |

- 16 -

Table of Contents

Advanced Drainage Systems, Inc.

The following table summarizes stock-based compensation expense by award type for the three months ended June 30, 2018 and 2017:

| | Three Months Ended | |
|--|-----------------------|---------|
| | June 30, 2018 | 2017 |
| | (in thousands) | |
| Stock-based compensation expense: | | |
| Equity-classified Stock Options | \$773 | \$1,084 |
| Restricted Stock | 543 | 368 |
| Non-Employee Directors | 243 | 238 |
| Total stock-based compensation expense | \$1,559 | \$1,690 |

2017 Omnibus Plan

On May 24, 2017, the Board of Directors approved the 2017 Omnibus Incentive Plan (the “2017 Incentive Plan”) which was approved by the Company’s stockholders on July 17, 2017. The 2017 Incentive Plan provides for the issuance of a maximum of 3.5 million shares of the Company’s common stock for awards made thereunder, which awards may consist of stock options, restricted stock, restricted stock units, stock appreciation rights, phantom stock, cash-based awards, performance awards (which may take the form of performance cash, performance units or performance shares) or other stock-based awards.

During the three months ended June 30, 2018, the Company granted 0.1 million shares of restricted stock. The grant date fair value of the restricted stock was \$2.3 million.

Performance Units - In addition, the Company granted 0.1 million performance units, subject to performance and services conditions. The grant date fair value of the performance units was \$2.8 million, based on the market price of the Company’s common stock at the date of the grant. For the performance units, 50% of the award is based upon the achievement of certain levels of Return on Invested Capital for the performance period and 50% is based upon the achievement of certain levels of Free Cash Flow for the performance period. The performance units have a 3-year performance period from April 1, 2018 through March 31, 2021. The performance units, and any accrued dividend equivalents, will be settled in shares of the Company’s common stock, if the applicable performance and service conditions are satisfied.

Options – During the three months ended June 30, 2018, the Company granted 0.2 million nonqualified stock options under the 2017 Incentive Plan. The grant date fair value of the nonqualified stock options was \$1.9 million. The Company estimates the fair value of stock options using a Black-Scholes option-pricing model. The following table summarizes the assumptions used in estimate the fair value of stock-options during the three months ended June 30, 2018:

| | Three Months Ended |
|---|--------------------|
| | June 30, 2018 |
| Common stock price | \$25.75 |
| Expected stock price volatility | 30.5% |
| Risk-free interest rate | 2.9% |
| Weighted-average expected option life (years) | 6.0 |
| Dividend yield | 1.2% |

13. BUSINESS SEGMENTS INFORMATION

The Company operates its business in two distinct operating and reportable segments based on the markets it serves: “Domestic” and “International.” The Chief Operating Decision Maker (“CODM”) evaluates segment reporting based on Net sales and Segment Adjusted EBITDA. The Company calculates Segment Adjusted EBITDA as net income or loss before interest, income taxes, depreciation and amortization, stock-based

- 17 -

Table of Contents

Advanced Drainage Systems, Inc.

compensation expense, non-cash charges and certain other expenses. Beginning, April 1, 2018, the Company revised its allocation of allowances for returns, rebates, and discounts between Pipe and Allied Products for segment reporting purposes. Prior to April 1, 2018, the Company allocated substantially all returns, rebates, and discounts to Pipe net sales. These changes did not impact the Company's previously reported consolidated financial results. The prior period segment results and related disclosures have been recast to conform to the current year presentation under the new allocation methodology. The following table sets forth reportable segment information with respect to the amount of Net sales contributed by each class of similar products for the periods presented:

| | Three Months Ended | |
|----------------------|--------------------|-----------|
| | June 30, | 2017 |
| | 2018 | |
| | (In thousands) | |
| Domestic | | |
| Pipe | \$242,026 | \$228,623 |
| Allied Products | 100,472 | 90,874 |
| Total domestic | 342,498 | 319,497 |
| International | | |
| Pipe | 34,448 | 29,954 |
| Allied Products | 10,901 | 8,908 |
| Total international | 45,349 | 38,862 |
| Total Net sales | \$387,847 | \$358,359 |

The following sets forth certain additional financial information attributable to the reportable segments for the periods presented:

| | Domestic | International | Total |
|---|----------------|---------------|-----------|
| | (In thousands) | | |
| For the three months ended June 30, 2018 | | | |
| Net sales | \$342,498 | \$ 45,349 | \$387,847 |
| Segment Adjusted EBITDA | 68,832 | 6,311 | 75,143 |
| Interest expense | 3,757 | 45 | 3,802 |
| Income tax expense | 13,257 | 1,027 | 14,284 |
| Depreciation and amortization | 15,953 | 1,874 | 17,827 |
| Equity in net loss of unconsolidated affiliates | — | 133 | 133 |
| Capital expenditures | 5,881 | 993 | 6,874 |
| For the three months ended June 30, 2017 | | | |
| Net sales | \$319,497 | \$ 38,862 | \$358,359 |

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| | | | |
|--|--------|--------|--------|
| Segment Adjusted EBITDA | 55,089 | 5,256 | 60,345 |
| Interest expense | 4,385 | 94 | 4,479 |
| Income tax expense | 9,515 | 231 | 9,746 |
| Depreciation and amortization | 16,263 | 1,958 | 18,221 |
| Equity in net loss (income) of unconsolidated affiliates | 218 | (466) | (248) |
| Capital expenditures | 17,108 | 841 | 17,949 |

- 18 -

Table of Contents

Advanced Drainage Systems, Inc.

The following sets forth certain additional financial information attributable to the reportable segments as of the periods presented:

| | June 30, | March 31, |
|--|----------------|--------------|
| | 2018 | 2018 |
| | (In thousands) | |
| Investments in unconsolidated affiliates | | |
| International | \$ 11,028 | \$ 12,343 |
| Total | \$ 11,028 | \$ 12,343 |
| Total identifiable assets | | |
| Domestic | \$963,346 | \$904,718 |
| International | 145,746 | 142,822 |
| Eliminations | (18,186) | (4,298) |
| Total | \$ 1,090,906 | \$ 1,043,242 |

The following reconciles segment adjusted EBITDA to net income for the periods presented:

| | For the Three Months Ended June 30, | | | |
|--|-------------------------------------|---------------|----------|---------------|
| | 2018 | | 2017 | |
| | Domestic | International | Domestic | International |
| | (In thousands) | | | |
| Reconciliation of Segment Adjusted EBITDA: | | | | |
| Net income | \$30,589 | \$ 3,062 | \$15,150 | \$ 3,324 |
| Depreciation and amortization | 15,953 | 1,874 | 16,263 | 1,958 |
| Interest expense | 3,757 | 45 | 4,385 | 94 |
| Income tax expense | 13,257 | 1,027 | 9,515 | 231 |
| Segment EBITDA | 63,556 | 6,008 | 45,313 | 5,607 |
| Derivative fair value adjustments | (12) | — | 191 | — |
| Foreign currency transaction gains | — | (171) | — | (869) |
| Loss on disposal of assets and costs from exit and disposal activities | 1,009 | 95 | 3,319 | 104 |
| Unconsolidated affiliates interest, tax, depreciation and amortization ^(a) | — | 379 | 294 | 414 |
| Contingent consideration remeasurement | 2 | — | 26 | — |
| Stock-based compensation expense | 1,559 | — | 1,690 | — |

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| | | | | |
|--|----------|----------|----------|----------|
| ESOP deferred stock-based compensation | 4,021 | — | 2,614 | — |
| Executive retirement (benefit) expense | (328) | — | 15 | — |
| Restatement-related (benefit) costs ^(b) | (1,231) | — | 1,460 | — |
| Transaction costs ^(c) | 256 | — | 167 | — |
| Segment Adjusted EBITDA | \$68,832 | \$ 6,311 | \$55,089 | \$ 5,256 |

- (a) Includes the proportional share of interest, income taxes, depreciation and amortization related to the South American Joint Venture and the former Tigre-ADS USA joint venture, which are accounted for under the equity method of accounting.
- (b) Represents expenses recorded related to legal, accounting and other professional fees incurred in connection with the restatement of the prior period financial statements as reflected in the fiscal year 2015 Form 10-K and fiscal year 2016 Form 10-K/A. The benefit recognized in fiscal 2019 is the result of insurance proceeds received in fiscal 2019.
- (c) Represents expenses recorded related to legal, accounting and other professional fees incurred in connection with the debt refinancing and asset acquisitions and dispositions.

- 19 -

Table of Contents

Advanced Drainage Systems, Inc.

14. SUBSEQUENT EVENTS

Dividends on Common Stock- During the second quarter of fiscal 2019, the Company declared a quarterly cash dividend of \$0.08 per share of common stock. The dividend is payable on September 14, 2018 to stockholders of record at the close of business on August 31, 2018.

- 20 -

Table of Contents

Advanced Drainage Systems, Inc.

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

Unless the context otherwise indicates or requires, as used in this Quarterly Report on Form 10-Q, the terms "we," "our," "us," "ADS" and the "Company" refer to Advanced Drainage Systems, Inc. and its directly- and indirectly-owned subsidiaries as a combined entity, except where it is clear that the terms mean only Advanced Drainage Systems, Inc. exclusive of its subsidiaries.

Our fiscal year begins on April 1 and ends on March 31. Unless otherwise noted, references to "year" pertain to our fiscal year. For example, 2019 refers to fiscal 2019, which is the period from April 1, 2018 to March 31, 2019.

The following discussion and analysis of the financial condition and results of our operations should be read in conjunction with our Condensed Consolidated Financial Statements and related footnotes included elsewhere in this Quarterly Report on Form 10-Q and with the audited Consolidated Financial Statements included in our Fiscal 2018 Form 10-K, as filed with the Securities and Exchange Commission (the "SEC") on May 30, 2018. In addition to historical condensed consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. This discussion contains forward-looking statements that are based on the beliefs of our management, as well as assumptions made by, and information currently available to, our management. Our actual results could differ materially from those discussed in the forward-looking statements. For more information, see the section below entitled "Forward Looking Statements."

We consolidate all of our joint ventures for purposes of GAAP, except for our South American Joint Venture and our former joint venture, Tigre-ADS USA.

Overview

We are the leading manufacturer of high performance thermoplastic corrugated pipe, providing a comprehensive suite of water management products and superior drainage solutions for use in the underground construction and infrastructure marketplace. Our innovative products are used across a broad range of end markets and applications, including non-residential, residential, agriculture and infrastructure applications. We have established a leading position in many of these end markets by leveraging our national sales and distribution platform, our overall product breadth and scale and our manufacturing excellence. In the United States, our national footprint combined with our strong local presence and broad product offering make us the leader in an otherwise highly fragmented sector comprised of many smaller competitors. We believe the markets we serve in the United States represent approximately \$11 billion of annual revenue opportunity. In addition, we believe the increasing acceptance of thermoplastic pipe products in international markets represents an attractive growth opportunity.

Our products are generally lighter, more durable, more cost effective and easier to install than comparable alternatives made with traditional materials. Following our entrance into the non-residential construction market with the introduction of N-12 corrugated polyethylene pipe in the late 1980s, our pipe products have been displacing products made with traditional materials, such as reinforced concrete, corrugated steel and polyvinyl chloride ("PVC"), across an ever expanding range of end markets. This has allowed us to consistently gain market share and achieve above-market growth throughout economic cycles. We expect to continue to drive conversion to our products from traditional materials as contractors, civil design engineers and municipal agencies increasingly acknowledge the superior

physical attributes and compelling value proposition of our thermoplastic products. In addition, we believe that overall demand for our products will benefit as the regulatory environment continues to evolve.

Our broad product line includes HDPE pipe, PP pipe and related water management products. Building on our core drainage businesses, we have aggressively pursued attractive ancillary product categories such as storm and septic chambers, PVC drainage structures, fittings and filters, and water quality filters and separators. We refer to these ancillary product categories as Allied Products. Given the scope of our overall sales and distribution platform, we have been able to drive growth within our Allied Products and believe there are significant growth opportunities going forward.

- 21 -

Table of Contents

Advanced Drainage Systems, Inc.

Restructuring Activities

In fiscal 2018, we initiated restructuring activities designed to improve our cost structure, including closing two underutilized manufacturing facilities, reducing headcount and eliminating nonessential costs. The following table summarizes the restructuring activity included in Loss on disposal of assets and costs from exit and disposal activities recorded during the three months ended June 30, 2018 and 2017:

| | Three Months Ended | |
|---------------------------------------|-----------------------|----------------|
| | June 30, 2018 | 2017 |
| | (in thousands) | |
| Accelerated depreciation | \$— | \$2,041 |
| Plant severance | (35) | 641 |
| Corporate severance | — | — |
| Other restructuring activities | 31 | — |
| Total restructuring activities | \$(4) | \$2,682 |

The following table summarizes the line items of the Condensed Consolidated Statements of Operations where the expenses above would have been recorded to absent of a restructuring program:

| | Three Months Ended | |
|---------------------------------------|--------------------------|----------------|
| | June 30, 2018 | 2017 |
| | (in thousands) | |
| Cost of goods sold | \$(4) | \$2,682 |
| Selling expenses | — | — |
| General and administrative expenses | — | — |
| Total restructuring activities | \$(4) | \$2,682 |

The restructuring costs above represent one-time expenses and are not indicative of expected costs or cost savings in future periods.

As of June 30, 2018, we have a \$2.8 million severance liability related to the restructuring activities, which is recorded in Other accrued liabilities and Other liabilities in the Condensed Consolidated Balance Sheet.

- 22 -

Table of Contents

Advanced Drainage Systems, Inc.

Results of Operations

Three Months Ended June 30, 2018 Compared With Three Months Ended June 30, 2017

The following table summarizes our operating results as a percentage of net sales that have been derived from our Condensed Consolidated Financial Statements for the three months ended June 30, 2018 and 2017. We believe this presentation is useful to investors in comparing historical results.

| | For the Three Months Ended June 30, | |
|---|---|--------|
| | 2018 | 2017 |
| Consolidated Statements of Operations data: | | |
| Net sales | 100.0% | 100.0% |
| Cost of goods sold | 74.3 | 75.8 |
| Gross profit | 25.7 | 24.2 |
| Selling | 6.2 | 6.4 |
| General and administrative | 5.5 | 7.4 |
| Loss on disposal of assets and costs from exit and disposal activities | 0.3 | 1.0 |
| Intangible amortization | 0.5 | 0.6 |
| Income from operations | 13.2 | 8.8 |
| Interest expense | 1.0 | 1.2 |
| Derivative gains and other income, net | (0.2) | (0.3) |
| Income before income taxes | 12.4 | 7.9 |
| Income tax expense | 3.7 | 2.7 |
| Equity in net loss (income) of unconsolidated affiliates | — | (0.1) |
| Net income | 8.7 | 5.2 |
| Less: net income attributable to noncontrolling interest | 0.4 | 0.2 |
| Net income attributable to ADS | 8.3 % | 5.0 % |

Net sales - Net sales were \$387.8 million in the three months ended June 30, 2018, increasing \$29.5 million, or 8.2%, over the comparable period in fiscal 2018.

For the Three
Months Ended June
30,

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| | 2018 | 2017 | \$ Variance | % Variance | |
|----------------------|----------------|-----------|-------------|------------|---|
| | (In thousands) | | | | |
| Domestic | | | | | |
| Pipe | \$242,026 | \$228,623 | \$ 13,403 | 5.9 | % |
| Allied Products | 100,472 | 90,874 | 9,598 | 10.6 | % |
| Total domestic | 342,498 | 319,497 | 23,001 | 7.2 | % |
| International | | | | | |
| Pipe | 34,448 | 29,954 | 4,494 | 15.0 | % |
| Allied Products | 10,901 | 8,908 | 1,993 | 22.4 | % |
| Total international | 45,349 | 38,862 | 6,487 | 16.7 | % |
| Total net sales | \$387,847 | \$358,359 | \$ 29,488 | 8.2 | % |

Domestic net sales increased \$23.0 million, or 7.2%, in the three months ended June 30, 2018, over the comparable period in the previous fiscal year. Our domestic pipe sales increased by \$13.4 million, or 5.9%, which was primarily attributable to price increases and changes in product mix of \$16.7 million. The increase in pipe is offset by a \$3.1 million decrease in pipe volume. Allied Product sales increased \$9.6 million, or 10.6% led by our storm chambers and structures product lines.

International net sales increased \$6.5 million, or 16.7%, in the three months ended June 30, 2018 over the comparable period in the previous fiscal year. Our international pipe sales increased by \$4.5 million, or 15.0%,

Table of Contents

Advanced Drainage Systems, Inc.

which was primarily attributable to price increases and changes in product mix of \$1.5 million. The increase was also attributable to the increased Allied Product sales of \$2.0 million primarily in Canada.

Cost of goods sold and Gross profit - Cost of goods sold increased by \$16.5 million, or 6.1%, and gross profit increased by \$13.0 million, or 14.9%, in the three months ended June 30, 2018 over the comparable period in the previous fiscal year.

| | For the Three Months Ended June 30, | | | | |
|---------------------|---|----------|-------------|------------|---|
| | 2018 | 2017 | \$ Variance | % Variance | |
| | (In thousands) | | | | |
| Gross Profit | | | | | |
| Domestic | \$91,435 | \$80,326 | \$ 11,109 | 13.8 | % |
| International | 8,256 | 6,413 | 1,843 | 28.7 | % |
| Total gross profit | \$99,691 | \$86,739 | \$ 12,952 | 14.9 | % |

The increase in domestic gross profit of \$11.1 million, or 13.8%, was due to the gross profit impact of the net sales increase discussed above and a decrease in labor and overhead costs of \$4.6 million. These increases were offset by an increase in material and transportation costs of \$13.4 million.

International gross profit increased \$1.8 million, or 28.7%, in the three months ended June 30, 2018 compared to the same period in fiscal 2018, primarily due to the gross profit impact of the net sales increase discussed above. In addition, we implemented cost containment measures to mitigate increasing material costs.

Selling expenses - As a percentage of net sales, selling expenses were relatively flat at 6.2% in the three months ended June 30, 2018 as compared to 6.4% in the prior year.

General and administrative expenses - General and administrative expenses for the three months ended June 30, 2018 decreased \$5.3 million from the prior year period. The decrease was primarily due to a decrease in professional and legal fees, including insurance proceeds, of \$4.6 million resulting from decreased restatement costs and a \$0.3 million decrease in executive retirement expenses.

Loss on disposal of assets and costs from exit and disposal activities – In the three months ended June 30, 2018, we recorded a loss on other disposals and partial disposals of property, plant and equipment of approximately \$1.1 million.

Intangible amortization - Intangible amortization remained relatively flat as a percentage of net sales.

Interest expense - Interest expense decreased \$0.7 million in the three months ended June 30, 2018 compared to the same period in fiscal 2018, primarily due to a \$0.6 million unrealized gain on the interest rate swap.

Derivative gains and other income, net - Derivative gains and other income, net remained relatively flat as a percentage of net sales.

Income tax expense - For the three months ended June 30, 2018 and 2017, we had effective tax rates of 29.7% and 34.8%, respectively. The decrease in the effective tax rate was primarily due to impact of the Tax Cuts and Jobs Act (the "Tax Act").

Equity in net loss (income) of unconsolidated affiliates - Equity in net loss (income) of unconsolidated affiliates represents our proportionate share of income or loss attributed to our unconsolidated joint venture in which we have significant influence, but not control, over operations. The Equity in net loss (income) of unconsolidated affiliates decreased to a \$0.1 million loss for the three months ended June 30, 2018 from a \$0.2 million income for the three months ended June 30, 2017.

- 24 -

Table of Contents

Advanced Drainage Systems, Inc.

Net income attributable to noncontrolling interest - Net income attributable to noncontrolling interest increased from net income of \$0.7 million for the three months ended June 30, 2017 to net income of \$1.4 million for the three months ended June 30, 2018.

Non-GAAP Financial Measures

In addition to financial results reported in accordance with GAAP, we have provided the following non-GAAP financial measures: Adjusted EBITDA and Free Cash Flow. These non-GAAP financial measures are used in addition to and in conjunction with results presented in accordance with GAAP. However, these measures are not intended to be a substitute for those reported in accordance with GAAP. These measures may be different from non-GAAP financial measures used by other companies, even when similar terms are used to identify such measures.

Adjusted EBITDA - Adjusted EBITDA, a non-GAAP financial measure, has been presented in this Quarterly Report on Form 10-Q as a supplemental measure of financial performance that is not required by, or presented in accordance with, GAAP. We calculate adjusted EBITDA as net income before interest, income taxes, depreciation and amortization, stock-based compensation expense, non-cash charges and certain other expenses.

Adjusted EBITDA is included in this Quarterly Report on Form 10-Q because it is a key metric used by management and our Board of Directors to assess our financial performance. Adjusted EBITDA is frequently used by analysts, investors and other interested parties to evaluate companies in our industry. In addition to covenant compliance and executive performance evaluations, we use adjusted EBITDA to supplement GAAP measures of performance to evaluate the effectiveness of our business strategies, to make budgeting decisions and to compare our performance against that of other peer companies using similar measures.

Adjusted EBITDA is not a GAAP measure of our financial performance and should not be considered as an alternative to net income as a measure of financial performance or cash flows from operations or any other performance measure derived in accordance with GAAP, and it should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items. Adjusted EBITDA contains certain other limitations, including the failure to reflect our cash expenditures, cash requirements for working capital needs and cash costs to replace assets being depreciated and amortized. In evaluating adjusted EBITDA, you should be aware that in the future we will incur expenses that are the same as or similar to some of the adjustments in this presentation, such as stock-based compensation expense, derivative fair value adjustments, and foreign currency transaction losses. Our presentation of adjusted EBITDA should not be construed to imply that our future results will be unaffected by any such adjustments. Management compensates for these limitations by relying on our GAAP results in addition to using adjusted EBITDA supplementally. Our measure of adjusted EBITDA is not necessarily comparable to other similarly titled captions of other companies due to different methods of calculation.

Table of Contents

Advanced Drainage Systems, Inc.

The following table presents a reconciliation of Adjusted EBITDA to Net income, the most comparable GAAP measure, for each of the periods indicated.

| | Three Months Ended | |
|--|-----------------------|----------|
| | June 30, 2018 | 2017 |
| | (In thousands) | |
| Net income | \$33,651 | \$18,474 |
| Depreciation and amortization | 17,827 | 18,221 |
| Interest expense | 3,802 | 4,479 |
| Income tax expense | 14,284 | 9,746 |
| EBITDA | 69,564 | 50,920 |
| Derivative fair value adjustments | (12) | 191 |
| Foreign currency transaction gains | (171) | (869) |
| Loss on disposal of assets and costs from exit and disposal activities | 1,104 | 3,423 |
| Unconsolidated affiliates interest, tax, depreciation and amortization ^(a) | 379 | 708 |
| Contingent consideration remeasurement | 2 | 26 |
| Stock-based compensation expense | 1,559 | 1,690 |
| ESOP deferred stock-based compensation | 4,021 | 2,614 |
| Executive retirement (benefit) expense | (328) | 15 |
| Restatement-related (benefit) costs ^(b) | (1,231) | 1,460 |
| Transaction costs ^(c) | 256 | 167 |
| Adjusted EBITDA | \$75,143 | \$60,345 |

(a) Includes the proportional share of interest, income taxes, depreciation and amortization related to the South American Joint Venture and the former Tigre-ADS USA joint venture, which are accounted for under the equity method of accounting.

(b) Represents expenses recorded related to legal, accounting and other professional fees incurred in connection with the restatement of the prior period financial statements as reflected in the fiscal year 2015 Form 10-K and fiscal year 2016 Form 10-K/A. The benefit recognized in fiscal 2019 is the result of insurance proceeds received in fiscal 2019.

(c) Represents expenses recorded related to legal, accounting and other professional fees incurred in connection with the debt refinancing and asset acquisitions and dispositions.

Table of Contents

Advanced Drainage Systems, Inc.

Free Cash Flow - Free cash flow is a non-GAAP financial measure that comprises cash flow from operations less capital expenditures. Free cash flow is a measure used by management and our Board of Directors to assess our ability to generate cash. Accordingly, free cash flow has been presented in this Quarterly Report on Form 10-Q as a supplemental measure of liquidity that is not required by, or presented in accordance with GAAP, because management believes that free cash flow provides useful information to investors and others in understanding and evaluating our ability to generate cash flow from operations after capital expenditures.

Free cash flow is not a GAAP measure of our liquidity and should not be considered as an alternative to cash flow from operating activities as a measure of liquidity or any other liquidity measure derived in accordance with GAAP. Our measure of free cash flow is not necessarily comparable to other similarly titled captions of other companies due to different methods of calculation.

The following table presents a reconciliation of free cash flow to Cash flow from operating activities, the most comparable GAAP measure, for each of the periods indicated.

| | Three Months Ended | |
|-------------------------------------|-----------------------|------------|
| | June 30, 2018 | 2017 |
| | (in thousands) | |
| Cash flow from operating activities | \$9,831 | \$(16,537) |
| Capital expenditures | (6,874) | (17,949) |
| Free Cash Flow | \$2,957 | \$(34,486) |

Liquidity and Capital Resources

Our primary liquidity requirements are working capital, capital expenditures, debt service, and dividend payments for our convertible preferred stock and common stock. We have historically funded, and expect to continue to fund, our operations primarily through internally generated cash flow, debt financings, equity issuance and capital and operating leases. From time to time, we may explore additional financing methods and other means to raise capital. There can be no assurance that any additional financing will be available to us on acceptable terms or at all.

As of June 30, 2018, we had \$14.4 million in cash that was held by our foreign subsidiaries. Prior to the Tax Act, our intent was to indefinitely reinvest our earnings in foreign subsidiaries with the exception of cash dividends paid by our ADS Mexicana joint venture. As a result of the Tax Act, we continue to evaluate our strategy with our foreign cash but we still intend to indefinitely reinvest our earnings in foreign subsidiaries.

Working Capital and Cash Flows

As of June 30, 2018, we had \$429.4 million in liquidity, including \$18.4 million of cash, \$361.0 million in borrowings available under our Revolving Credit Facility net of \$9.8 million of outstanding letters of credit, and \$50.0 million

under the Senior Notes, described below. We believe that our cash on hand, together with the availability of borrowings under our Revolving Credit Facility and other financing arrangements and cash generated from operations, will be sufficient to meet our working capital requirements, anticipated capital expenditures, scheduled interest payments on our indebtedness and the dividend payment requirement for our convertible preferred stock for at least the next twelve months.

Working Capital - Working capital increased to \$284.3 million as of June 30, 2018, from \$237.2 million as of March 31, 2018. The increase in working capital is primarily due to an increase in accounts receivables of \$56.9 million due to the seasonality of operations offset by a \$9.7 million increase in accrued income taxes.

Operating Cash Flows - Cash flows provided by operating activities for the three months ended June 30, 2018 was \$9.8 million as compared with cash used in operating activities of \$16.5 million for the three months ended June 30, 2017. Cash flows from operating activities during the three months ended June 30, 2018 was primarily impacted by changes in working capital, specifically an increase in accounts payable, accrued expenses and other liabilities, and increased income from continuing operations.

- 27 -

Table of Contents

Advanced Drainage Systems, Inc.

Investing Cash Flows - During the three months ended June 30, 2018 and 2017, cash used for investing activities was \$7.0 million and \$18.2 million, respectively. The decrease in cash used for investing activities was primarily due to decreases in capital expenditures and purchases of property, plant and equipment through financing. Our capital expenditures for the three months ended June 30, 2018 were used primarily for new equipment and facility expansions and upgrades.

Financing Cash Flows - During the three months ended June 30, 2018, cash used for financing activities was \$1.6 million due to dividends paid and payments on our capital lease obligations offset by net borrowings on our Revolving Credit Facility. During the three months ended June 30, 2017, cash provided by financing activities was \$37.2 million, due to increased borrowings on our Senior Notes and Revolving Credit Facility associated with the debt refinancing and \$7.9 million of repurchases of our common stock under the stock repurchase program.

Capital Expenditures

Capital expenditures totaled \$6.9 million and \$17.9 million for the three months ended June 30, 2018 and 2017, respectively. Our capital expenditures for the three months ended June 30, 2018 were used primarily to support facility expansions, equipment replacements, our recycled resin initiatives and technology.

We currently anticipate that we will make capital expenditures of approximately \$60 to \$70 million in fiscal year 2019. Such capital expenditures are expected to be financed using funds generated by operations. As of June 30, 2018, there were no material contractual obligations or commitments related to these planned capital expenditures.

Employee Stock Ownership Plan (“ESOP”)

The Company established the Advanced Drainage Systems, Inc. ESOP (the “ESOP” or the “Plan”) effective April 1, 1993 to enable eligible employees to acquire stock ownership in ADS in the form of redeemable convertible preferred shares. The Plan was funded by an existing tax-qualified profit-sharing retirement plan, as well as a 30-year term loan from ADS. Within 30 days following the repayment of the ESOP loan, which will occur no later than March 2023, the shares of redeemable convertible preferred stock owned by the ESOP will be converted into shares of the Company’s common stock.

The Company is obligated to make contributions to the Plan, which, when aggregated with the Plan’s dividends, equal the amount necessary to enable the Plan to make its regularly scheduled payments of principal and interest due on its term loan to ADS. Compensation expense is recognized based upon the average annual fair value of the shares during the period which ADS receives payments on the term loan, and the number of ESOP shares allocated to participant accounts.

As disclosed in “Note 15. Employee Benefit Plans” to the Consolidated Financial Statements included in “Item 8. Financial Statements and Supplementary Data” of our Fiscal 2018 Form 10-K, redeemable convertible preferred stock can convert to common stock upon retirement, disability, death, or vested terminations over the life of the Plan. As stated above, within 30 days following the repayment of the ESOP loan, all redeemable convertible preferred stock will be converted to common stock, which will be no later than March 2023.

The ESOP's conversion of redeemable convertible preferred stock into common stock will have a meaningful impact on the Company's net income, net income per share and common shares outstanding. The outstanding shares of common stock would be 32% greater after conversion.

Impact on Net Income – Following the repayment of the ESOP loan discussed above, the Company will no longer be required to apply the two-class method to determine Net income per share. In addition, the Company would not be required to recognize the fair value of ESOP deferred compensation attributable to the shares of redeemable convertible preferred shares allocated.

The impact of the ESOP on net income includes the fair value of ESOP deferred compensation attributable to the shares of redeemable convertible preferred stock allocated to employee ESOP accounts during the applicable period, which is a non-cash charge to our earnings and not deductible for income tax purposes.

- 28 -

Table of Contents

Advanced Drainage Systems, Inc.

| | Three Months Ended June 30, | |
|--|-----------------------------|-----------|
| | 2018 | 2017 |
| | (In thousands) | |
| Net income attributable to ADS | \$ 32,280 | \$ 17,742 |
| ESOP deferred stock-based compensation | 4,021 | 2,614 |

Impact on Common Stock Outstanding – The repayment of the ESOP loan and related conversion of redeemable convertible preferred shares will have an impact on the number of common shares outstanding. As shares are converted, the number of common shares outstanding will increase.

| | Three Months Ended June 30, | |
|---|-----------------------------|------|
| | 2018 | 2017 |
| | (Shares in millions) | |
| Weighted average common shares outstanding | 56.6 | 55.3 |
| Conversion of redeemable convertible shares | 17.9 | 18.6 |

Financing Transactions

Secured Bank Term Loans - On June 22, 2017, we entered into a Second Amended and Restated Credit Agreement with PNC, which amends and restates the original agreement dated as of June 12, 2013, to provide us a \$550 million Revolving Credit Facility, which is more fully described in our Fiscal 2018 Form 10-K.

As of June 30, 2018, the outstanding principal drawn on the Revolving Credit Facility was \$179.2 million, with \$361.0 million available to be drawn on the U.S. facility, net of \$9.8 million of outstanding letters of credit.

ADS Mexicana Revolving Credit Facility - On June 22, 2018, the Company's \$12.0 million Revolving Credit Facility – ADS Mexicana matured. At June 22, 2018, there were no borrowings under the Revolving Credit Facility – ADS Mexicana.

ADS Mexicana's Revolving Credit Facility was replaced by an Intercompany Revolving Credit Promissory Note (the "Intercompany Note") with a capacity of \$12.0 million. The Intercompany Note matures on June 22, 2022. The Intercompany Note indemnifies the ADS Mexicana joint venture partner for 49% of any unpaid borrowing. The interest rates under the Intercompany Note are determined by certain base rates or LIBOR rates plus an applicable margin based on the Leverage Ratio. As of June 30, 2018 there were no borrowings under the Intercompany Note.

Fiscal 2019 Amendment to the Secured Bank Term Loans – On July 9, 2018, the Company amended the Second Amended and Restated Credit (the "Credit Agreement") and the Second Amended and Restated Private Shelf Agreement (the "Private Shelf Agreement") to amend the definition of Consolidated EBITDA and changed the timing of the quarterly rate adjustments. In addition, the amendment to the Credit Agreement clarified the process of a transition to replace LIBOR which is being phased out.

Senior Notes - On December 11, 2009, we entered into a private shelf agreement with Prudential Investment Management Inc., or Prudential, which agreement, as amended and restated on September 24, 2010 and subsequently further amended, provides for the issuance by us of senior secured promissory notes to Prudential or its affiliates from time to time in the aggregate principal amount up to \$100 million. On June 22, 2017, we entered into the Second

Amended and Restated Private Shelf Agreement with Prudential, which amends and restates the agreement dated as of September 24, 2010, to provide for the issuance of secured senior notes to Prudential or its affiliates from time to time in the aggregate principal amount of up to \$175 million, which is more fully described in our Fiscal 2018 Form 10-K. We have \$50 million available for issuance of senior notes under the private shelf agreement. At June 30, 2018, the outstanding principal balance on these notes was \$125 million.

Covenant Compliance

Our outstanding debt agreements and instruments contain various restrictive covenants including, but not limited to, limitations on additional indebtedness and capital distributions, including dividend payments. The two primary debt covenants of the amended ADS Revolving Credit Facility and Senior Notes include a Leverage Ratio and an Interest Coverage Ratio maintenance covenant. For any relevant period of determination, the Leverage Ratio is calculated by

- 29 -

Table of Contents

Advanced Drainage Systems, Inc.

dividing Total Consolidated Indebtedness (funded debt plus guarantees) by Consolidated EBITDA, as defined by the credit facility. The current upper limit is 4.0 times (or 4.25 as of the date of any acquisitions permitted under the amended agreement for which the aggregate consideration is \$100.0 million or greater). The Interest Coverage Ratio is calculated by dividing the sum of Consolidated EBITDA by consolidated interest expense. The current minimum ratio is 3.0 times.

For further information, see “Note 12. Debt” to the Consolidated Financial Statements included in “Item 8. Financial Statements and Supplementary Data” of our Fiscal 2018 Form 10-K. We were in compliance with our debt covenants as of June 30, 2018.

Off-Balance Sheet Arrangements

Excluding the guarantees of 50% and 49% of certain debt of our unconsolidated South American Joint Venture and our former joint venture Tigre-ADS USA, respectively, as further discussed in “Note 8. Related Party Transactions” to the Condensed Consolidated Financial Statements, we do not have any other off-balance sheet arrangement. As of June 30, 2018, our South American Joint Venture and Tigre-ADS USA had approximately \$13.4 million and \$2.5 million, respectively, of outstanding debt subject to our guarantees. The Company was released from the guarantee of Tigre-ADS USA’s debt on July 12, 2018. We do not believe that these guarantees will have a current or future effect on our financial condition, results of operations, liquidity, or capital resources.

Critical Accounting Policies and Estimates

With the exception of the accounting pronouncements adopted during fiscal 2018 discussed in “Note 1. Background and Summary of Significant Accounting Policies” and “Note 3. Revenue Recognition,” there have been no changes in critical accounting policies from those disclosed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Fiscal 2018 Form 10-K.

Table of Contents

Advanced Drainage Systems, Inc.

Forward-Looking Statements

This Quarterly Report on Form 10-Q (“Form 10-Q”) includes forward-looking statements. Some of the forward-looking statements can be identified by the use of terms such as “believes,” “expects,” “may,” “will,” “would,” “should,” “could,” “see,” “predict,” “potential,” “continue,” “intends,” “plans,” “projects,” “estimates,” “anticipates” or other comparable terms. These forward-looking statements include all matters that are not related to present facts or current conditions or that are not historical facts. They appear in a number of places throughout this Form 10-Q and include statements regarding our intentions, beliefs or current expectations concerning, among other things, our consolidated results of operations, financial condition, liquidity, prospects, growth strategies, and the industries in which we operate and include, without limitation, statements relating to our future performance.

Forward-looking statements are subject to known and unknown risks and uncertainties, many of which are beyond our control. We caution you that forward-looking statements are not guarantees of future performance and that our actual consolidated results of operations, financial condition, liquidity and industry development may differ materially from those made in or suggested by the forward-looking statements contained in this Quarterly Report on Form 10-Q. In addition, even if our actual consolidated results of operations, financial condition, liquidity and industry development are consistent with the forward-looking statements contained in this Form 10-Q, those results or developments may not be indicative of results or developments in subsequent periods. A number of important factors could cause actual results to differ materially from those contained in or implied by the forward-looking statements, including those reflected in forward-looking statements relating to our operations and business, the risks and uncertainties discussed in this Form 10-Q (including under the headings “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations”), and those described from time to time in our other filings with the SEC. Factors that could cause actual results to differ from those reflected in forward-looking statements relating to our operations and business include:

- fluctuations in the price and availability of resins and other raw materials and our ability to pass any increased costs of raw materials on to our customers in a timely manner;
- volatility in general business and economic conditions in the markets in which we operate, including without limitation, factors relating to availability of credit, interest rates, fluctuations in capital and business and consumer confidence;
- cyclical and seasonality of the non-residential and residential construction markets and infrastructure spending;
- the risks of increasing competition in our existing and future markets, including competition from both manufacturers of high performance thermoplastic corrugated pipe and manufacturers of products using alternative materials;
- our ability to continue to convert current demand for concrete, steel and polyvinyl chloride (“PVC”) pipe products into demand for our high performance thermoplastic corrugated pipe and Allied Products;
- the effect of weather or seasonality;
- the loss of any of our significant customers;
- the risks of doing business internationally;
- the risks of conducting a portion of our operations through joint ventures;
- our ability to expand into new geographic or product markets;
- our ability to achieve the acquisition component of our growth strategy;
 - the risk associated with manufacturing processes;

- our ability to manage our assets;
- the risks associated with our product warranties;
- our ability to manage our supply purchasing and customer credit policies;
- the risks associated with our self-insured programs;

- 31 -

Table of Contents

Advanced Drainage Systems, Inc.

- our ability to control labor costs and to attract, train and retain highly-qualified employees and key personnel;
- our ability to protect our intellectual property rights;
- changes in laws and regulations, including environmental laws and regulations;
- our ability to project product mix;
- the risks associated with our current levels of indebtedness;
- fluctuations in our effective tax rate, including from the recently enacted Tax Cuts and Jobs Act;
- changes to our operating results, cash flows and financial condition attributable to the recently enacted Tax Cuts and Jobs Act;
- our ability to meet future capital requirements and fund our liquidity needs;
- the risk that information may arise that would require the Company to make adjustments or revisions or to restate further the financial statements and other financial data for certain prior periods and any future periods;
- any delay in the filing of any filings with the SEC;
- the review of potential weaknesses or deficiencies in the Company’s disclosure controls and procedures, and discovering further weaknesses of which we are not currently aware or which have not been detected; and
- additional uncertainties related to accounting issues generally.

All forward-looking statements are made only as of the date of this report and we do not undertake any obligation, other than as may be required by law, to update or revise any forward-looking statements to reflect future events or developments. Comparisons of results for current and any prior periods are not intended to express any future trends, or indications of future performance, unless expressed as such, and should only be viewed as historical data.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are subject to various market risks, primarily related to changes in interest rates, credit, raw material supply prices and, to a lesser extent, foreign currency exchange rates. Our financial position, results of operations or cash flows may be negatively impacted in the event of adverse movements in the respective market rates or prices in each of these risk categories. Our exposure in each category is limited to those risks that arise in the normal course of business, as we do not engage in speculative, non-operating transactions. Our exposure to market risk has not materially changed from what we previously disclosed in Part II. Item 7A. “Quantitative and Qualitative Disclosures about Market Risk” of our Annual Report on Form 10-K for the fiscal year ended March 31, 2018.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

The Company’s Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) are responsible for evaluating the effectiveness of our disclosure controls and procedures as defined in the Securities Exchange Act of 1934, as amended (the “Exchange Act”) rules 13a-15(e) and 15d-15(e). The Company’s disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed in the Company’s reports under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to management, including the Company’s CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on those material weaknesses, and the evaluation of our disclosure controls and

Table of Contents

Advanced Drainage Systems, Inc.

procedures, the Company's CEO and CFO concluded that the Company's disclosure controls and procedures were effective as of June 30, 2018.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act that occurred during the three months ended June 30, 2018 that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

- 33 -

Table of Contents

Advanced Drainage Systems, Inc.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

As previously disclosed in the Company's Fiscal 2018 Form 10-K, the Company's historical accounting practices were the subject of an investigation by SEC's Division of Enforcement (the "Enforcement Division"), which began in August 2015. That matter was resolved on July 10, 2018 via a settlement between the Company and the SEC. Pursuant to the settlement, the Company consented to the entry of an administrative order without admitting or denying the findings therein. The order required the Company to cease and desist from committing or causing any violations and any future violations of certain provisions of the federal securities laws and the rules promulgated thereunder and to pay a civil monetary penalty of \$1.0 million, which payment has been made. The Company previously accrued an expense for the penalty amount during Fiscal 2018.

Please see "Note 10. Commitments and Contingencies," of the Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q for more information regarding legal proceedings.

Item 1A. Risk Factors

Important risk factors that could affect our operations and financial performance, or that could cause results or events to differ from current expectations, are described in "Part I, Item 1A — Risk Factors" of our Fiscal 2018 Form 10-K. These factors are further supplemented by those discussed in "Part II, Item 7A — Quantitative and Qualitative Disclosures about Market Risk" of our Fiscal 2018 Form 10-K and in "Part I, Item 3 — Quantitative and Qualitative Disclosures about Market Risk" and "Part II, Item 1 — Legal Proceedings" of this Quarterly Report on Form 10-Q.

- 34 -

Table of Contents

Advanced Drainage Systems, Inc.

Item 2. Unregistered Sale of Equity Securities

In February 2017, our Board of Directors authorized the repurchase of up to \$50 million of our common stock. Repurchases of common stock will be made in accordance with applicable securities laws. We did not repurchase any shares of common stock during the three months ended June 30, 2018. As of June 30, 2018, approximately \$42.1 million of common stock may be repurchased under the authorization. The stock repurchase program does not obligate us to acquire any particular amount of common stock, and may be suspended or terminated at any time at our discretion.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Table of Contents

Advanced Drainage Systems, Inc.

Item 6. Exhibits

The following exhibits are filed herewith or incorporated herein by reference.

Exhibit

Number Exhibit Description

- 10.1 Form of Performance Unit Award Agreement pursuant to 2017 Omnibus Incentive Plan (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K (File No. 001-36557) filed with the Securities Exchange Commission on May 30, 2018).
- 31.1* Certification of President and Chief Executive Officer of Advanced Drainage Systems, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2* Certification of Executive Vice President and Chief Financial Officer of Advanced Drainage Systems, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1* Certification of Principal Executive Officer of Advanced Drainage Systems, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2* Certification of Principal Financial Officer of Advanced Drainage Systems, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS* XBRL Instance Document.
- 101.SCH* XBRL Taxonomy Extension Schema.
- 101.CAL* XBRL Taxonomy Extension Calculation Linkbase.
- 101.DEF* XBRL Taxonomy Extension Definition Linkbase.
- 101.LAB* XBRL Taxonomy Extension Label Linkbase.
- 101.PRE* XBRL Taxonomy Extension Presentation Linkbase.
- * Filed herewith

Table of Contents

Advanced Drainage Systems, Inc.

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.

Date: August 9, 2018

ADVANCED DRAINAGE SYSTEMS, INC.

By: /s/ D. Scott Barbour
D. Scott Barbour
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Scott A. Cottrill
Scott A. Cottrill
Executive Vice President, Chief Financial Officer and Secretary
(Principal Financial Officer)

By: /s/ Tim A. Makowski
Tim A. Makowski
Vice President, Controller, and Chief Accounting Officer