

ADVANCED DRAINAGE SYSTEMS, INC.

Form 10-Q

May 31, 2016

Table of Contents

**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, 2015**

**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**  
**(State or Other Jurisdiction of**

**51-0105665**  
**(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, or a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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 April 29, 2016, the registrant had 54,446,402 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 April 29, 2016, 102,223 shares of unvested restricted common stock were outstanding and 24,819,105 shares of ESOP, preferred stock, convertible into 19,090,856 shares of common stock, were outstanding. As of April 29, 2016, 73,639,481 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****TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
ITEM 1. Condensed Consolidated Financial Statements (Unaudited)	
<u>Condensed Consolidated Balance Sheets as of June 30, 2015 and March 31, 2015</u>	1
<u>Condensed Consolidated Statements of Operations for the three months ended June 30, 2015 and 2014</u>	2
<u>Condensed Consolidated Statements of Comprehensive Income for the three months ended June 30, 2015 and 2014</u>	3
<u>Condensed Consolidated Statements of Cash Flows for the three months ended June 30, 2015 and 2014</u>	4
<u>Condensed Consolidated Statements of Stockholders' Equity and Mezzanine Equity for the three months ended June 30, 2015 and 2014</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>	19
ITEM 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	31
ITEM 4. <u>Controls and Procedures</u>	32
<b><u>PART II. OTHER INFORMATION</u></b>	
ITEM 1. <u>Legal Proceedings</u>	33
ITEM 1A. <u>Risk Factors</u>	33
ITEM 2. <u>Unregistered Sale of Equity Securities</u>	33
ITEM 3. <u>Defaults Upon Senior Securities</u>	33
ITEM 4. <u>Mine Safety Disclosures</u>	33
ITEM 5. <u>Other Information</u>	33
ITEM 6. <u>Exhibits</u>	34
<b><u>SIGNATURES</u></b>	35
<b><u>EXHIBIT INDEX</u></b>	36

**Table of Contents****PART I. FINANCIAL INFORMATION****ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

<b>(Amounts in thousands, except par value)</b>	<b>As of</b>	
	<b>June 30, 2015</b>	<b>March 31, 2015</b>
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash	\$ 4,847	\$ 3,623
Receivables (less allowance for doubtful accounts of \$5,220 and \$5,423, respectively)	229,684	154,294
Inventories	258,977	269,842
Deferred income taxes and other current assets	20,858	18,972
<b>Total current assets</b>	<b>514,366</b>	<b>446,731</b>
Property, plant and equipment, net	389,283	377,067
<b>Other assets:</b>		
Goodwill	98,894	98,679
Intangible assets, net	55,761	58,055
Other assets	59,561	61,167
<b>Total assets</b>	<b>\$ 1,117,865</b>	<b>\$ 1,041,699</b>
<b>LIABILITIES, MEZZANINE EQUITY AND STOCKHOLDERS EQUITY</b>		
<b>Current liabilities:</b>		
Current maturities of debt obligations	\$ 10,215	\$ 9,580
Current maturities of capital lease obligations	17,661	15,731
Accounts payable	109,163	111,893
Other accrued liabilities	61,821	54,349
Accrued income taxes	8,672	6,041
<b>Total current liabilities</b>	<b>207,532</b>	<b>197,594</b>
Long-term debt obligation	431,754	390,315
Long-term capital lease obligations	56,515	45,503
Deferred tax liabilities	64,225	65,088
Other liabilities	30,165	28,602
<b>Total liabilities</b>	<b>790,191</b>	<b>727,102</b>
Commitments and contingencies (see Note 8)		
<b>Mezzanine equity:</b>		
Redeemable convertible preferred stock: \$0.01 par value; 47,070 shares authorized; 44,170 shares issued; 25,413 and 25,639 shares outstanding,	317,665	320,490

respectively		
Deferred compensation    unearned ESOP shares	(210,697)	(212,469)
Total mezzanine equity	106,968	108,021
<b>Stockholders' equity:</b>		
Common stock; \$0.01 par value: 1,000,000 shares authorized; 153,560 shares issued; 53,839 and 53,522 shares outstanding, respectively	12,393	12,393
Paid-in capital	705,179	700,977
Common stock in treasury, at cost	(443,660)	(445,065)
Accumulated other comprehensive loss	(14,430)	(15,521)
Retained deficit	(54,933)	(62,621)
Total ADS stockholders' equity	204,549	190,163
Noncontrolling interest in subsidiaries	16,157	16,413
Total stockholders' equity	220,706	206,576
<b>Total liabilities, mezzanine equity and stockholders' equity</b>	<b>\$ 1,117,865</b>	<b>\$ 1,041,699</b>

See accompanying notes to condensed consolidated financial statements.

Table of Contents

**ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

(Amounts in thousands, except per share data)	<b>Three Months Ended June 30,</b>	
	<b>2015</b>	<b>2014</b>
Net sales	\$ 349,124	\$ 326,434
Cost of goods sold	276,538	265,576
Gross profit	72,586	60,858
Operating expenses:		
Selling	21,227	19,552
General and administrative	18,286	15,798
Loss on disposal of assets or businesses	866	64
Intangible amortization	2,526	2,613
Income from operations	29,681	22,831
Other expense (income):		
Interest expense	4,286	5,051
Derivative losses (gains) and other expense (income), net	6,580	(216)
Income before income taxes	18,815	17,996
Income tax expense	7,371	7,893
Equity in net (income) loss of unconsolidated affiliates	(354)	662
Net income	11,798	9,441
Less net income attributable to noncontrolling interest	1,088	875
Net income attributable to ADS	10,710	8,566
Change in fair value of Redeemable convertible preferred stock		(18,373)
Dividends to Redeemable convertible preferred stockholders	(371)	(37)
Dividends paid to unvested restricted stockholders	(6)	
Net income (loss) available to common stockholders and participating securities	10,333	(9,844)
Undistributed income allocated to participating securities	(858)	
<b>Net income (loss) available to common stockholders</b>	<b>\$ 9,475</b>	<b>\$ (9,844)</b>
<b>Weighted average common shares outstanding:</b>		
Basic	53,623	47,536
Diluted	54,055	47,536
<b>Net income (loss) per share:</b>		
Basic	\$ 0.18	\$ (0.21)

Diluted	\$	0.18	\$	(0.21)
<b>Cash dividends declared per share</b>	\$	0.05	\$	

See accompanying notes to condensed consolidated financial statements.



Table of Contents

**ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

(Unaudited)

(Amounts in thousands)	<b>Three Months Ended June 30,</b>	
	<b>2015</b>	<b>2014</b>
Net income	\$ 11,798	\$ 9,441
Other comprehensive income:		
Currency translation	509	159
Total other comprehensive income	509	159
Comprehensive income	12,307	9,600
Less other comprehensive loss attributable to noncontrolling interest, net of tax	(582)	(146)
Less net income attributable to noncontrolling interest	1,088	875
<b>Total comprehensive income attributable to ADS</b>	<b>\$ 11,801</b>	<b>\$ 8,871</b>

See accompanying notes to condensed consolidated financial statements.

Table of Contents

**ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

(Amounts in thousands)	<b>Three Months Ended June 30,</b>	
	<b>2015</b>	<b>2014</b>
<b>Cash Flows from Operating Activities</b>	\$ (18,142)	\$ (18,542)
<b>Cash Flows from Investing Activities</b>		
Capital expenditures	(10,595)	(7,432)
Proceeds from sale of assets or businesses		60
Investment in unconsolidated affiliates		(7,566)
Additions of capitalized software	(940)	(408)
Issuance of note receivable to related party	(3,854)	
Other investing activities	(172)	(310)
<b>Net cash used in investing activities</b>	<b>(15,561)</b>	<b>(15,656)</b>
<b>Cash Flows from Financing Activities</b>		
Proceeds from Revolving Credit Facility	130,400	91,000
Payments on Revolving Credit Facility	(90,100)	(50,600)
Payments on term loan	(1,875)	(1,250)
Proceeds from notes, mortgages and other debt	6,926	
Payments of notes, mortgages, and other debt	(3,217)	(317)
Payments on capital lease obligation	(4,192)	(3,504)
Cash dividends paid	(3,784)	(509)
Other financing activities	587	253
<b>Net cash provided by financing activities</b>	<b>34,745</b>	<b>35,073</b>
Effect of exchange rate changes on cash	182	(86)
<b>Net change in cash</b>	<b>1,224</b>	<b>789</b>
Cash at beginning of period	3,623	3,931
<b>Cash at end of period</b>	<b>\$ 4,847</b>	<b>\$ 4,720</b>

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)

Paid -In Capital	Common Stock in Treasury		Accumulated Other Comprehensive Loss	Retained Earnings (Deficit)	Total ADS Stock- holders Equity	Non- controlling Interest in Subsidiaries	Total Stock- holders Equity	Redeemable Common Stock		Redeemable Convertible Preferred
	Shares	Amount						Shares	Amount	
\$ 12,438	100,810	\$ (448,439)	\$ (6,830)	\$ (2,412)	\$ (433,286)	\$ 18,584	\$ (414,702)	38,320	\$ 549,119	26,129
				8,566	8,566	875	9,441			
			305		305	(146)	159			
						(509)	(509)			
(900)					(900)		(900)			
127	(56)	251			378		378			
93	7	(93)								
701					701		701			
618	(73)	289			907		907			
(13,077)				(5,296)	(18,373)		(18,373)			
				(110,312)	(110,312)		(110,312)		110,312	
\$	<b>100,688</b>	<b>\$ (447,992)</b>	<b>\$ (6,525)</b>	<b>\$ (109,454)</b>	<b>\$ (552,014)</b>	<b>\$ 18,804</b>	<b>\$ (533,210)</b>	<b>38,320</b>	<b>\$ 659,431</b>	<b>26,129</b>
\$ 700,977	100,038	\$ (445,065)	\$ (15,521)	\$ (62,621)	\$ 190,163	\$ 16,413	\$ 206,576		\$	25,639

Edgar Filing: ADVANCED DRAINAGE SYSTEMS, INC. - Form 10-Q

			10,710	10,710	1,088	11,798		
	1,091			1,091	(582)	509		
			(333)	(333)		(333)		
			(2,689)	(2,689)		(2,689)		
					(762)	(762)		
1,353				1,353		1,353		
363	(77)	341		704		704		
444				444		444		
(10)	(66)	291		281		281		
2,052	(174)	773		2,825		2,825		(226)
<b>\$ 705,179</b>	<b>99,721</b>	<b>\$ (443,660)</b>	<b>\$ (14,430)</b>	<b>\$ (54,933)</b>	<b>\$ 204,549</b>	<b>\$ 16,157</b>	<b>\$ 220,706</b>	<b>\$ 25,413</b>

See accompanying notes to condensed consolidated financial statements.

**Table of Contents**

**ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**(Amounts in thousands, except per share data)**

**1. BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Description of Business***

Advanced Drainage Systems, Inc. (collectively with its subsidiaries referred to as **ADS**, the **Company**, **we**, **us** and **our**), 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. Our 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. The reportable segments are 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.

***2014 Initial Public Offering ( IPO )***

On July 11, 2014, in anticipation of the IPO, we executed a 4.707-for-one split of our common and our preferred stock. The effect of the stock split on outstanding shares and earnings per share has been retroactively applied to all periods presented.

On July 25, 2014, we completed the IPO of our common stock, which resulted in the sale by the Company of 5,289 shares of common stock. We received total proceeds from the IPO of \$79,131 after excluding underwriter discounts and commissions of \$5,501, based upon the price to the public of \$16.00 per share. After deducting other offering expenses, we used the net proceeds to reduce the outstanding indebtedness under the revolving portion of our credit facility. The common stock is listed on the New York Stock Exchange ( **NYSE** ) under the symbol **WMS**.

On August 22, 2014, an additional 600 shares of common stock were sold by certain selling stockholders of the Company as a result of the partial exercise by the underwriters of the over-allotment option granted by the selling stockholders to the underwriters in connection with the IPO. The shares were sold at the public offering price of \$16.00 per share. The Company did not receive any proceeds from the sale of such additional shares.

***2014 Secondary Public Offering***

On December 9, 2014, we completed a secondary public offering of our common stock, which resulted in the sale of 10,000 shares of common stock by a certain selling stockholder of the Company at a public offering price of \$21.25.

We did not receive any proceeds from the sale of shares by the selling stockholder.

On December 15, 2014, an additional 1,500 shares of common stock were sold by a certain selling stockholder of the Company as a result of the full exercise by the underwriters of the over-allotment option granted by the selling stockholder to the underwriters in connection with the secondary public offering. The shares were sold at the public offering price of \$21.25 per share. The Company did not receive any proceeds from the sale of such additional shares.

***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, 2015 was derived from audited financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2015 ( Fiscal 2015 Form 10-K ). In our opinion, 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, 2015 and the results of operations for the three months ended June 30, 2015 and 2014 and cash flows for the three months ended June 30, 2015 and 2014. The interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements, including the notes thereto filed in our Fiscal 2015 Form 10-K.

**Table of Contents*****Principles of Consolidation***

Our condensed consolidated financial statements include the Company, our wholly-owned subsidiaries, our majority-owned subsidiaries, including ADS Mexicana, S.A. de C.V. (together with its affiliate ADS Corporativo, S.A. de C.V., ADS Mexicana ) and variable interest entities ( VIEs ) of which we are the primary beneficiary. We use the equity method of accounting for equity investments where we exercise significant influence but do not hold a controlling financial interest. Such investments are recorded in Other assets in our Condensed Consolidated Balance Sheets and the related equity earnings from these investments are included in Equity in net (income) loss of unconsolidated affiliates in our Condensed Consolidated Statements of Operations. All intercompany balances and transactions have been eliminated in consolidation.

***Recent Accounting Pronouncements***

*Stock-Based Compensation* In March 2016, the Financial Accounting Standards Board issued an accounting standards update which is intended to simplify certain aspects of the accounting for stock-based compensation. This amendment contains changes to the accounting for excess tax benefits, whereby excess tax benefits will be recognized in the income statement rather than in additional paid-in capital on the balance sheet. The amendment also contains potential changes to the accounting for forfeitures, whereby entities can elect to either continue to apply the current GAAP requirement to estimate forfeitures when determining compensation expense, or to alternatively reverse the compensation expense of forfeited awards when they occur. This update is effective for fiscal years beginning after December 15, 2016, including interim periods within those years, and early adoption is permitted. We expect to adopt this standard effective April 1, 2017. We are currently evaluating the impact of this standard on our consolidated financial statements.

With the exception of the pronouncement described above, there have been no new accounting pronouncements issued since the filing of our Fiscal 2015 Form 10-K that have significance, or potential significance, to our condensed consolidated financial statements.

**2. INVENTORIES**

Inventories as of June 30, 2015 and March 31, 2015 consisted of the following:

<b>(Amounts in thousands)</b>	<b>June 30, 2015</b>	<b>March 31, 2015</b>
Raw materials	\$ 52,733	\$ 50,198
Finished goods	206,244	219,644
<b>Total inventories</b>	<b>\$ 258,977</b>	<b>\$ 269,842</b>

We had no work-in-process inventories as of June 30, 2015 and March 31, 2015.

**3. GOODWILL AND INTANGIBLE ASSETS*****Goodwill***

The change in carrying amount of goodwill by reportable segment is as follows:

(Amounts in thousands)	Domestic	International	Total
Balance at March 31, 2015	\$ 87,507	\$ 11,172	\$ 98,679
Currency translation		215	215
<b>Balance at June 30, 2015</b>	<b>\$ 87,507</b>	<b>\$ 11,387</b>	<b>\$ 98,894</b>

*Intangible Assets*

Intangible assets as of June 30, 2015 and March 31, 2015 consisted of the following:

(Amounts in thousands)	June 30, 2015			March 31, 2015		
	Gross Intangible	Accumulated Amortization	Net Intangible	Gross Intangible	Accumulated Amortization	Net Intangible
Definite-lived intangible assets						
Developed technology	\$ 40,579	\$ (27,358)	\$ 13,221	\$ 40,579	\$ (26,405)	\$ 14,174
Customer relationships	35,568	(19,501)	16,067	43,167	(26,113)	17,054



**Table of Contents**

(Amounts in thousands)	June 30, 2015			March 31, 2015		
	Gross Intangible	Accumulated Amortization	Net Intangible	Gross Intangible	Accumulated Amortization	Net Intangible
Patents	6,617	(3,703)	2,914	6,547	(3,550)	2,997
Non-compete and other contractual agreements	1,256	(644)	612	1,365	(691)	674
Trademarks and tradenames	14,313	(3,317)	10,996	14,248	(3,051)	11,197
Total definite-lived intangible assets	98,333	(54,523)	43,810	105,906	(59,810)	46,096
Indefinite-lived intangible assets						
Trademarks	11,951		11,951	11,959		11,959
<b>Total intangible assets</b>	<b>\$ 110,284</b>	<b>\$ (54,523)</b>	<b>\$ 55,761</b>	<b>\$ 117,865</b>	<b>\$ (59,810)</b>	<b>\$ 58,055</b>

**4. FAIR VALUE MEASUREMENT**

The fair value measurements and disclosure principles of ASC 820 - Fair Value Measurements and Disclosures define fair value, establish a framework for measuring fair value and provide disclosure requirements about fair value measurements. These principles define a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity has the ability to access as of the measurement date.

Level 2 Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

When applying fair value principles in the valuation of assets and liabilities, we are 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 periods presented. Our fair value estimates take into consideration the credit risk of both the Company and our counterparties.

When active market quotes are not available for financial assets and liabilities, we use 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. Generally, the fair value of our 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 June 30, 2015 and March 31, 2015 were as follows:

(Amounts in thousands)	June 30, 2015			
	Total	Level 1	Level 2	Level 3
<b>Assets:</b>				
Derivative assets - diesel fuel contracts	\$ 373	\$	\$ 373	\$
<b>Total assets at fair value on a recurring basis</b>	<b>\$ 373</b>	<b>\$</b>	<b>\$ 373</b>	<b>\$</b>
<b>Liabilities:</b>				
Derivative liability - interest rate swaps	\$ 682	\$	\$ 682	\$
Derivative liability - diesel fuel contracts	1,956		1,956	
Derivative liability - propylene swaps	10,205		10,205	
Derivative liability - foreign currency contracts	11		11	
Contingent consideration for acquisitions	2,285			2,285
<b>Total liabilities at fair value on a recurring basis</b>	<b>\$ 15,139</b>	<b>\$</b>	<b>\$ 12,854</b>	<b>\$ 2,285</b>

- 8 -

**Table of Contents**

(Amounts in thousands)	March 31, 2015			
	Total	Level 1	Level 2	Level 3
<b>Assets:</b>				
Derivative assets - currency forward contracts	\$ 28	\$	\$ 28	\$
<b>Total assets at fair value on a recurring basis</b>	<b>\$ 28</b>	<b>\$</b>	<b>\$ 28</b>	<b>\$</b>
<b>Liabilities:</b>				
Derivative liability - interest rate swaps	\$ 765	\$	\$ 765	\$
Derivative liability - diesel fuel contracts	2,841		2,841	
Derivative liability - propylene swaps	5,142		5,142	
Contingent consideration for acquisitions	2,444			2,444
<b>Total liabilities at fair value on a recurring basis</b>	<b>\$ 11,192</b>	<b>\$</b>	<b>\$ 8,748</b>	<b>\$ 2,444</b>

Changes in the fair value of recurring fair value measurements using significant unobservable inputs (Level 3) for the three months ended June 30, 2015 and 2014 were as follows:

(amounts in thousands)	Contingent consideration
<b>Balance at March 31, 2015</b>	<b>\$ 2,444</b>
Change in fair value	55
Payments of contingent consideration liability	(214)
<b>Balance at June 30, 2015</b>	<b>\$ 2,285</b>

(amounts in thousands)	Three Months Ended June 30, 2014				
	Contingent consideration	Redeemable common stock	convertible preferred stock	Deferred compensation - earned ESOP shares	Total
<b>Balance at March 31, 2014</b>	<b>\$ 2,898</b>	<b>\$ 549,119</b>	<b>\$ 291,720</b>	<b>\$ (197,888)</b>	<b>\$ 645,849</b>
Allocation of ESOP shares to participants				3,587	3,587
Change in fair value	(18)	110,312	57,178	(38,805)	128,667
Payments of contingent consideration liability	(183)				(183)
<b>Balance at June 30, 2014</b>	<b>\$ 2,697</b>	<b>\$ 659,431</b>	<b>\$ 348,898</b>	<b>\$ (233,106)</b>	<b>\$ 777,920</b>

For the three months ended June 30, 2015 and June 30, 2014, respectively, there were no transfers in or out of Levels 1, 2, and 3.

*Valuation of our Contingent Consideration for Acquisitions*

The fair values of the contingent consideration payables for prior period acquisitions were calculated with reference to the estimated future value of the Inserta Tee and FleXstorm businesses, which are based on a discounted cash flow model. The undiscounted value is discounted to the present value using a market discount rate. The categorization of the framework used to price this liability is considered a Level 3, due to the subjective nature of the unobservable inputs used to determine the fair value.

*Valuation of our Redeemable Common Stock*

Prior to July 2014, the Company had certain shares of common stock outstanding allowing the holder to put its shares to us for cash. This Redeemable common stock was historically recorded at its fair value in the mezzanine equity section of our Condensed Consolidated Balance Sheets and changes in fair value were recorded in Retained earnings. Historically, the fair value of a share of common stock was determined by management by applying industry-appropriate multiples to EBITDA and performing a discounted cash flow analysis. Under the industry-appropriate multiples approach, to arrive at concluded multiples, we considered differences between the risk and return characteristics of ADS and the guideline companies. Under the discounted cash flow analysis, the cash flows expected to be generated by the Company were discounted to their present value equivalent using a rate of return that reflects the relative risk of an investment in ADS, as well as the time value of money. This return was an overall rate based upon the individual rates of return for invested capital (equity and interest-bearing debt). The

---

**Table of Contents**

return, known as the weighted average cost of capital ( WACC ), was calculated by weighting the required returns on interest-bearing debt and common stock in proportion to their estimated percentages in an expected capital structure. The WACC used was 11% as of June 30, 2014. An increase in the WACC would decrease the fair value of the Redeemable common stock. The categorization of the framework used to price this temporary equity was considered a Level 3, due to the subjective nature of the unobservable inputs used to determine the fair value.

The redemption feature of our Redeemable common stock allowing the holder to put its shares to us for cash, as discussed in the previous paragraph, was not in effect upon effectiveness of the IPO on July 25, 2014. As a result, the Redeemable common stock was recorded as mezzanine equity at fair value through the effective date of the IPO and was subsequently reclassified at that fair value to stockholders' equity. See Note 1. Background and Summary of Significant Accounting Policies for more information on the IPO.

***Nonrecurring Fair Value Measurements******Valuation of our Redeemable Convertible Preferred Stock***

The Trustee of the Company's ESOP has the ability to put the shares of our Redeemable convertible preferred stock to the Company. Prior to July 2014, our Redeemable convertible preferred stock was recorded at its fair value in the mezzanine equity section of our Condensed Consolidated Balance Sheets and changes in fair value were recorded in Retained earnings. Accordingly, we estimated the fair value of the Redeemable Convertible Preferred Stock through estimating the fair value of the Company's common stock and applying certain adjustments including for the fair value of the total dividends to be received and assuming conversion of the Redeemable convertible preferred stock to common stock at the stated conversion ratio per our Certificate of Incorporation. The categorization of the framework used to price this temporary equity was considered a Level 3, due to the subjective nature of the unobservable inputs used to determine the fair value.

Upon the effective date of the IPO, the redemption feature of our Redeemable convertible preferred stock allowing the Trustee of the Company's ESOP to put shares to us for cash was no longer applicable. However, if our common stock, which our Redeemable convertible preferred stock may convert to, is no longer a registration-type class of security (e.g., in the event of a delisting), the option held by the Trustee, which granted it the ability to put the shares of our Redeemable convertible preferred stock to us, would then become applicable. Preferred securities that become redeemable upon a contingent event that is not solely within the control of the Company should be classified outside of equity. As of June 30, 2015, the Company has determined that it is not probable that the redemption feature will become applicable. Since the Redeemable convertible preferred stock is not currently redeemable and it is not probable that the instrument will become redeemable, subsequent adjustment to fair value is not required. As such, the Redeemable convertible preferred stock was recorded to fair value at the effective date of the IPO on July 25, 2014 and will remain in mezzanine equity without further adjustment to carrying value unless it becomes probable that the redemption feature will become applicable. See Note 1. Background and Summary of Significant Accounting Policies for more information on the IPO.

***Valuation of our Goodwill and Indefinite Lived Intangible Assets***

Goodwill and indefinite lived intangible assets are tested for impairment annually as of March 31 or whenever events or changes in circumstances indicate the carrying value may be greater than fair value.

**5. RELATED PARTY TRANSACTIONS**

*ADS Mexicana*

ADS conducts business in Mexico and Central America through its joint venture ADS Mexicana. ADS owns 51% of the outstanding stock of ADS Mexicana and consolidates ADS Mexicana for financial reporting purposes. During the three months ended June 30, 2015 and 2014, ADS Mexicana compensated certain owners and former owners of Grupo Altima, the joint venture partner of ADS Mexicana, for consulting services related to the operations of the business. These cash payments totaled \$63 and \$75 for the three months ended June 30, 2015 and 2014, respectively.

Occasionally, ADS and ADS Mexicana jointly enter into agreements for pipe sales with their related parties which totaled \$0 and \$1,312 for the three months ended June 30, 2015 and 2014, respectively. Outstanding receivables related to these sales were \$865 and \$1,005 as of June 30, 2015 and March 31, 2015, respectively.

In April 2015, ADS Mexicana borrowed \$3,000 under a revolving credit facility arrangement with Scotia Bank and loaned that amount to ADS, and such loan was repaid in May 2015. In June 2015, ADS Mexicana borrowed \$3,854 under the Scotia Bank credit facility and loaned it to an entity owned by a Grupo Altima owner, and such loan was repaid in July 2015. ADS does not guarantee the borrowings from this facility and therefore, does not anticipate any required contributions related to the balance of this credit facility.

**Table of Contents**

We are the guarantor of 100% of ADS Mexicana's credit facility and our maximum potential payment under this guarantee totals \$12,000.

**South American Joint Venture**

The Tuberias Tigre ADS Limitada joint venture ( South American Joint Venture ) manufactures and sells HDPE corrugated pipe in the South American market. We are the guarantor for 50% of the South American Joint Venture's credit facility, and the debt guarantee is shared equally with the joint venture partner. Our maximum potential obligation under this guarantee totals \$7,400 as of June 30, 2015. The maximum borrowings permitted under the South American Joint Venture's credit facility are \$19,000. 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 South American Joint Venture's debt is for the life of the credit facility which matures on February 5, 2017. ADS does not anticipate any required contributions related to the balance of this credit facility. As of June 30, 2015 and March 31, 2015, the outstanding principal balances of the credit facility including letters of credit were \$14,700 and \$13,600, respectively. The weighted average interest rate as of June 30, 2015 was 3.25% on U.S. dollar denominated loans and 6.32% on Chilean peso denominated loans.

ADS and the South American Joint Venture have entered into shared services arrangements in order to execute the joint venture services. Included within these arrangements are the lease of an office and plant location used to conduct business and operating expenses related to these leased facilities. Occasionally, ADS and South American Joint Venture jointly enter into agreements for pipe sales with their related parties which totaled \$699 and \$317 for the three months ended June 30, 2015 and 2014, respectively.

**BaySaver**

Additionally, ADS holds an equity method investment in BaySaver Technologies, LLC ( BaySaver ), which is 55% owned by our wholly-owned subsidiary ADS Ventures, Inc. This equity method investment 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 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. Occasionally, ADS and BaySaver jointly enter into agreements for sales of pipe and Allied Products with their related parties in immaterial amounts.

See Note 14. Subsequent Events *Subsequent Event Related to the Acquisition of an Additional Interest in BaySaver* for information about the Company's acquisition of a controlling interest in BaySaver in July 2015.

**6. DEBT**

Long-term debt as of June 30, 2015 and March 31, 2015 consisted of the following:

<b>(Amounts in thousands)</b>		<b>June 30, 2015</b>	<b>March 31, 2015</b>
Bank Term Loans			
Revolving Credit Facility	ADS	\$ 245,400	\$ 205,100

Edgar Filing: ADVANCED DRAINAGE SYSTEMS, INC. - Form 10-Q

Term Note	89,375	91,250
Senior Notes payable	100,000	100,000
ADS Mexicana credit facility	3,854	
Industrial revenue bonds	3,340	3,545
Total	441,969	399,895
Current maturities	(10,215)	(9,580)
<b>Long-term debt obligation</b>	<b>\$ 431,754</b>	<b>\$ 390,315</b>

***ADS Mexicana Scotia Bank Revolving Credit Facility***

On December 11, 2014, our joint venture, ADS Mexicana, entered into a credit agreement with Scotia Bank. The credit agreement provides for revolving loans up to a maximum aggregate principal amount of \$5,000. The proceeds of the revolving credit facility have primarily been used for short-term investments and are available for working capital needs. The interest rates of the revolving credit facilities are determined by LIBOR rates, Tasa de Interes Interbancaria de Equilibrio (TIIE) or the Costos de Captacion rates, plus an applicable margin. The applicable interest rate for the outstanding loan was 4.81% as of June 30, 2015. The Scotia Bank revolving credit facility matures on December 11, 2017. The obligations under the revolving credit facility are not guaranteed by ADS. As of June 30, 2015, there was \$3,854 outstanding principal drawn on the Scotia Bank revolving credit facility with \$1,146 available to be drawn.



**Table of Contents****7. 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, and exchange rate fluctuations. For interest rate swaps, 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 and gains and losses related to the mark-to-market adjustments for changes in fair value of the derivative contracts are recorded in the Condensed Consolidated Statements of Operations as Derivative losses (gains) and other expense (income), net. The Company recognized losses on mark-to-market adjustments for changes in fair value on derivative contracts of \$3,761 and \$96 for the three months ended June 30, 2015 and 2014, respectively.

A summary of the fair value of derivatives at June 30, 2015 and March 31, 2015 is presented below:

(Amounts in thousands)	June 30, 2015			
	Assets		Liabilities	
	Receivables	Other assets	Other accrued liabilities	Other liabilities
Interest rate swaps	\$	\$	\$	\$ (682)
Foreign exchange forward contracts			(11)	
Diesel fuel option collars and swaps	287	86	(1,370)	(586)
Propylene swaps			(7,595)	(2,610)

(Amounts in thousands)	March 31, 2015			
	Assets		Liabilities	
	Receivables	Other assets	Other accrued liabilities	Other liabilities
Interest rate swaps	\$	\$	\$ (150)	\$ (615)
Foreign exchange forward contracts	28			
Diesel fuel option collars and swaps			(1,883)	(958)
Propylene swaps			(4,412)	(730)

**8. COMMITMENTS AND CONTINGENCIES*****Purchase Commitments***

We will, from time to time, secure supplies of resin raw material by agreeing to purchase quantities during a future given period at a fixed price. These purchase contracts are short term in nature and occur in the ordinary course of business. Under such purchase contracts, we have agreed to purchase resin over the period July 2015 through December 2015 at a committed purchase cost of \$26,580.

***Litigation***

On July 29, 2015, a putative stockholder class action, Christopher Wyche, individually and on behalf of all others similarly situated v. Advanced Drainage Systems, Inc., et al. (Case No. 1:15-cv-05955-KPF), was commenced in the U.S. District Court for the Southern District of New York, naming the Company, along with Joseph A. Chlapaty, the Company's Chief Executive Officer, and Mark B. Sturgeon, the Company's former Chief Financial Officer, as

defendants and alleging violations of the federal securities laws. An amended complaint was filed on April 28, 2016. The amended complaint alleges that the Company made material misrepresentations and/or omissions of material fact in its public disclosures during the period from July 25, 2014 through March 29, 2016, in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder. Plaintiffs seek an unspecified amount of monetary damages on behalf of the putative class and an award of costs and expenses, including counsel fees and expert fees. The Company believes that it has valid and meritorious defenses and will vigorously defend against these allegations, but litigation is subject to many uncertainties and the outcome of this matter is not predictable with assurance. While it is reasonably possible that this matter ultimately could be decided unfavorably to the Company, the Company is currently unable to estimate the range of the possible losses, but they could be material.

On August 12, 2015, the SEC Division of Enforcement ( Enforcement Division ) informed the Company that it was conducting an informal inquiry with respect to the Company. As part of this inquiry, the Enforcement Division requested the voluntary production of certain documents generally related to the Company's accounting practices. Subsequent to the initial voluntary production request, the Company received document subpoenas from the Enforcement Division pursuant to a formal order of investigation. The Company has from the outset cooperated with the Enforcement Division's investigation and intends to continue to do so. While it is reasonably possible that this investigation ultimately could be resolved unfavorably to the Company, the Company is currently unable to estimate the range of possible losses, but they could be material.

**Table of Contents**

We are involved from time to time in various legal proceedings that arise in the ordinary course of our 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. We believe that such litigation, claims, and administrative proceedings will not have a material adverse impact on our financial position or our results of operations. We record a liability when a loss is considered probable, and the amount can be reasonably estimated. In management's opinion, none of these proceedings are material in relation to our consolidated operations, cash flows, or financial position, and we have adequate accrued liabilities to cover our estimated probable loss exposure.

**9. ACCUMULATED OTHER COMPREHENSIVE LOSS**

The following table presents the changes in the balance of Accumulated other comprehensive loss ( AOCL ) for the three months ending June 30, which consists entirely of foreign currency translation gains (losses):

<b>(Amounts in thousands)</b>	<b>Accumulated Other Comprehensive Loss</b>
Balance at April 1, 2014	\$ (6,830)
Other comprehensive income	305
<b>Balance at June 30, 2014</b>	<b>\$ (6,525)</b>
Balance at April 1, 2015	(15,521)
Other comprehensive income	1,091
<b>Balance at June 30, 2015</b>	<b>\$ (14,430)</b>

**10. INCOME TAXES**

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, 2015 and 2014, the Company utilized an effective tax rate of 39.2% and 43.9%, respectively, to calculate its provision for income taxes. These rates are higher than the federal statutory rate of 35% due principally to state and local taxes, partially offset by foreign income taxed at lower rates.

**11. NET INCOME (LOSS) PER SHARE**

Basic net income (loss) per share is calculated by dividing the Net income (loss) attributable to common stockholders by the weighted-average number of common shares outstanding during the period, without consideration for common stock equivalents. Diluted net income (loss) per share is computed by dividing the Net income (loss) attributable to

common stockholders by the weighted-average number of common share equivalents outstanding for the period.

Holders of unvested restricted stock have nonforfeitable rights to dividends when declared on common stock, and holders of Redeemable convertible preferred stock participate in dividends on an as-converted basis when declared on common stock. As a result, unvested restricted stock and Redeemable convertible preferred stock meet the definition of participating securities, which requires us to apply the two-class method to compute both basic and diluted net income (loss) 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.

The dilutive effect of stock options and unvested restricted stock is based on the more dilutive of the treasury stock method or the diluted two-class method. In computing diluted net income (loss) per share, income available to common shareholders used in the basic net income (loss) per share calculation (numerator) is adjusted, subject to sequencing rules, for certain adjustments that would result from the assumed issuance of potential common shares. Diluted net income (loss) per share assumes the Redeemable convertible preferred stock would have been cash settled as we had the choice of settling in cash or shares, and we had demonstrated past practice and intent of cash settlement prior to the effective date of the IPO. Therefore, these shares are excluded from the calculation through the effective date of the IPO. After the effective date of the IPO, Management's intent is to share settle; therefore, these shares are included in the calculation from July 26, 2014 through June 30, 2015, if dilutive. For purposes of the calculation of diluted net income (loss) per share, stock options and unvested restricted stock are considered to be potential common stock and are only included in the calculations when their effect is dilutive.

**Table of Contents**

Prior to the effective date of the IPO, the Company's Redeemable common stock was included in the weighted-average number of common shares outstanding for calculating basic and diluted net income (loss) per share.

The following table presents information necessary to calculate net income (loss) per share for the three months ended June 30, 2015 and 2014, 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:

(Amounts in thousands, except per share data)	Three Months Ended June 30,	
	2015	2014
<b>NET INCOME (LOSS) PER SHARE BASIC:</b>		
Net income attributable to ADS	\$ 10,710	\$ 8,566
Adjustment for:		
Change in fair value of Redeemable convertible preferred stock		(18,373)
Dividends to Redeemable convertible preferred stockholders	(371)	(37)
Dividends paid to unvested restricted stockholders	(6)	
Net income (loss) available to common stockholders and participating securities	10,333	(9,844)
Undistributed income allocated to participating securities	(858)	
Net income (loss) available to common stockholders Basic	9,475	(9,844)
Weighted average number of common shares outstanding Basic	53,623	47,536
Net income (loss) per common share Basic	\$ 0.18	\$ (0.21)
<b>NET INCOME (LOSS) PER SHARE DILUTED:</b>		
Net income (loss) available to common stockholders Basic	\$ 9,475	\$ (9,844)
Weighted average number of common shares outstanding Basic	53,623	47,536
Assumed exercise of stock options	432	
Weighted average number of common shares outstanding Diluted	54,055	47,536
Net income (loss) per common share Diluted	\$ 0.18	\$ (0.21)
Potentially dilutive securities excluded as anti-dilutive	6,673	93

**12. BUSINESS SEGMENTS INFORMATION**

We operate our business in two distinct operating and reportable segments based on the markets we serve: Domestic and International. The Chief Operating Decision Maker ( CODM ) evaluates segment reporting based on net sales and Segment Adjusted EBITDA (a non-GAAP measure). We calculate Segment Adjusted EBITDA as net income or loss before interest, income taxes, depreciation and amortization, stock-based compensation expense, non-cash charges and certain other expenses.

**Domestic**

Our Domestic segment manufactures and markets products throughout the United States. We maintain and serve these markets through strong product distribution relationships with many of the largest national and independent waterworks distributors, major national retailers as well as an extensive network of hundreds of small to medium-sized distributors across the U.S. We also sell through a broad variety of buying groups and co-ops in the United States. Products include Singlewall pipe, N-12 HDPE pipe sold into the Storm sewer and Infrastructure markets, High Performance PP pipe sold into the Storm sewer and sanitary sewer markets, and our broad line of Allied Products including StormTech, Nyloplast, Arc Septic Chambers, Inserta Tee, BaySaver filters and water quality structures, Fittings, and FleXstorm. Our Domestic segment sales are diversified across all regions of the country.

### ***International***

Our International segment manufactures and markets products in regions outside of the United States, with a growth strategy focused on our owned facilities in Canada and through our joint ventures, with local partners in Mexico, Central America and South America. Our joint venture strategy provides us with local and regional access to new markets such as Brazil, Chile, Argentina, Peru and Colombia. Our Mexican joint venture through ADS Mexicana primarily serves the Mexican markets, while our joint venture through the South American Joint Venture is our primary channel to serve the South American markets. Our product line includes Singlewall pipe, N-12 HDPE pipe, and High Performance PP pipe. The Canadian market also sells our broad line of Allied Products, while sales in Latin America are currently concentrated in fittings and Nyloplast.

**Table of Contents**

The following table sets forth reportable segment information with respect to the amount of net sales contributed by each class of similar products of our consolidated gross profit for the three ended June 30, 2015 and 2014, respectively:

(Amounts in thousands)	Three Months Ended June 30,	
	2015	2014
<b>Domestic</b>		
Pipe	\$ 220,533	\$ 216,036
Allied Products	77,631	73,589
<b>Total domestic</b>	<b>298,164</b>	<b>289,625</b>
<b>International</b>		
Pipe	42,376	29,931
Allied Products	8,584	6,878
<b>Total international</b>	<b>50,960</b>	<b>36,809</b>
<b>Total net sales</b>	<b>\$ 349,124</b>	<b>\$ 326,434</b>

The following sets forth certain additional financial information attributable to our reportable segments for the three months ended June 30, 2015, and 2014, respectively:

(Amounts in thousands)	Three months ended June 30,	
	2015	2014
<b>Net sales</b>		
Domestic	\$ 298,164	\$ 289,625
International	50,960	36,809
<b>Total</b>	<b>\$ 349,124</b>	<b>\$ 326,434</b>
<b>Gross profit</b>		
Domestic	\$ 59,659	\$ 54,067
International	12,927	6,791
<b>Total</b>	<b>\$ 72,586</b>	<b>\$ 60,858</b>
<b>Segment Adjusted EBITDA</b>		
Domestic	\$ 41,277	\$ 40,992
International	10,536	4,137
<b>Total</b>	<b>\$ 51,813</b>	<b>\$ 45,129</b>
<b>Interest expense</b>		

Edgar Filing: ADVANCED DRAINAGE SYSTEMS, INC. - Form 10-Q

Domestic	\$	4,037	\$	5,042
International		249		9
<b>Total</b>	<b>\$</b>	<b>4,286</b>	<b>\$</b>	<b>5,051</b>
<b>Depreciation and amortization</b>				
Domestic	\$	16,417	\$	14,658
International		2,222		1,368
<b>Total</b>	<b>\$</b>	<b>18,639</b>	<b>\$</b>	<b>16,026</b>
<b>Equity in net income (loss) of unconsolidated affiliates</b>				
Domestic	\$	336	\$	153
International		18		(815)
<b>Total</b>	<b>\$</b>	<b>354</b>	<b>\$</b>	<b>(662)</b>
<b>Capital expenditures</b>				
Domestic	\$	8,844	\$	6,919
International		1,751		513
<b>Total</b>	<b>\$</b>	<b>10,595</b>	<b>\$</b>	<b>7,432</b>

- 15 -



**Table of Contents**

The following sets forth certain additional financial information attributable to our reporting segments as of June 30, 2015 and March 31, 2015, respectively:

	June 30, 2015	March 31, 2015
<b>Investment in unconsolidated affiliates</b>		
Domestic	\$ 7,798	\$ 7,957
International	16,931	17,081
<b>Total</b>	<b>\$ 24,729</b>	<b>\$ 25,038</b>
<b>Total identifiable assets</b>		
Domestic	\$ 1,004,758	\$ 942,267
International	179,000	168,624
Eliminations	(65,893)	(69,193)
<b>Total</b>	<b>\$ 1,117,865</b>	<b>\$ 1,041,699</b>

**Reconciliation of Segment Adjusted EBITDA to Consolidated Net Income**

(Amounts in thousands)	Three Months Ended June 30,			
	2015		2014	
	Domestic	International	Domestic	International
<b>Reconciliation of Segment Adjusted EBITDA:</b>				
<b>Net income</b>	<b>\$ 5,542</b>	<b>\$ 6,256</b>	<b>\$ 7,843</b>	<b>\$ 1,598</b>
Depreciation and amortization	16,417	2,222	14,658	1,368
Interest expense, net	4,037	249	5,042	9
Income tax expense	6,317	1,054	7,414	479
Segment EBITDA	32,313	9,781	34,957	3,454
Derivative fair value adjustments	3,721	40	96	
Foreign currency transaction losses		317		130
Loss (gain) on sale of assets/businesses	1,052	(186)	60	4
Unconsolidated affiliates interest, tax, depreciation and amortization <sup>(a)</sup>	286	584	249	549
Contingent consideration remeasurement	55		(18)	
Stock-based compensation	725		2,246	
ESOP deferred compensation	3,125		2,687	
Transaction costs <sup>(b)</sup>			715	
<b>Segment Adjusted EBITDA</b>	<b>\$ 41,277</b>	<b>\$ 10,536</b>	<b>\$ 40,992</b>	<b>\$ 4,137</b>

- (a) Includes our proportional share of interest, income taxes, depreciation and amortization related to our South American Joint Venture, our BaySaver joint venture and our 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 IPO.

### **13. SUPPLEMENTAL CASH FLOW INFORMATION**

During the three months ended June 30, 2015 and 2014, the Company acquired Property, plant and equipment under capital lease and incurred lease obligations of \$16,718 and \$14,662, respectively.

### **14. SUBSEQUENT EVENTS**

#### ***Subsequent Event Related to the Acquisition of an Additional Interest in BaySaver***

On July 17, 2015, ADS Ventures, Inc. ( ADS/V ), a wholly-owned subsidiary of the Company, acquired an additional 10% of the issued and outstanding membership interests in BaySaver, increasing the Company's total ownership interest in BaySaver to 65%, for a purchase price of \$3,200, plus contingent consideration with an initial estimated fair value of \$750. Concurrent with our purchase of the additional membership investment, the BaySaver joint venture agreement was amended to modify the voting rights from an equal vote for each member to a vote based upon the ownership interest. We have accounted for this transaction as a business combination with BaySaver being consolidated into our financial statements after July 17, 2015.

**Table of Contents**

As we had accounted for our investment in BaySaver prior to the purchase of the additional 10% membership interest under the equity method of accounting, we accounted for this transaction as a step acquisition and recognized a loss of \$490 on remeasurement to fair value of our previously held investment. The fair value of our BaySaver investment immediately before the July 17, 2015 acquisition was measured based on a combination of the discounted cash flow and guideline public company valuation methods and involves significant unobservable inputs (Level 3). These inputs include projected sales, margin, required rate of return and tax rate for the discounted cash flow method, as well as implied pricing multiples, and guideline public company group for the guideline public company method.

The purchase price was determined as follows:

<b>(Amounts in thousands)</b>	
Acquisition-date fair value of our prior equity interest	\$ 4,220
Acquisition-date fair value of noncontrolling interest	6,330
Cash paid at acquisition date	3,200
Fair value of contingent consideration	750
<b>Total purchase price</b>	<b>\$ 14,500</b>

The preliminary purchase price has been allocated to the estimated fair values of acquired tangible and intangible assets, assumed liabilities and goodwill. The preliminary fair value of identifiable intangible assets has been determined primarily using the income approach, which involves significant unobservable inputs (Level 3 inputs). These inputs include projected sales, margin, required rate of return and tax rate, as well as an estimated royalty rate in the cases of the developed technology and trade name and trademark intangibles. The developed technology and trade name and trademark intangibles are valued using a relief-from-royalty method.

Redeemable noncontrolling interest in subsidiaries will be classified as mezzanine equity in our Condensed Consolidated Balance Sheets due to a put option held by the joint venture partner which may be exercised on or after April 1, 2017. The Redeemable noncontrolling interest in subsidiaries balance will be accreted to the redemption value using the effective interest method until April 1, 2017.

The excess of the preliminary purchase price over the fair value of the net assets acquired of \$2,495 was allocated to goodwill, assigned to the Domestic segment, and consists primarily of the acquired workforce and sales and cost synergies the two companies anticipate realizing as a combined company. None of the goodwill is deductible for tax purposes.

Certain estimated values for the acquisition, including intangible assets, goodwill and deferred tax assets are not yet finalized. The preliminary purchase price allocation is as follows:

<b>(Amounts in thousands)</b>	
Cash	\$ 12
Other current assets	2,262
Property, plant and equipment	164
Goodwill	2,495
Intangible assets	10,800

Edgar Filing: ADVANCED DRAINAGE SYSTEMS, INC. - Form 10-Q

Other assets	152
Current liabilities	(1,385)

**Total purchase price** **\$ 14,500**

The acquired identifiable intangible assets represent customer relationships of \$5,400, developed technology of \$4,000 and trade name and trademark of \$1,400, each of which have an estimated 10-year useful life. Transaction costs were immaterial.

- 17 -

**Table of Contents**

***Subsequent Events Related to the Bank Term Loans and Senior Notes***

Our long-term debt primarily consists of amounts outstanding under a Revolving Credit Facility with borrowing capacity of \$325,000 for ADS, Inc., a Revolving Credit Facility for ADS-Mexicana with borrowing capacity of \$12,000, and a \$100,000 term note (collectively, the Bank Term Loans ), and the \$100,000 of outstanding senior promissory notes ( Senior Notes ). The amendments and consents described below that occurred between July 2015 and February 2016 related to the delay in the filing of the Fiscal 2015 Form 10-K, and the restatement of the Company s previously issued financial statements (the Restatement ) as reflected in the Fiscal 2015 Form 10-K, which was filed with the SEC on March 29, 2016.

In July 2015, the Company obtained consents from the requisite holders of its Bank Term Loans and its Senior Notes to waive certain actual and potential covenant violations. Specifically, the covenant violations were the result of the fact that the Company had not delivered its fiscal 2015 audited financial statements within 90 days of March 31, 2015, and did not expect to be able to file its first quarter fiscal 2016 quarterly financial statements within 45 days of June 30, 2015. The consents extended the time for delivery of the fiscal 2015 audited financial statements and the first quarter fiscal 2016 quarterly financial statements to September 30, 2015, whereby an event of default was waived as long as those financial statements were delivered within the thirty day grace period after September 30, 2015.

In August 2015, the Company entered into amended agreements related to the Bank Term Loans and Senior Notes in connection with the Company s determination that a substantial portion of its transportation and equipment leases should be treated as capital leases rather than as operating leases. The material terms of each amended agreement modify certain definitions applicable to the Company s affirmative and negative financial covenants, including the minimum fixed charge coverage ratio, the maximum leverage ratio, and the limits on indebtedness, to accommodate the Company s treatment of its transportation and equipment leases as capital leases rather than operating leases, along with corresponding changes to the provisions outlining the application of GAAP in the definition of accounting terms used in various financial covenants. The amendments also waive any potential event of default that may exist under any of the respective agreements as a result of changes to the Company s financial statements related to lease accounting, and do not require the Company to deliver restated financial statements or compliance certificates for any annual or quarterly period prior to the fiscal year ended March 31, 2015.

In October 2015, the Company obtained additional consents from the requisite holders of its Bank Term Loans and its Senior Notes to further extend the time for delivery of its fiscal 2015 audited financial statements and the first quarter fiscal 2016 quarterly financial statements, as well as to extend the time for delivery of its second quarter fiscal 2016 quarterly financial statements. The consents extended the time for delivery of the fiscal 2015 audited financial statements and the first quarter fiscal 2016 quarterly financial statements to November 30, 2015, as well as extended the time for delivery of the second quarter fiscal 2016 quarterly financial statements to December 31, 2015, whereby an event of default was waived as long as those financial statements were delivered within the thirty day grace period after those dates.

In December 2015, the Company entered into additional amended agreements related to the Bank Term Loans and Senior Notes that further extend the time for delivery of its fiscal 2015 audited financial statements and the first and second quarter fiscal 2016 quarterly financial statements. The December 2015 amended agreements extended the time for delivery of the fiscal 2015 audited financial statements and the first and second quarter fiscal 2016 quarterly financial statements to January 31, 2016, whereby an event of default was waived as long as those financial statements were delivered within the thirty day grace period after that date. The December 2015 amended agreements also modify certain definitions applicable to the Company s affirmative and negative financial covenants, including with respect to the treatment of the costs related to the Company s restatement for purposes of the calculation of the minimum fixed charge coverage ratio and the maximum leverage ratio. As part of the December 2015 amended

agreements, the lenders also consented to the Company's payment of a \$0.05 per share common stock dividend in December 2015.

In February 2016, the Company entered into additional amended agreements related to the Bank Term Loans and Senior Notes that further extend the time for delivery of its fiscal 2015 audited financial statements and the first and second quarter fiscal year 2016 quarterly financial statements, as well as to extend the time for delivery of its third quarter fiscal year 2016 quarterly financial statements. The February 2016 amended agreements extended the time for delivery of the fiscal year 2015 audited financial statements and the first, second and third quarter fiscal 2016 quarterly financial statements to April 1, 2016, whereby an event of default was waived as long as those financial statements were delivered by that date without regard to any grace period. As part of the February 2016 amended agreements, the lenders also consented to the Company's payment of the previously declared annual dividend of \$0.0195 per share to be paid on shares of preferred stock in March 2016.

***Subsequent Event Related to the ADS Mexicana Scotia Bank Revolving Credit Facility***

On May 27, 2016, ADS Mexicana obtained a waiver on a covenant from Scotia Bank relating to ADS Mexicana failing to notify Scotia Bank of changes in legal organizational structure and payment of dividends.

---

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

*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, 2016 refers to fiscal 2016, which is the period from April 1, 2015 to March 31, 2016.*

*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 2015 Form 10-K, as filed with the Securities and Exchange Commission (the "SEC") on March 29, 2016. 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, our BaySaver joint venture, and our Tigre-ADS USA joint venture.*

**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 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 North America, our national footprint combined with our strong local presence and broad product offering makes 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 \$10.5 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 has been displacing traditional materials, such as reinforced concrete, corrugated steel and PVC, across an ever expanding range of end markets. This has allowed us to consistently gain share and achieve above market growth throughout economic cycles. We expect to continue to drive conversion to our products from traditional products 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 corrugated high density polyethylene (or "HDPE") pipe, polypropylene (or "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.

## Recent Developments

### *2014 Initial Public Offering ( IPO )*

On July 11, 2014, in anticipation of the IPO, we executed a 4.707-for-one split of our common and our preferred stock. The effect of the stock split on outstanding shares and earnings per share has been retroactively applied to all periods presented.

On July 25, 2014, we completed the IPO of our common stock, which resulted in the sale by the Company of 5,289,474 shares of common stock. We received total proceeds from the IPO of \$79.1 million after excluding underwriter discounts and commissions of \$5.5 million, based upon the price to the public of \$16.00 per share. After deducting other offering expenses of \$6.9 million, we used the net proceeds of \$72.2 million to reduce the outstanding indebtedness under the revolving portion of our credit facility. The common stock is listed on the NYSE under the symbol WMS.



**Table of Contents**

On August 22, 2014, an additional 600,000 shares of common stock were sold by certain selling stockholders of the Company as a result of the partial exercise by the underwriters of the over-allotment option granted by the selling stockholders to the underwriters in connection with the IPO. The shares were sold at the public offering price of \$16.00 per share. The Company did not receive any proceeds from the sale of such additional shares.

**2014 Secondary Public Offering ( Secondary Public Offering )**

On December 9, 2014, we completed a Secondary Public Offering of our common stock, which resulted in the sale of 10,000,000 shares of common stock by a certain selling stockholder of the Company at a public offering price of \$21.25 per share. We did not receive any proceeds from the sale of shares by the selling stockholder.

On December 15, 2014, an additional 1,500,000 shares of common stock were sold by a certain selling stockholder of the Company as a result of the full exercise by the underwriters of the over-allotment option granted by the selling stockholder to the underwriters in connection with the Secondary Public Offering. The shares were sold at the public offering price of \$21.25 per share. The Company did not receive any proceeds from the sale of such additional shares.

**Acquisition of Ideal Pipe**

On January 30, 2015, Hancor of Canada, Inc., a wholly-owned subsidiary of the Company, acquired all issued and outstanding shares of Ideal Drain Tile Limited and Wave Plastics Inc., the sole partners of Ideal Pipe (together Ideal Pipe ) for a contractual purchase price of \$55.7 million Canadian dollars, financed through our existing line of credit facility. Ideal Pipe designs, manufactures and markets high performance thermoplastic corrugated pipe and related water management products used across a broad range of Canadian end markets and applications, including nonresidential, residential, agriculture, and infrastructure applications. The acquisition further strengthens our positions in Canada by increasing our size and scale in the market, as well as enhancing our manufacturing, marketing and distribution capabilities. The results of operations of Ideal Pipe are included in our Consolidated Statements of Operations after January 30, 2015.

**Results of Operations****Three Months Ended June 30, 2015 Compared With Three Months Ended June 30, 2014**

The following table summarizes certain financial information relating to our operating results that have been derived from our condensed consolidated financial statements for the three months ended June 30, 2015 and 2014. Also included is certain information relating to the operating results as a percentage of net sales. We believe this presentation is useful to investors in comparing historical results.

(Amounts in thousands, except per share data)	Three Months Ended June 30, % of		Three Months Ended June 30, % of		% Variances
	2015	Net Sales	2014	Net Sales	
<b>Consolidated Statements of Operations data:</b>					
Net sales	\$ 349,124	100.0%	\$ 326,434	100.0%	7.0%
Cost of goods sold	276,538	79.2%	265,576	81.4%	4.1%
Gross profit	72,586	20.8%	60,858	18.6%	19.3%
Selling expenses	21,227	6.1%	19,552	6.0%	8.6%

Edgar Filing: ADVANCED DRAINAGE SYSTEMS, INC. - Form 10-Q

General and administrative expenses	18,286	5.2%	15,798	4.8%	15.7%
Loss on disposal of assets or businesses	866	0.2%	64		*
Intangible amortization	2,526	0.7%	2,613	0.8%	(3.3%)
Income from operations	29,681	8.5%	22,831	7.0%	30.0%
Interest expense	4,286	1.2%	5,051	1.6%	(15.1%)
Derivative losses (gains) and other expense (income), net	6,580	1.9%	(216)	(0.1%)	*
Income before income taxes	18,815	5.4%	17,996	5.5%	4.6%
Income tax expense	7,371	2.1%	7,893	2.4%	(6.6%)
Equity in net (income) loss of unconsolidated affiliates	(354)	(0.1%)	662	0.2%	(153.5%)
Net income	11,798	3.4%	9,441	2.9%	25.0%
Less net income attributable to noncontrolling interest	1,088	0.3%	875	0.3%	24.3%

- 20 -

**Table of Contents**

(Amounts in thousands)	Three Months Ended June 30, 2015	% of Net Sales	Three Months Ended June 30, 2014	% of Net Sales	% Variances
<b>Net income attributable to ADS</b>	<b>\$ 10,710</b>	<b>3.1%</b>	<b>\$ 8,566</b>	<b>2.6%</b>	<b>25.0%</b>

**Other financial data:**

Adjusted EBITDA <sup>(a)</sup>	\$ 51,813	14.8%	\$ 45,129	13.8%	14.8%
System-Wide Net Sales <sup>(a)</sup>	\$ 371,133	106.3%	\$ 346,224	106.1%	7.2%
Adjusted Earnings Per Fully Converted Share <sup>(a)</sup>	\$ 0.19		\$ 0.17		13.6%

(a) See section entitled Non-GAAP Financial Measures for further information.

\* not meaningful

*Net sales*

(Amounts in thousands)	Three Months Ended June 30,		
	2015	2014	% Variance
<b>Domestic</b>			
Pipe	\$ 220,533	\$ 216,036	2.1%
Allied Products	77,631	73,589	5.5%
<b>Total domestic</b>	<b>298,164</b>	<b>289,625</b>	<b>2.9%</b>
<b>International</b>			
Pipe	42,376	29,931	41.6%
Allied Products	8,584	6,878	24.8%
<b>Total international</b>	<b>50,960</b>	<b>36,809</b>	<b>38.4%</b>
<b>Total net sales</b>	<b>\$ 349,124</b>	<b>\$ 326,434</b>	<b>7.0%</b>

Net sales totaled \$349.1 million in the three months ended June 30, 2015, increasing \$22.7 million, or 7.0%, over the comparable period in fiscal year 2015.

Domestic net sales increased \$8.5 million, or 2.9%, in the three months ended June 30, 2015, as compared to the prior fiscal year period. The growth was achieved by volume gains in both our Pipe and Allied Products, which increased \$4.5 million and \$4.0 million, respectively, in the three months ended June 30, 2015. Pipe sales were up \$4.5 million, or 2.1%, as modest gains were achieved in the non-residential and residential markets, which offset small declines in the infrastructure and agriculture markets. Pipe selling prices increased 2.0% compared to the prior fiscal year. Allied Product sales increased \$4.0 million, or 5.5%, due to favorable sales volume sold primarily into the non-residential, residential and infrastructure markets.

International net sales increased \$14.2 million, or 38.4%, in the three months ended June 30, 2015 over the comparable fiscal year 2015 period. The significant increase was primarily attributed to the impact of the acquisition of Ideal Pipe in Canada which closed in the fourth quarter of fiscal year 2015. Incremental sales revenues from Ideal

Pipe during the three months ended June 30, 2015 amounted to approximately \$12.2 million. The balance of the international sales growth is primarily related to increased sales in Mexico, which was driven by a 23.1% increase in pipe volume. In addition, the Canadian dollar was approximately 11% weaker against the U.S. dollar in the three month period ended June 30, 2015, compared to the three month period ended June 30, 2014, which had a negative impact on Net sales for Canada of \$3.6 million during the three month period ended June 30, 2015.

System-Wide Net Sales were \$371.1 million in the first three months of fiscal year 2016, an increase of \$24.9 million, or 7.2%, over System-Wide Net Sales of \$346.2 million in the first three months of fiscal year 2015. Net sales at our South American Joint Venture were \$14.3 million and \$14.0 million for the three months ended June 30, 2015 and 2014, respectively, up only 2.1% as the Brazilian economy continues to lag behind others in the region. Net sales at our BaySaver and Tigre-ADS USA joint ventures provided incremental sales during the first quarter resulting in a combined increase of \$1.9 million in net sales for the three months ended June 30, 2015 as compared to the prior fiscal year period.

## **Table of Contents**

### *Cost of goods sold and Gross profit*

Cost of goods sold increased \$10.9 million or 4.1% to \$276.5 million for the three months ended June 30, 2015 compared to \$265.6 million for the three months ended June 30, 2014.

Gross profit for the three months ended June 30, 2015 increased \$11.7 million to \$72.6 million, a 19.3% increase over the \$60.9 million for the comparable fiscal year 2015 period. Gross profit as a percentage of net sales was 20.8% for the three months ended June 30, 2015 as compared to 18.6% for the comparable fiscal year 2015 period.

Domestic gross profit increased \$5.6 million, or 10.4%, to \$59.7 million for the three months ended June 30, 2015 as compared to \$54.1 million for the comparable fiscal year 2015 period. In addition to the impact of the 2.9% increase in domestic net sales over the comparable fiscal year 2015 period, the increase in domestic gross profit was also impacted by a decline in freight costs due to lower diesel fuel prices which dropped approximately 29.0% over the comparable fiscal year 2015 period. Growth in sales of higher margin Allied Products also contributed to the overall increase in gross profit.

International gross profit increased \$6.1 million, or 89.7% from \$6.8 million to \$12.9 million in the first quarter of fiscal year 2016 compared to the same period in fiscal year 2015, largely due to the incremental impact of the gross profit for Ideal Pipe in Canada, which contributed approximately \$3.3 million of the total increase in international gross profit. The remaining increase is primarily attributed to additional ADS operations in Canada and Mexico during the first quarter of fiscal year 2016.

### *Selling expenses*

Selling expenses consist of field selling and customer service expenditures for personnel engaged in sales and sales support functions. Field selling and customer service expenditures primarily consists of personnel costs (salaries, benefits, and variable sales commissions), travel and entertainment expenses, marketing, promotion, and advertising expenses, as well as bad debt provisions.

Selling expenses for the three months ended June 30, 2015 increased \$1.6 million, or 8.6%, over the comparable fiscal year 2015 period, slightly higher than the 7.0% increase in net sales over the same period. The increase was primarily the result of increases in variable selling expenses due to higher sales volume and investments in additional sales coverage and growth initiatives. As a percentage of net sales, selling expenses increased to 6.1% in the first quarter of fiscal 2016 as compared to 6.0% in the prior year.

### *General and administrative expenses*

General and administrative expenses consists of personnel costs (salaries, benefits, and other personnel-related expenses, including stock-based compensation), recruitment and relocation expenses, accounting and legal fees, corporate business travel expenses, rent and utilities for the administrative offices, director fees, investor relations, membership fees, office supplies, insurance and other miscellaneous expenses.

General and administrative expenses for the three months ended June 30, 2015 increased \$2.5 million, or 15.7%, over the comparable fiscal year 2015 period. The increase was primarily the result of increases in corporate overhead expenses of \$0.9 million, increased salary and compensation expenses of \$0.9 million, higher professional fees of \$1.0 million, and the impact of including \$0.7 million of Ideal Pipe costs in the fiscal year 2016 period, offset partially by lower stock compensation expenses of \$1.5 million.

The \$1.0 million increase in professional fees was due to audit and legal fee increases in connection with operating as a public company. The \$1.5 million decrease in non-cash stock-based compensation was due to a \$0.6 million decrease in stock option expense and a \$0.9 million decrease in restricted stock expense during the fiscal year 2016 period.

*Loss on disposal of assets or businesses*

Loss on disposal of equipment for the three months ended June 30, 2015 was \$0.9 million compared to \$0.1 million for the comparable fiscal year 2015 period.

*Intangible amortization*

Intangible amortization remained relatively flat at \$2.5 million and \$2.6 million for the three months ended June 30, 2015 and 2014, respectively, as a result of intangible assets of \$7.8 million becoming fully amortized during fiscal 2015 offset by the impact of the acquisition of Ideal Pipe intangible assets in the fourth quarter of fiscal year 2015.

*Interest expense*

Interest expense for the three months ended June 30, 2015 decreased \$0.8 million, or 15.1%, over the comparable fiscal year 2015 period. Our average overall debt outstanding was down by approximately \$36.9 million or 7.0% for the quarter ending June 30,

---

**Table of Contents**

2015 compared to the average balance outstanding for the quarter ending June 30, 2014 which resulted in lower interest costs. The average debt balance for the quarter ending June 30, 2014 was higher by \$52.5 million primarily due to the large special dividend paid during the last quarter of fiscal year 2014 which carried into fiscal year 2015 and was offset by \$15.6 million higher average capital lease obligations for the quarter ending June 30, 2015 compared to the quarter ending June 30, 2014.

*Derivative losses (gains) and other expense (income), net*

For the three months ended June 30, 2015, we incurred derivative losses and other expense, net of \$6.6 million compared to income, net of \$0.2 million in the comparable fiscal year 2015 period. During the quarter ended June 30, 2015, the Company absorbed losses from cash settlements of derivative hedges for propylene raw material and diesel fuel amounting to \$2.7 million. Another \$3.8 million of expense was recognized in connection with mark-to-market adjustments related to the various hedge programs. Net hedging losses for the comparable prior period amounted to only \$0.1 million.

*Income tax expense*

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 one-time charges, as well as discrete events. For the three months ended June 30, 2015 and 2014, the Company recorded income tax provisions of \$7.4 million and \$7.9 million, respectively, which represents effective tax rates of 39.2% and 43.9%, respectively. These rates are higher than the federal statutory rate of 35% due principally to state and local income taxes, partially offset by foreign income taxed at lower rates.

*Equity in net (income) loss of unconsolidated affiliates*

Equity in net (income) loss of unconsolidated affiliates represents our proportionate share of income or loss attributed to the three unconsolidated joint ventures in which we have significant influence, but not control, over operations. For the three months ended June 30, 2015, the Company recognized income of \$0.4 million compared to a net loss of \$0.7 million over the comparable fiscal year 2015 period. Most of the positive change was due to stronger performance from the South American joint venture, which had roughly break-even results (less than \$0.1 million of income) in the three months ended June 30, 2015, rather than \$0.8 million of loss in the comparable fiscal year 2015 period. The remainder of the variance is related to the performance of our domestic joint ventures.

*Net income attributable to noncontrolling interest*

The net income attributable to noncontrolling interest represents the share of ADS Mexicana net income attributable to the minority interest holders. Net income attributable to noncontrolling interest for the three months ended June 30, 2015 increased \$0.2 million to income of \$1.1 million compared to income of \$0.9 million for the comparable fiscal year 2015 period.

*Net income attributable to ADS and Net income (loss) per share*

First quarter net income attributable to ADS for fiscal year 2016 of approximately \$10.7 million increased from fiscal year 2015 first quarter's net income attributable to ADS of \$8.6 million, as influenced by the factors noted above. Net earnings per share for the first quarter fiscal year 2016 was \$0.18 per basic and diluted share, as compared to net loss of (\$0.21) per basic and diluted share recorded in the comparable fiscal year 2015 period. The income available to common shareholders for the three months ended June 30, 2014 was reduced by \$18.4 million or \$0.39 per share for

common stockholders relating to the fair value appreciation of Redeemable convertible preferred stock classified in mezzanine equity.

*Adjusted EBITDA* <sup>(a)</sup>

<b>(Amounts in thousands)</b>	<b>Three Months Ended June 30,</b>		
	<b>2015</b>	<b>2014</b>	<b>% Variance</b>
Domestic	\$ 41,277	\$ 40,992	0.7%
International	10,536	4,137	154.7%
<b>Total adjusted EBITDA</b>	<b>\$ 51,813</b>	<b>\$ 45,129</b>	<b>14.8%</b>
As a percentage of net sales	14.8%	13.8%	

(a) See section entitled "Non-GAAP Financial Measures" for more information.



**Table of Contents****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, System-Wide Net Sales and Adjusted Earnings Per Fully Converted Share. 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 is a non-GAAP financial measure that is comprised of net income before interest, income taxes, depreciation and amortization, stock-based compensation, non-cash charges and certain other expenses. Our definition of Adjusted EBITDA may differ from similar measures used by other companies, even when similar terms are used to identify such measure. Adjusted EBITDA is a key metric used by management and our board of directors to assess our financial performance and evaluate the effectiveness of our business strategies. Accordingly, we believe that Adjusted EBITDA provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management and Board of Directors.

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

(Amounts in thousands)	Three Months Ended June 30,	
	2015	2014
<b>Net income</b>	<b>\$ 11,798</b>	<b>\$ 9,441</b>
Depreciation and amortization	18,639	16,026
Interest expense	4,286	5,051
Income tax expense	7,371	7,893
<b>EBITDA</b>	<b>42,094</b>	<b>38,411</b>
Derivative fair value adjustments	3,761	96
Foreign currency transaction losses	317	130
Loss on sale of assets or businesses	866	64
Unconsolidated affiliates interest, tax, depreciation and amortization <sup>(a)</sup>	870	798
Contingent consideration remeasurement	55	(18)
Stock-based compensation	725	2,246
ESOP deferred stock-based compensation	3,125	2,687
Transaction costs <sup>(b)</sup>		715
<b>Adjusted EBITDA</b>	<b>\$ 51,813</b>	<b>\$ 45,129</b>

(a) Includes our proportional share of interest, income taxes, depreciation and amortization related to our South American Joint Venture, our BaySaver joint venture and our 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 IPO.

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

- 24 -

**Table of Contents**

(Amounts in thousands)	Three Months Ended June 30,			
	2015		2014	
	Domestic	International	Domestic	International
<b>Net income</b>	<b>\$ 5,542</b>	<b>\$ 6,256</b>	<b>\$ 7,843</b>	<b>\$ 1,598</b>
Depreciation and amortization	16,417	2,222	14,658	1,368
Interest expense	4,037	249	5,042	9
Income tax expense	6,317	1,054	7,414	479
<b>Segment EBITDA</b>	<b>32,313</b>	<b>9,781</b>	<b>34,957</b>	<b>3,454</b>
Derivative fair value adjustments	3,721	40	96	
Foreign currency transaction losses		317		130
Loss (gain) on sale of assets or businesses	1,052	(186)	60	4
Unconsolidated affiliates interest, tax, depreciation and amortization <sup>(a)</sup>	286	584	249	549
Contingent consideration remeasurement	55		(18)	
Stock-based compensation	725		2,246	
ESOP deferred stock-based compensation	3,125		2,687	
Transaction costs <sup>(b)</sup>			715	
<b>Segment Adjusted EBITDA</b>	<b>\$ 41,277</b>	<b>\$ 10,536</b>	<b>\$ 40,992</b>	<b>\$ 4,137</b>

(a) Includes our proportional share of interest, income taxes, depreciation and amortization related to our South American Joint Venture, our BaySaver joint venture and our 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 IPO.

*System-Wide Net Sales.* System-Wide Net Sales is a non-GAAP measure which equals the sum of the net sales of our domestic and international segments plus all net sales from our unconsolidated joint ventures. We participate in three unconsolidated joint ventures, the South American Joint Venture; BaySaver ; and Tigre-ADS USA, Inc. ( Tigre-ADS USA ), which is 49% owned by our wholly-owned subsidiary ADS Ventures, Inc. We use this metric to measure the overall performance of our business across all of our geographies and markets we serve.

Our South American Joint Venture is managed as an integral part of our international segment and our BaySaver and Tigre-ADS USA joint ventures are managed as an integral part of our domestic segment. However, they are not consolidated under GAAP. System-Wide Net Sales is prepared as if our South American Joint Venture, our BaySaver joint venture, and our Tigre-ADS USA joint venture were accounted for as consolidated subsidiaries.

The reconciliation of our System-Wide Net Sales to Net sales is as follows:

(Amounts in thousands)	Three Months Ended June 30,	
	2015	2014
<b>Net sales</b>	<b>\$ 349,124</b>	<b>\$ 326,434</b>
Net sales associated with our unconsolidated affiliates		
South American Joint Venture <sup>(a)</sup>	14,277	13,920

Edgar Filing: ADVANCED DRAINAGE SYSTEMS, INC. - Form 10-Q

BaySaver joint venture <sup>(b)</sup>	3,126	2,337
Tigre-ADS USA joint venture <sup>(c)</sup>	4,606	3,533
<b>System-Wide Net Sales</b>	<b>\$ 371,133</b>	<b>\$ 346,224</b>

(a) On July 31, 2009, we entered into an arrangement to form our South American Joint Venture.

(b) On July 15, 2013, we entered into an arrangement to form our BaySaver joint venture.

(c) On April 7, 2014, we entered into an arrangement to form our Tigre-ADS USA joint venture.

*Adjusted Earnings Per Fully Converted Share (Non-GAAP)*. Adjusted Earnings Per Fully Converted Share (Non-GAAP) is a non-GAAP, supplemental measure of financial performance that is not required by, or presented in accordance with GAAP. We calculate Adjusted Earnings Per Fully Converted Share (Non-GAAP) by adjusting our historical net income (loss) per share Basic and weighted average common shares outstanding Basic amounts for the conversion of all shares of Redeemable convertible preferred stock into ADS common stock at the conversion ratio of one Redeemable convertible preferred share for every 0.7692 share of common stock as of the beginning of each period presented.

**Table of Contents**

To effect this adjustment, we have (1) removed the adjustment for the change in fair value of Redeemable convertible preferred stock classified as mezzanine equity from the numerator of the historical Net income (loss) per share Basic computation, (2) made a corresponding adjustment to the amount allocated to participating securities under the two-class earnings per share computation method, and (3) added back ESOP deferred compensation attributable to the shares of 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.

We have also made adjustments to historical Net income (loss) per share - Basic, and the corresponding Weighted average common shares outstanding Basic to assume share conversion of the Redeemable convertible preferred stock to ADS common stock.

Adjusted Earnings Per Fully Converted Share (Non-GAAP) is included in this report because it is a key metric used by management and our board of directors to assess our financial performance. Adjusted Earnings Per Fully Converted Share (Non-GAAP) 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 Adjusted Earnings Per Fully Converted Share (Non-GAAP), and the corresponding Weighted Average Common Shares Outstanding Fully Converted (Non-GAAP) to our historical net income (loss) per share and corresponding historical weighted average common share amounts, the most comparable GAAP measure, for each of the periods indicated.

(Amounts in thousands, except per share data)	Three Months Ended June 30,	
	2015	2014
<b>Net income (loss) available to common stockholders</b>	<b>\$ 9,475</b>	<b>\$ (9,844)</b>
Add: Adjustments to net income (loss) available to common stockholders	1,235	18,410
Adjusted net income attributable to ADS (Non-GAAP)	10,710	8,566
Add: Fair value of ESOP compensation related to Redeemable convertible preferred stock	3,125	2,687
Adjusted net income (Non-GAAP)	<b>\$ 13,835</b>	<b>\$ 11,253</b>
Weighted Average Common Shares Outstanding Basic	53,623	47,536
Add: Unvested restricted shares	148	263
Redeemable convertible preferred shares	19,693	20,099
Total Weighted Average Common Shares Outstanding Fully Converted (Non-GAAP)	73,464	67,898
<b>Adjusted Earnings Per Fully Converted Share (Non-GAAP)</b>	<b>\$ 0.19</b>	<b>\$ 0.17</b>

**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 operation primarily through equity issuance, internally generated cash flow and debt financings. 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, 2015, we had \$4.8 million in cash that was held by our foreign subsidiaries. Our intent is to reinvest our earnings in foreign subsidiaries. In the event that foreign earnings are repatriated, these amounts will be subject to income tax liabilities in the appropriate tax jurisdiction.

### ***Working Capital and Cash Flows***

During the three months ended June 30, 2015, our net increase in cash amounted to \$1.2 million compared to a net increase of \$0.8 million for the three months ended June 30, 2014. During the three months ended June 30, 2015, our source of funds was primarily driven by operating earnings, seasonal borrowings on our Revolving Credit facility and proceeds from notes, mortgages, and other debt. For the same period ending June 30, 2015, our use of cash was primarily driven by increased accounts receivable balances and capital expenditures. During the three months ended June 30, 2014, our source of funds was primarily driven by operating earnings and seasonal borrowings on our Revolving Credit facility. For the same period ending June 30, 2014, our use of cash was primarily driven by increased accounts receivable balances and capital expenditures.

**Table of Contents**

As of June 30, 2015, we had \$89.1 million in liquidity, including \$4.8 million of cash and \$84.3 million in borrowings available under our Revolving Credit Facilities, 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 dividend payment requirement for our convertible preferred stock for at least the next twelve months.

As of June 30, 2015, we had total consolidated indebtedness of approximately \$442.0 million. We repaid a portion of our outstanding indebtedness in fiscal year 2015 with the net proceeds from our initial public offering which closed on July 25, 2014.

The following table sets forth the major sources and uses of cash for each of the periods presented:

(Amounts in thousands)	Three Months Ended	
	June 30,	
	2015	2014
<b>Statement of Cash Flows data:</b>		
Net cash used in operating activities	\$ (18,142)	\$ (18,542)
Net cash used in investing activities	(15,561)	(15,656)
Net cash from financing activities	34,745	35,073

*Working Capital*

Net working capital increased to \$306.8 million as of June 30, 2015, from \$249.1 million as of March 31, 2015, primarily due to the increases in accounts receivable of \$75.4 million resulting from sales increases. This change was offset partially by a decrease of \$10.8 million in inventory and an increase of \$7.5 million in accounts payable, accrued expenses, and accrued income taxes.

*Operating Cash Flows*

Cash flow from operating activities for the three months ended June 30, 2015 was a use of \$18.1 million as compared with cash used by operating activities of \$18.5 million for the three months ended June 30, 2014. Cash flow from operating activities during the three months ended June 30, 2015 was impacted by higher growth in accounts receivable compared to the prior year driven by sales revenues increasing \$22.7 million or 7.0% versus the three months ended June 30, 2014.

*Investing Cash Flows*

During the three months ended June 30, 2015, cash used for investing activities was \$15.6 million, primarily due to capital expenditures in support of operations and additions of capitalized software. During the three months ended June 30, 2014, cash used for investing activities was \$15.7 million, primarily due to capital expenditures in support of operations and an investment in a domestic joint venture operation.

*Financing Cash Flows*

During the three months ended June 30, 2015, cash provided from financing activities was \$34.7 million, utilizing borrowings on our Revolving Credit facility to support our typical seasonal demand increase following the winter

months and proceeds from notes, mortgages, and other debt. During the three months ended June 30, 2014, cash provided from financing activities was \$35.1 million, utilizing borrowings on our Revolving Credit Facility to support our typical seasonal demand increase.

*Capital Expenditures*

Capital expenditures totaled \$10.6 million, and \$7.4 million for the three months ended June 30, 2015 and June 30, 2014, respectively. Our capital expenditures for the three months ended June 30, 2015 were used primarily to support facility expansions, equipment replacements and our recycled resin initiatives.

We currently anticipate that we will make capital expenditures of approximately \$45 million in fiscal year 2016. Such capital expenditures are expected to be financed using funds generated by operations. As of June 30, 2015, there were no material contractual obligations or commitments related to these planned capital expenditures.



---

**Table of Contents*****Financing Transactions******Bank Term Loans***

On September 24, 2010, we entered into a credit agreement with PNC Bank, National Association, or PNC, as administrative agent, and lender parties thereto. The credit agreement, as amended and restated on June 12, 2013 and subsequently further amended, provides for our Bank Term Loans consisting of (i) the Revolving Credit Facility providing for revolving loans and letters of credit of up to a maximum aggregate principal amount of \$325 million, (ii) the Term Loan Facility providing for the Term Loans in an aggregate original principal amount of \$100 million, and (iii) the ADS Mexicana Revolving Credit Facility, described below. The Bank Term Loans also permit us to add additional commitments to the Revolving Credit Facility or the Term Loan Facility not to exceed \$50 million in the aggregate. The proceeds of the Revolving Credit Facility are primarily used to provide for our ongoing working capital and capital expenditure needs, to finance acquisitions and distributions, and for our other general corporate purposes. The proceeds of the Term Loan Facility were primarily used for our general corporate purposes. The interest rates on the Bank Term Loans are determined by certain base rates or LIBOR rates, plus an applicable margin. The obligations under the Bank Term Loans are guaranteed by certain of our subsidiaries and secured by substantially all of our personal property assets. On December 20, 2013, we amended the Revolving Credit Facility to, among other terms, make certain amendments in order to permit the payment of a cash dividend. For further information about the Bank Term Loans, see Note 12. Debt to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data of our Fiscal 2015 Form 10-K. As of June 30, 2015, the outstanding principal drawn on the Revolving Credit Facility was \$245.4 million, with \$72.3 million available to be drawn on the U.S. facility. As of June 30, 2015, the outstanding principal balance of the Term Loan was \$89.4 million. As a result of the Restatement and delay in the filing of the Fiscal 2015 Form 10-K, the Revolving Credit Facility was amended to extend the reporting deadlines for financial statements and debt covenant calculations until April 1, 2016. The Company has satisfied the amended reporting requirements.

***ADS Mexicana Revolving Credit Facility***

On September 24, 2010, our joint venture ADS Mexicana entered into a credit agreement with PNC, as administrative agent, and lender parties thereto. The credit agreement, as amended and restated on June 12, 2013 and subsequently further amended, provides for revolving loans and letters of credit of up to a maximum aggregate principal amount of \$12 million. The proceeds of the Revolving Credit Facility are primarily used to cover working capital needs. The interest rates of the revolving credit facilities are determined by certain base rates or LIBOR rates, plus an applicable margin. The obligations under the Revolving Credit Facility are guaranteed by us and certain of our subsidiaries and secured by substantially all of our assets. For further information about the Bank term loans, see Note 12. Debt to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data of our Fiscal 2015 Form 10-K. As of June 30, 2015, there was no outstanding principal drawn on the Revolving Credit Facility and the entire \$12.0 million was available to be drawn. As a result of the Restatement and delay in the filing of the Fiscal 2015 Form 10-K, the ADS Mexicana Revolving Credit Facility was amended to extend the reporting deadlines for financial statements and debt covenant calculations until April 1, 2016. The Company has satisfied the amended reporting requirements.

***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. Pursuant to the private shelf agreement, on September 27, 2010,

we issued \$75 million in aggregate principal amount of the 5.60% Senior Series A Notes due September 24, 2018 to repurchase outstanding shares of common stock from certain of our stockholders and to repurchase outstanding shares of convertible preferred stock from the ESOP. On July 24, 2013, we issued \$25 million in aggregate principal amount of the 4.05% Senior Series B Notes due September 24, 2019 for our general corporate purposes. The Senior Notes are guaranteed by certain of our subsidiaries and secured by substantially all of our assets. On December 20, 2013, we amended the private shelf agreement to, among other terms, make certain amendments in order to permit the payment of a cash dividend. For further information about the Senior Notes, see Note 12. Debt to the Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data of our Fiscal 2015 Form 10-K. We have no further amount available for issuance of senior notes under the private shelf agreement. At June 30, 2015 the outstanding principal balance on these notes was \$100.0 million. As a result of the Restatement and delay in the filing of the Fiscal 2015 Form 10-K, the Senior Notes were amended to extend the reporting deadlines for financial statements and debt covenant calculations until April 1, 2016. The Company has satisfied the amended reporting requirements.

### *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 include a Leverage

## **Table of Contents**

Ratio and a Fixed Charge Ratio. For any relevant period of determination, The Leverage Ratio is calculated by dividing Total Consolidated Indebtedness (funded debt plus guarantees) by Consolidated EBITDA. The current upper limit is 4.0 times. The Fixed Charge Ratio is calculated by dividing the sum of Consolidated EBITDA minus Capital Expenditures minus cash Income Taxes paid, by the sum of Fixed Charges. Fixed Charges include cash Interest expense, scheduled principal payments on Indebtedness, and ESOP Capital Distributions in excess of \$10 million in a given fiscal year. The current minimum ratio is 1.25 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 2015 Form 10-K. We were in compliance with our debt covenants as of June 30, 2015.

## **Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements, with the exception of the guarantee of 50% of certain debt of our unconsolidated South American Joint Venture, as further discussed in Note 5. Related Party Transactions to the Condensed Consolidated Financial Statements. As of June 30, 2015, our South American Joint Venture had approximately \$14.7 million of outstanding debt. We do not believe that this guarantee will have a current or future effect on our financial condition, results of operations, liquidity, or capital resources.

## **Critical Accounting Policies and Estimates**

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 2015 Form 10-K.

## **Forward-Looking Statements**

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Some of the forward-looking statements can be identified by the use of terms such as believes, expects, may, will, would, should, could, seeks, predict, potential, continue, intends, 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 Quarterly Report on 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 Quarterly Report on 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 Quarterly Report on 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;

- 29 -

**Table of Contents**

cyclicality 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;

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;

our ability to meet future capital requirements and fund our liquidity needs;

the risk that additional information may arise that would require the Company to make additional adjustments or revisions or to restate further the financial statements and other financial data for certain prior periods and any future periods;

any further 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.

---

**Table of Contents****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.

***Interest Rate Risk***

We are subject to interest rate risk associated with our bank debt. Changes in interest rates impact the fair value of our fixed-rate debt, but there is no impact to earnings and cash flow. Alternatively, changes in interest rates do not affect the fair value of our variable-rate debt, but they do affect future earnings and cash flow. The Revolving Credit Facility, the Term Loan Facility, and our industrial development revenue bond, or IDRB, notes bear variable interest rates. The Revolving Credit Facility and Term Loan Facility bear interest either at LIBOR or the Prime Rate, at our option, plus applicable pricing margins. The IDRB notes bear interest at weekly commercial paper rates, plus applicable pricing margins. A 1.0% increase in interest rates on our variable-rate debt would increase our annual forecasted interest expense by approximately \$2.3 million based on our borrowings as of June 30, 2015. Assuming the Revolving Credit Facility is fully drawn, each 1.0% increase or decrease in the applicable interest rate would change our interest expense by approximately \$3.1 million per year. To mitigate the impact of interest rate volatility, we had two interest rate swaps in effect as of June 30, 2015. The first swap is a \$50.0 million notional value, non-amortizing swap, at a fixed LIBOR rate of 0.86% which expires on September 1, 2016. A second \$50.0 million notional value swap took effect on September 2, 2014 and expires on September 1, 2016. The rate is at a fixed LIBOR of 1.08%.

***Credit Risk***

Financial instruments that potentially subject us to a concentration of credit risk consist principally of accounts receivable. We provide our products to customers based on an evaluation of the customers' financial condition, generally without requiring collateral. Exposure to losses on receivables is principally dependent on each customer's financial condition. We monitor the exposure for credit losses and maintain allowances for anticipated losses. Concentrations of credit risk with respect to our accounts receivable are limited due to the large number of customers comprising our customer base and their dispersion among many different geographies.

***Raw Material and Commodity Price Risk***

Our primary raw materials used in the production of our products are polyethylene resin for HDPE pipe and polypropylene resin for PP pipe. As these resins are hydrocarbon-based materials, changes in the price of feedstocks, such as crude oil and natural gas, as well as changes in the market supply and demand may cause the cost of these resins to fluctuate significantly. Raw materials account for the majority of our cost of goods sold. Given the significance of these costs and the inherent volatility in supplier pricing, our ability to reflect these changes in the cost of resins in our product selling prices in an efficient manner, passing the increase on to our customers, contributes to the management of our overall supply price risk and the potential impact on our results of operations.

We manage supply risk with financial and physical hedge contracts for the HDPE and PP resins used in the manufacture of our Pipe and Allied Products, as well as for the diesel fuel used by our in-house fleet of delivery trucks. Our physical hedge contracts for HDPE resins are typically at a fixed price and volume over time. We use, to a limited extent, financial derivatives for PP resin in the form of fixed price swaps based on propylene monomer. For diesel fuel, we have utilized option contracts in the form of collars with put and call options.

We have supply contracts that typically include supply periods of greater than one year. Except for physical-hedged resin contracts, we generally do not enter into long-term purchase orders for the delivery of raw materials. Our orders with suppliers are flexible and do not normally contain minimum purchase volumes or fixed prices. Accordingly, our suppliers may change their selling prices or other relevant terms on a monthly basis, exposing us to pricing risk. Our use of pricing and forecasting tools, centralized procurement, additional sources of supply and incorporation of vertical integration for recycled material have increased our focus on efficiency and resulted in lower overall supply costs.

***Inflation Risk***

Our cost of goods sold is subject to inflationary pressures and price fluctuations of the raw materials we use, primarily high density polyethylene and polypropylene resins. Historically, we have generally been able over time to recover the effects of inflation and price fluctuations through sales price increases and production efficiencies related to technological enhancements and improvements. However, we cannot reasonably estimate our ability to successfully recover any price increases.



## **Table of Contents**

### ***Foreign Currency Exchange Rate Risk***

We have operations in countries outside of the United States, all of which use the respective local foreign currency as their functional currency. Each of these operations may enter into contractual arrangements with customers or vendors that are denominated in currencies other than its respective functional currency. Consequently, our results of operations may be affected by exposure to changes in foreign currency exchange rates and economic conditions in the regions in which we sell or distribute our products. Exposure to variability in foreign currency exchange rates from these transactions is managed, to the extent possible, by natural hedges which result from purchases and sales occurring in the same foreign currency within a similar period of time, thereby offsetting each other to varying degrees.

In addition to the foreign currency transaction-related gains and losses that are reflected within the results of operations, we are subject to foreign currency translation risk, as the financial statements for our foreign subsidiaries are measured and recorded in the respective subsidiary's functional currency and translated into U.S. dollars for consolidated financial reporting purposes. The resulting translation adjustments are recorded net of tax impact in the Condensed Consolidated Statement of Comprehensive Income.

### **Item 4. Controls and Procedures Evaluation of Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures that are designed to ensure that 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 Chief Executive Officer ("CEO") and Chief Financial Officer ("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.

As previously disclosed in our Fiscal 2015 Form 10-K, we concluded that our internal control over financial reporting was not effective based upon certain material weaknesses identified as of March 31, 2015. See "Item 9A Controls and Procedures" in our Fiscal 2015 Form 10-K. Although we are not required to comply with the internal control reporting requirements mandated by Section 404 of the Sarbanes-Oxley Act of 2002 for the fiscal quarter ended June 30, 2015 (the "Evaluation Date") due to the transition period established by rules of the SEC for newly-public companies, our internal control over financial reporting is an integral part of our disclosure controls and procedures. Our CEO and CFO have concluded that those material weaknesses previously identified in the Fiscal 2015 Form 10-K were still present as of the Evaluation Date. Based on those material weaknesses, and the evaluation of our disclosure controls and procedures, our CEO and CFO concluded that the Company's disclosure controls and procedures were not effective as of the Evaluation Date.

### **Changes in Internal Control over Financial Reporting**

Our remediation efforts were ongoing during the three months ended June 30, 2015, and, other than those remediation efforts described in "Remediation Process" in Item 9A of our Fiscal 2015 Form 10-K, there were no changes in our 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, 2015 that has materially affected, or is reasonably likely to

materially affect, our internal control over financial reporting.

- 32 -

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

On July 29, 2015, a putative stockholder class action, Christopher Wyche, individually and on behalf of all others similarly situated v. Advanced Drainage Systems, Inc., et al. (Case No. 1:15-cv-05955-KPF), was commenced in the U.S. District Court for the Southern District of New York, naming the Company, along with Joseph A. Chlapaty, the Company's Chief Executive Officer, and Mark B. Sturgeon, the Company's former Chief Financial Officer, as defendants and alleging violations of the federal securities laws. An amended complaint was filed April 28, 2016. The amended complaint alleges that the Company made material misrepresentations and/or omissions of material fact in its public disclosures during the period from July 25, 2014 through March 29, 2016, in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 promulgated thereunder. Plaintiffs seek an unspecified amount of monetary damages on behalf of the putative class and an award of costs and expenses, including counsel fees and expert fees. The Company believes that it has valid and meritorious defenses and will vigorously defend against these allegations, but litigation is subject to many uncertainties and the outcome of this matter is not predictable with assurance. While it is reasonably possible that this matter ultimately could be decided unfavorably to the Company, the Company is currently unable to estimate the range of the possible losses, but they could be material.

On August 12, 2015, the SEC Division of Enforcement ( Enforcement Division ) informed the Company that it was conducting an informal inquiry with respect to the Company. As part of this inquiry, the Enforcement Division requested the voluntary production of certain documents generally related to the Company's accounting practices. Subsequent to the initial voluntary production request, the Company received document subpoenas from the Enforcement Division pursuant to a formal order of investigation. The Company has from the outset cooperated with the Enforcement Division's investigation and intends to continue to do so. While it is reasonably possible that this investigation ultimately could be resolved unfavorably to the Company, the Company is currently unable to estimate the range of possible losses, but they could be material.

We are involved from time to time in various legal proceedings that arise in the ordinary course of our 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. We believe that such litigation, claims, and administrative proceedings will not have a material adverse impact on our financial position or our results of operations. We record a liability when a loss is considered probable, and the amount can be reasonably estimated. In management's opinion, none of these proceedings are material in relation to our consolidated operations, cash flows, or financial position, and we have adequate accrued liabilities to cover our estimated probable loss exposure.

**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 2015 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 2015 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.

**Item 2. Unregistered Sale of Equity Securities**

Not applicable.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

- 33 -

**Table of Contents**

**Item 6. Exhibits**

The exhibits listed in the Exhibit Index are incorporated herein by reference.

- 34 -

Table of Contents

**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: May 31, 2016

ADVANCED DRAINAGE SYSTEMS, INC.

By: /s/ Joseph A. Chlapaty  
Joseph A. Chlapaty  
President and Chief Executive Officer  
(Principal Executive Officer)

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

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

- 35 -

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Exhibit Description</b>
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	Interactive data files pursuant to Rule 405 of Regulation S-T.