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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number: 001-36557

ADVANCED DRAINAGE SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	51-0105665
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

4640 Trueman Boulevard, Hilliard, Ohio 43026

(Address of Principal Executive Offices, Including Zip Code)

(614) 658-0050

(Registrant's Telephone Number, Including Area Code)

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

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

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

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

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

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

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

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited) (In thousands, except par value)

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

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

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

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

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

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited) (In thousands)

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

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) (In thousands)

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

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

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND MEZZANINE EQUITY

(Unaudited) (In thousands)

...non ...s	Amount	Paid -In Capital	Common Stock in Treasury Shares	Amount	Accumulated Other Compreh-ensive Loss	Retained Deficit	Total ADS Stock-holders' Equity	Non-controlling Interest in Subsidiaries	Total Stock-holders' Equity	Redeemable Convertible Preferred Stock Shares	Amount	Deferred Compensation - Unearned ESOP Shares Shares	Amount
60	$12,393	$755,787	98,222	$(436,984)	$(24,815)	$(83,678)	$222,703	$14,907	$237,610	24,225	$302,814	15,863	$(198,21
	—	—	—	—	—	17,742	17,742	528	18,270	—	—	—	—
	—	—	—	—	2,576	—	2,576	851	3,427	—	—	—	—
	—	—	—	—	—	(458)	(458)	—	(458)	—	—	—	—
	—	—	—	—	—	(3,895)	(3,895)	—	(3,895)	—	—	—	—
	—	602	—	—	—	—	602	—	602	—	—	(161)	2,012
	—	3	(1)	3	—	—	6	—	6	—	—	—	—
	—	447	(33)	147	—	—	594	—	594	—	—	—	—
	—	13,714	—	—	—	—	13,714	—	13,714	—	—	—	—

	—	1,084	—	—	—	—	1,084	—	1,084	—	—	—	—
	—	3,237	(274)	1,220	—	—	4,457	—	4,457	(357)	(4,457)	—	—
	—	—	400	(7,947)	—	—	(7,947)	—	(7,947)	—	—	—	—
60	$12,393	$774,874	98,314	$(443,561)	$(22,239)	$(70,289)	$251,178	$16,286	$267,464	23,868	$298,357	15,702	$(196,20
9	$11,426	$364,908	413	$(8,277)	$(21,247)	$(39,214)	$307,596	$16,663	$324,259	23,300	$291,247	15,219	$(190,16
	—	—	—	—	—	32,280	32,280	1,033	33,313	—	—	—	—
	—	—	—	—	(3,437)	—	(3,437)	(1,375)	(4,812)	—	—	—	—
	—	—	—	—	—	(497)	(497)	—	(497)	—	—	—	—
	—	—	—	—	—	(4,545)	(4,545)	—	(4,545)	—	—	—	—
	—	—	—	—	—	—	—	(735)	(735)	—	—	—	—
	—	1,625	—	—	—	—	1,625	—	1,625	—	—	(192)	2,396

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

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

Advanced Drainage Systems, Inc.

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

Recent Accounting Guidance

Recently Adopted Accounting Guidance

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

Advanced Drainage Systems, Inc.

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

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

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

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

Recent Accounting Guidance Not Yet Adopted

Leases - In February 2016, the FASB issued an ASU which amends the guidance for leases. This standard contains principles that will require an entity to recognize most leases on the balance sheet by recording a right-of-use asset and a lease liability, unless the lease is a short-term lease that has an accounting lease term of twelve months or less. The standard also contains other changes to the current lease guidance that may result in changes to how entities determine which contractual arrangements qualify as a lease, the accounting for executory costs such as property taxes and insurance, as well as which lease origination costs will be capitalizable. The new standard also requires expanded quantitative and qualitative disclosures. This standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those years, and early adoption is permitted. The standard requires the use of the modified retrospective transition method, whereby the new guidance will be applied at the beginning of the earliest period presented in the financial statements of the period of adoption. The modified retrospective transition approach includes certain practical expedients that entities may elect to apply in transition. The Company expects to adopt this standard effective April 1, 2019. The Company has implemented a new software solution to improve the process of tracking and accounting for leases under the current and new standards. The Company has not yet determined whether to

Advanced Drainage Systems, Inc.

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

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

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

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

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

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

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

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

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

Table of Contents

Advanced Drainage Systems, Inc.

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

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

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

3. REVENUE RECOGNITION

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

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

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

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

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

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

Table of Contents

Advanced Drainage Systems, Inc.

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

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

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

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

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

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

4. INVENTORIES

Inventories as of the periods presented consisted of the following:

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

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

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

5. FAIR VALUE MEASUREMENT

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

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

Advanced Drainage Systems, Inc.

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

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

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

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

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

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

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

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

Table of Contents

Advanced Drainage Systems, Inc.

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

6. DERIVATIVE TRANSACTIONS

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

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

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

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

7.NET INCOME PER SHARE AND STOCKHOLDERS' EQUITY

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

Table of Contents

Advanced Drainage Systems, Inc.

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

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

anti-dilutive

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

8. RELATED PARTY TRANSACTIONS

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

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