ADVANCED DRAINAGE SYSTEMS, INC.
Form 10-Q
January 20, 2017
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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 September 30, 2016

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, or a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, and 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 December 31, 2016, the registrant had 55,113,227 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 December 31, 2016, 54,877 shares of unvested restricted common stock were outstanding and 24,307,856 shares of ESOP, preferred stock, convertible into 18,697,603 shares of common stock, were outstanding. As of December 31, 2016, 73,865,707 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.

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PART I. FINANCIAL INFORMATION

ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited) (In thousands, except par value)

	As of	
	September 30, 2016	**March 31, 2016**
ASSETS		
Current assets:		
Cash	$ 8,804	$ 6,555
Receivables (less allowance for doubtful accounts of $10,008 and $7,956, respectively)	215,294	186,883
Inventories	223,226	230,466
Deferred income taxes and other current assets	7,573	15,658
Total current assets	454,897	439,562
Property, plant and equipment, net	397,409	391,744
Other assets:		
Goodwill	100,696	100,885
Intangible assets, net	55,682	59,869
Other assets	46,195	45,256
Total assets	**$ 1,054,879**	**$ 1,037,316**
LIABILITIES, MEZZANINE EQUITY AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current maturities of debt obligations	$ 36,497	$ 35,870
Current maturities of capital lease obligations	20,640	19,231
Accounts payable	95,437	119,606
Current portion of liability-classified stock-based awards	14,344	10,118
Other accrued liabilities	59,582	65,099
Accrued income taxes	13,126	2,260
Total current liabilities	239,626	252,184
Long-term debt obligation (less unamortized debt issuance costs of $2,429 and $3,131, respectively)	312,712	312,214
Long-term capital lease obligations	59,170	56,809
Deferred tax liabilities	54,602	63,952
Other liabilities	32,147	37,921
Total liabilities	698,257	723,080
Commitments and contingencies (see Note 7)		

Mezzanine equity:		
Redeemable convertible preferred stock: $0.01 par value; 47,070 shares authorized; 44,170 shares issued; 24,429 and 24,819 shares outstanding, respectively	305,361	310,240
Deferred compensation unearned ESOP shares	(202,008)	(205,664)
Redeemable noncontrolling interest in subsidiaries	8,415	7,171
Total mezzanine equity	111,768	111,747
Stockholders equity:		
Common stock; $0.01 par value: 1,000,000 shares authorized; 153,560 shares issued; 55,020 and 54,437 shares outstanding, respectively	12,393	12,393
Paid-in capital	748,177	739,097
Common stock in treasury, at cost	(438,404)	(440,995)
Accumulated other comprehensive loss	(24,362)	(21,261)
Retained deficit	(67,109)	(101,778)
Total ADS stockholders equity	230,695	187,456
Noncontrolling interest in subsidiaries	14,159	15,033
Total stockholders equity	244,854	202,489
Total liabilities, mezzanine equity and stockholders equity	**$ 1,054,879**	**$ 1,037,316**

See accompanying notes to condensed consolidated financial statements.

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ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
Net sales	$ 360,785	$ 383,329	$ 718,361	$ 732,453
Cost of goods sold	270,273	296,800	531,243	571,447
Gross profit	90,512	86,529	187,118	161,006
Operating expenses:				
Selling	23,210	22,594	47,440	43,821
General and administrative	21,181	25,673	55,710	44,358
Loss on disposal of assets or businesses	737	295	939	1,161
Intangible amortization	2,128	2,341	4,315	4,867
Income from operations	43,256	35,626	78,714	66,799
Other expense:				
Interest expense	4,546	4,947	9,330	9,233
Derivative (gains) losses and other (income) expense, net	(1,734)	9,192	(4,771)	15,772
Income before income taxes	40,444	21,487	74,155	41,794
Income tax expense	15,348	5,187	29,542	13,066
Equity in net loss of unconsolidated affiliates	815	372	911	18
Net income	24,281	15,928	43,702	28,710
Less net income attributable to noncontrolling interest	547	3,582	1,695	4,670
Net income attributable to ADS	23,734	12,346	42,007	24,040
Accretion of Redeemable noncontrolling interest	(380)	(257)	(742)	(257)
Dividends to Redeemable convertible preferred stockholders	(415)	(362)	(840)	(733)
Dividends paid to unvested restricted stockholders	(24)	(6)	(54)	(12)
Net income available to common stockholders and participating securities	22,915	11,721	40,371	23,038
Undistributed income allocated to participating securities	(2,040)	(980)	(3,563)	(1,949)
Net income available to common stockholders	**$ 20,875**	**$ 10,741**	**$ 36,808**	**$ 21,089**
Weighted average common shares outstanding:				
Basic	54,429	53,882	54,250	53,753
Diluted	55,276	55,194	55,115	55,093

Net income per share:								
Basic	$	0.38	$	0.20	$	0.68	$	0.39
Diluted	$	0.38	$	0.19	$	0.67	$	0.38
Cash dividends declared per share	$	0.06	$	0.05	$	0.12	$	0.10

See accompanying notes to condensed consolidated financial statements.

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ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited) (In thousands)

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
Net income	$ 24,281	$ 15,928	$ 43,702	$ 28,710
Currency translation	(2,047)	(10,979)	(5,168)	(10,470)
Comprehensive income	22,234	4,949	38,534	18,240
Less other comprehensive loss attributable to noncontrolling interest, net of tax	(566)	(1,726)	(2,067)	(2,308)
Less net income attributable to noncontrolling interest	547	3,582	1,695	4,670
Total comprehensive income attributable to ADS	**$** 22,253	**$** 3,093	**$** 38,906	**$** 15,878

See accompanying notes to condensed consolidated financial statements.

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ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited) (In thousands)

	Six Months Ended September 30, 2016	Six Months Ended September 30, 2015
Cash Flows from Operating Activities	$ 45,576	$ 16,924
Cash Flows from Investing Activities		
Capital expenditures	(23,796)	(21,534)
Cash paid for acquisitions, net of cash acquired		(3,188)
Proceeds of note receivable to related party		3,854
Issuance of note receivable to related party		(3,854)
Other investing activities	(622)	(378)
Net cash used in investing activities	(24,418)	(25,100)
Cash Flows from Financing Activities		
Proceeds from Revolving Credit Facility	235,600	252,800
Payments on Revolving Credit Facility	(207,900)	(223,000)
Payments on Term Loan	(5,000)	(3,750)
Payments on Senior Notes	(25,000)	
Proceeds from notes, mortgages and other debt		6,682
Payments of notes, mortgages and other debt	(430)	(7,092)
Payments on capital lease obligations	(10,810)	(10,247)
Cash dividends paid	(7,338)	(8,173)
Proceeds from exercise of stock options	2,687	823
Other financing activities	(620)	(369)
Net cash (used in) provided by financing activities	(18,811)	7,674
Effect of exchange rate changes on cash	(98)	360
Net change in cash	2,249	(142)
Cash at beginning of period	6,555	3,623
Cash at end of period	**$ 8,804**	**$ 3,481**
SUPPLEMENTAL CASH FLOW INFORMATION		
Cash paid for income taxes	$ 3,125	$ 16,756
Cash paid for interest	9,409	8,702
Non-cash operating, investing and financing activities:		
	$ 14,915	$ 25,598

Acquisition of property, plant and equipment under capital lease and incurred lease obligations		
Balance in accounts payable for the acquisition of property, plant and equipment	1,165	195
Acquisition of property, plant and equipment under financing facility	3,153	

See accompanying notes to condensed consolidated financial statements.

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ADVANCED DRAINAGE SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND MEZZANINE EQUITY

(Unaudited) (In thousands)

	Paid -In	Common Stock in Treasury		Accumulated Other Comprehensive	Retained	Total ADS Stockholders	Non-controlling Interest in	Total Stockholders	Redeemable Convertible Preferred Stock		De Comp Un ESO
t	Capital	Shares	Amount	Loss	Deficit	Equity	Subsidiaries	Equity	Shares	Amount	Shares
3	$ 723,495	100,038	$ (445,065)	$ (15,521)	$ (114,590)	$ 160,712	$ 16,413	$ 177,125	25,639	$ 320,490	16,990
					24,040	24,040	4,559	28,599			
				(8,162)		(8,162)	(2,308)	(10,470)			
					(657)	(657)		(657)			
					(5,386)	(5,386)		(5,386)			
							(2,130)	(2,130)			
	2,707					2,707		2,707			(283)
	2,037	(77)	390			2,427		2,427			
	209	(66)	291			500		500			
	5,222	(442)	1,966			7,188		7,188	(575)	(7,188)	

	(159)					(159)		(159)			
3	$ 733,511	99,453	$ (442,418)	$ (23,683)	$ (96,593)	$ 183,210	$ 16,534	$ 199,744	25,064	$ 313,302	16,707
3	$ 739,097	99,123	$ (440,995)	$ (21,261)	$ (101,778)	$ 187,456	$ 15,033	$ 202,489	24,819	$ 310,240	$ 16,448
					42,007	42,007	1,193	43,200			
				(3,101)		(3,101)	(2,067)	(5,168)			
					(763)	(763)		(763)			
					(6,575)	(6,575)		(6,575)			
	1,447					1,447		1,447			(293)
	4,550	(236)	1,048			5,598		5,598			
	(4)	(47)	207			203		203			
	3,543	(300)	1,336			4,879		4,879	(390)	(4,879)	
	(456)					(456)		(456)			
3	**$ 748,177**	**98,540**	**$ (438,404)**	**$ (24,362)**	**$ (67,109)**	**$ 230,695**	**$ 14,159**	**$ 244,854**	**24,429**	**$ 305,361**	**16,155**

See accompanying notes to condensed consolidated financial statements.

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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. (collectively with its subsidiaries referred to as ADS or the Company), a Delaware Corporation, designs, manufactures and markets high performance thermoplastic corrugated pipe and related water management products, primarily in North and South America and Europe. The 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.

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, 2016 was derived from audited financial statements included in the Annual Report on Form 10-K/A for the year ended March 31, 2016 (Fiscal 2016 Form 10-K/A). The accompanying unaudited condensed consolidated financial statements contain all adjustments, of a normal recurring nature, necessary to present fairly its financial position as of September 30, 2016 and the results of operations and cash flows for the three and six months ended September 30, 2016 and 2015. 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 2016 Form 10-K/A.

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

Debt Issuance Costs The Financial Accounting Standards Board (FASB) issued two Accounting Standards Updates (ASU) relating to presentation of debt issuance costs during calendar year 2015. These updates require that debt issuance costs be presented as a direct deduction from recognized debt liabilities except for those relating to line of credit arrangements. The Company adopted the updates on April 1, 2016 on a retrospective basis. See Note 5. Debt for additional information about the impact of the adoption of the updates.

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Deferred Tax Assets and Liabilities In November 2015, the FASB issued an ASU which requires entities to classify all deferred tax assets and liabilities, as well as any related valuation allowance, as non-current, rather than separately record the current and non-current portions. The Company adopted this standard on April 1, 2016 on a prospective basis and prior periods have not been adjusted. The impact of the adoption of this standard was a reduction to the net current deferred tax assets balance included in Deferred income taxes and other current assets on the Condensed Consolidated Balance Sheets from $11.7 million as of March 31, 2016 to zero as of September 30, 2016, with all deferred tax assets and liabilities as of September 30, 2016 now being classified as non-current. The update had no effect on the Company s Condensed Consolidated Statements of Operations, Condensed Consolidated Statements of Comprehensive Income, Condensed Consolidated Statements of Cash Flows and Condensed Consolidated Statements of Stockholders Equity and Mezzanine Equity.

Consolidation In February 2015, the FASB issued an accounting standards update to make changes to consolidation guidance to address concerns of stakeholders that current accounting for certain legal entities might require a reporting entity to consolidate another legal entity in situations in which the reporting entity s contractual rights do not give it the ability to act primarily on its own behalf, the reporting entity does not hold a majority of the legal entity s voting rights, or the reporting entity is not exposed to a majority of the legal entity s economic benefits or obligations. The Company adopted this standard effective April 1, 2016. The update has had no effect on the Company s condensed consolidated financial statements.

Recent Accounting Guidance Not Yet Adopted

Definition of a Business In January 2017, the FASB issued an accounting standards update 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 expects to adopt this standard effective April 1, 2018. The Company is currently evaluating the impact of this standard on its 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 2016 Form 10-K that have significance, or potential significance, to the condensed consolidated financial statements.

2. INVENTORIES

Inventories as of the periods presented consisted of the following:

	September 30, 2016	March 31, 2016
	(In thousands)	
Raw materials	$ 53,463	$ 46,604
Finished goods	169,763	183,862
Total inventories	$ 223,226	$ 230,466

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

3. 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, the Company maximizes the use of quoted market prices and minimizes the use of unobservable inputs. When active market quotes are not available for financial assets and liabilities, the Company 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. 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:

	September 30, 2016			
	Total	**Level 1**	**Level 2**	**Level 3**
	(In thousands)			
Assets:				
Derivative assets diesel fuel contracts	$ 274	$	$ 274	$
Total assets at fair value on a recurring basis	$ 274	$	$ 274	$
Liabilities:				
Derivative liability - diesel fuel contracts	717		717	
Derivative liability - propylene swaps	1,380		1,380	
Contingent consideration for acquisitions	1,997			1,997
Total liabilities at fair value on a recurring basis	$ 4,094	$	$ 2,097	$ 1,997

	March 31, 2016			
	Total	**Level 1**	**Level 2**	**Level 3**
	(In thousands)			
Assets:				
Derivative assets - diesel fuel contracts	$ 11	$	$ 11	$
Total assets at fair value on a recurring basis	**$ 11**	**$**	**$ 11**	**$**
Liabilities:				
Derivative liability - interest rate swaps	$ 252	$	$ 252	$
Derivative liability - diesel fuel contracts	2,615		2,615	
Derivative liability - propylene swaps	8,027		8,027	
Contingent consideration for acquisitions	2,858			2,858
Total liabilities at fair value on a recurring basis	**$ 13,752**	**$**	**$ 10,894**	**$ 2,858**

For the six months ended September 30, 2016 and 2015, respectively, there were no transfers in or out of Levels 1, 2 and 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	
	September 30, 2016	**September 30, 2015**
	(In thousands)	
Balance at the beginning of the period	**$ 2,199**	**$ 2,285**
Acquisition		750
Change in fair value	31	45
Payments of contingent consideration liability	(233)	(211)
Balance at the end of the period	**$ 1,997**	**$ 2,869**

	Six Months Ended	
	September 30, 2016	September 30, 2015
	(In thousands)	
Balance at the beginning of the period	**$ 2,858**	**$ 2,444**
Acquisition		750
Change in fair value	57	100
Payments of contingent consideration liability	(918)	(425)
Balance at the end of the period	**$ 1,997**	**$ 2,869**

4. 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. During the three and six months ended September 30, 2016 and 2015, 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 and a noncompete arrangement. These cash payments were $0.1 million or less in each of the three and six month periods ended September 30, 2016 and 2015.

Occasionally, ADS and ADS Mexicana jointly enter into agreements for pipe sales with related parties. There were no such sales in either the three and six months ended September 30, 2016 or 2015. However, outstanding receivables related to such sales from prior periods were $0.3 million as of September 30, 2016 and March 31, 2016.

In April 2015, ADS Mexicana borrowed $3.0 million under a revolving credit facility arrangement with Scotia Bank and loaned that amount to ADS. The loan was repaid in May 2015. In June 2015, ADS Mexicana borrowed $3.9 million 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. The applicable interest rates for the loans were 2.15% and 4.81%, respectively. 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.

The Company is the guarantor of 100% of a second credit facility for ADS Mexicana, and the Company s maximum potential payment under this guarantee totals $12.0 million. The outstanding balance as of September 30, 2016 was $2.7 million and there were no borrowings outstanding under this facility as of March 31, 2016.

South American Joint Venture

The Tuberias Tigre ADS Limitada joint venture (the South American Joint Venture) manufactures and sells HDPE corrugated pipe in the South American market. ADS is 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. The Company s maximum potential obligation under this guarantee totals $11.0 million as of September 30, 2016. The maximum borrowings permitted under the South American Joint Venture s credit facility are $19.0 million. This credit facility allows borrowings in either Chilean pesos or US dollars at a fixed interest rate determined at inception of each draw on the facility. The guarantee of the South American Joint Venture s debt expires on July 31, 2017. ADS does not anticipate any required contributions related to the balance of this credit facility. As of September 30, 2016 and March 31, 2016, the outstanding principal balances of the credit facility including letters of credit were $17.1 million and $16.7 million, respectively. The weighted average interest rate as of September 30, 2016 was 2.00% on U.S. dollar denominated loans and 7.11% 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, the South American Joint Venture enters into agreements for pipe sales with ADS and its other related parties, which totaled $0.3 million and $0.5 million for the three and six months ended September 30, 2016, respectively, and $0.2 million and $0.9 million for the three and six months ended September 30, 2015, respectively.

BaySaver

BaySaver Technologies LLC (BaySaver) is a joint venture that was established to produce and distribute water quality filters and separators used in the removal of sediment and pollution from storm water. ADS owns 65% of the outstanding stock of BaySaver and consolidates its interest in BaySaver. Prior to July 17, 2015, the Company accounted for Baysaver as an equity method investment.

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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, which were immaterial for the periods presented.

5. DEBT

The adoption during the quarter ended June 30, 2016 of the accounting standard updates relating to debt issuance costs required retrospective presentation, which led the Company to reduce its Other assets and its Long-term debt obligation on its Condensed Consolidated Balance Sheet as of March 31, 2016 by $3.1 million. The updates had no effect on the Company s Condensed Consolidated Statements of Operations, Condensed Consolidated Statements of Comprehensive Income, Condensed Consolidated Statements of Cash Flows and Condensed Consolidated Statements of Stockholders Equity and Mezzanine Equity. Long-term debt as of the periods presented consisted of the following:

	September 30, 2016	**March 31, 2016**
	(In thousands)	
Bank Term Loans		
Revolving Credit Facility ADS	$ 191,000	$ 166,000
Revolving Credit Facility ADS Mexicana	2,700	
Term Note	77,500	82,500
Senior Notes payable	75,000	100,000
Industrial revenue bonds	2,285	2,715
ADS Mexicana Scotia bank revolving credit facility		
Equipment financing	3,153	
Total	351,638	351,215
Unamortized debt issuance costs	(2,429)	(3,131)
Current maturities	(36,497)	(35,870)
Long-term debt obligation	**$ 312,712**	**$ 312,214**

In June 2016, ADS signed a Master Loan and Security Agreement for the financing of equipment in the U.S. and Canada for an aggregate amount of up to $4.5 million. During fiscal 2017, the Company issued $3.2 million of Equipment Notes with an average fixed interest rate at 2.58%. Each Equipment Note amortizes the principal over five years and is payable monthly.

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 and foreign currency exchange rate fluctuations. For interest rate swaps, 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 exchange forward contracts, contract settlement gains and losses are recorded in the Condensed Consolidated Statements of Operations in Derivative (gains) losses and other (income) expense, 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) losses and other (income) expense, net.

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

	Three Months Ended September 30,	
	2016	**2015**
	(in thousands)	
Propylene swaps	$ (3,334)	$ 4,496
Diesel fuel option collars	(689)	1,348
Interest rate swaps	(130)	(71)
Total unrealized mark-to-market (gains) losses	**$ (4,153)**	**$ 5,773**
Propylene swaps	1,611	2,965
Diesel fuel option collars	679	764
Foreign exchange forward contracts		(38)
Total realized losses	**$ 2,290**	**$ 3,691**

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	Six Months Ended September 30, 2016	2015
	(in thousands)	
Propylene swaps	$ (6,647)	$ 9,559
Diesel fuel option collars	(2,161)	90
Interest rate swaps	(252)	(115)
Total unrealized mark-to-market (gains) losses	**$ (9,060)**	**$ 9,534**
Propylene swaps	4,683	5,401
Diesel fuel option collars	1,385	1,102
Foreign exchange forward contracts		(38)
Total realized losses	**$ 6,068**	**$ 6,465**

In addition to the above amounts, Derivative (gains) losses and other (income) expense, net in the Condensed Consolidated Statements of Operations also includes other non-operating expense of $0.1 million and income of $1.8 million for the three and six month period ending September 30, 2016, and income of $0.3 million and $0.2 million for the three and six month period ending September 30, 2015, respectively. A summary of the fair value of derivatives as of the periods presented is as follows:

	September 30, 2016			
	Assets		Liabilities	
	Receivables	Other assets	Other accrued liabilities	Other liabilities
	(In thousands)			
Interest rate swaps	$	$	$	$
Diesel fuel option collars and swaps	208	66	(664)	(53)
Propylene swaps			(1,380)	

	March 31, 2016			
	Assets		Liabilities	
	Receivables	Other assets	Other accrued liabilities	Other liabilities
	(In thousands)			
Interest rate swaps	$	$	$ (252)	$
Diesel fuel option collars and swaps		11	(2,609)	(6)
Propylene swaps			(8,027)	

7. COMMITMENTS AND CONTINGENCIES

Purchase Commitments

The Company secures supplies of resin raw material by agreeing to purchase quantities during a future given period at a fixed price. These purchase contracts range from 1 to 12 months and occur in the ordinary course of business. Under such purchase contracts in place at September 30, 2016, ADS has agreed to purchase resin over the period October 2016 through December 2016 at a committed purchase cost of $6.1 million.

Litigation and Other 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 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.

The Company is involved from time to time in various legal proceedings that arise in the ordinary course of its business, including but not limited to commercial disputes, environmental matters, employee related claims, intellectual property disputes and litigation in connection with transactions including acquisitions and divestitures. The Company believes that such litigation, claims and administrative proceedings will not have a material adverse impact on its financial position or its results of operations. The Company records 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 the Company s consolidated operations, cash flows, or financial position, and the Company has adequate accrued liabilities to cover its estimated probable loss exposure.

8. 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 six months ended September 30, 2016 and 2015, the Company utilized an effective tax rate of 39.8% and 31.3%, respectively, to calculate its provision for income taxes. These rates differ from the federal statutory rate of 35% due to state and local taxes and non-deductible expenses, offset by foreign income taxed at lower rates. For the six months ended September 30, 2015, uncertain tax positions related to foreign jurisdictions were released due to the lapse of statute of limitations.

9. STOCK-BASED COMPENSATION

ADS has several programs for stock-based payments to employees and directors, including stock options and restricted stock. Equity-classified restricted stock awards are measured based on the grant-date estimated fair value of each award. Liability-classified stock option and restricted stock awards are re-measured at fair value at each reporting date until the date of settlement, and the pro-rata vested portion of the award is recognized as a liability.

The Company accounts for all stock options granted to employees as liability-classified awards. Prior to the Company s IPO in July 2014, the Company also accounted for all restricted stock granted to employees as liability-classified awards. However, since the IPO, the Company also accounted for all restricted stock granted to employees as equity-classified awards. The Company accounts for all restricted stock granted to directors as equity-classified awards.

The Company recognized stock-based compensation expense (benefit) in the following line items of the Condensed Consolidated Statements of Operations for the three and six month periods ended September 30, 2016 and 2015:

(Amounts in thousands)	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015	Six Months Ended September 30, 2016	Six Months Ended September 30, 2015
Component of income before income taxes:				
Cost of goods sold	$ (100)	$	$	$
Selling expenses	(100)		200	
General and administrative expenses	(2,708)	1,170	5,912	2,212
Total stock-based compensation expense	**$ (2,908)**	**$ 1,170**	**$ 6,112**	**$ 2,212**

Stock Options

Our 2000 stock option plan (2000 Plan) provides for the issuance of statutory and non-statutory stock options to management based upon the discretion of the Board of Directors. The plan generally provides for grants with the exercise price equal to fair value on the date of grant, which vest in three equal annual amounts beginning in year five and expire after approximately 10 years from issuance.

Our 2013 stock option plan (2013 Plan) provides for the issuance of non-statutory common stock options to management subject to the Board s discretion. The plan generally provides for grants with the exercise price equal to fair value on the date of

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grant. The grants generally vest in five equal annual amounts beginning in year one and expire after approximately 10 years from issuance. Options issued to the Chief Executive Officer vest equally over four years and expire after approximately 10 years from issuance.

The Company determines the fair value of the options based on the Black-Scholes option pricing model. This methodology requires significant inputs including the price of our common stock, risk-free interest rate, dividend yield and expiration date.

We estimate the fair value of stock options using a Black-Scholes option-pricing model, with assumptions as follows:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
Common stock price	$23.06 - $28.17	$26.35 - $32.37	$22.00 - $28.17	$26.35 - $33.03
Expected stock price volatility	29.5% - 35.9%	28.9% - 45.1%	29.5% - 35.9%	28.9% - 45.1%
Risk-free interest rate	0.7% - 1.3%	0.1% - 1.8%	0.7% - 1.3%	0.1% - 1.8%
Weighted-average expected option life (years)	0.3 5.7	0.3 6.7	0.3 5.7	0.3 6.7
Dividend yield	1.0%	0.7%	1.0%	0.7%

10. NET INCOME PER SHARE

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.

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

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
(In thousands, except per share data)				
NET INCOME PER SHARE BASIC:				
Net income attributable to ADS	$ 23,734	$ 12,346	$ 42,007	$ 24,040
Adjustments for:				
Accretion of Redeemable noncontrolling interest	(380)	(257)	(742)	(257)
Dividends to Redeemable convertible preferred stockholders	(415)	(362)	(840)	(733)
Dividends paid to unvested restricted stockholders	(24)	(6)	(54)	(12)
Net income available to common stockholders and participating securities	22,915	11,721	40,371	23,038
	(2,040)	(980)	(3,563)	(1,949)

Undistributed income allocated to participating securities								
Net income available to common stockholders Basic		20,875		10,741		36,808		21,089
Weighted average number of common shares outstanding Basic		54,429		53,882		54,250		53,753
Net income per common share Basic	$	0.38	$	0.20	$	0.68	$	0.39
NET INCOME PER SHARE DILUTED:								
Net income available to common stockholders Diluted	$	20,875	$	10,741	$	36,808	$	21,089
Weighted average number of common shares outstanding Basic		54,429		53,882		54,250		53,753
Assumed exercise of stock options		847		1,312		865		1,340
Weighted average number of common shares outstanding Diluted		55,276		55,194		55,115		55,093
Net income per common share Diluted	$	0.38	$	0.19	$	0.67	$	0.38
Potentially dilutive securities excluded as anti-dilutive		6,264		6,476		6,355		6,583

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11. BUSINESS SEGMENTS INFORMATION

The Company operates its business in two distinct operating and reportable segments based on the markets it serves: Domestic and International . The Chief Operating Decision Maker (CODM) evaluates segment reporting based on Net sales and Segment Adjusted EBITDA, which is calculated as net income or loss before interest, income taxes, depreciation and amortization, stock-based compensation expense, non-cash charges and certain other expenses.

The following table sets forth reportable segment information with respect to the amount of Net sales contributed by each class of similar products for the periods presented:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
	(In thousands)		(In thousands)	
Domestic				
Pipe	$ 222,026	$ 238,291	$ 445,336	$ 458,826
Allied Products	89,747	89,009	179,200	166,640
Total domestic	**311,773**	**327,300**	**624,536**	**625,466**
International				
Pipe	38,910	44,542	73,282	86,917
Allied Products	10,102	11,487	20,543	20,070
Total international	**49,012**	**56,029**	**93,825**	**106,987**
Total Net sales	**$ 360,785**	**$ 383,329**	**$ 718,361**	**$ 732,453**

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

	Domestic	**International**	**Total**
		(In thousands)	
For the three months ended September 30, 2016			
Net sales	$ 311,773	$ 49,012	$ 360,785
Gross profit	79,736	10,776	90,512
Segment Adjusted EBITDA	57,114	8,487	65,601
Interest expense	4,436	110	4,546
Income tax expense	13,824	1,524	15,348
Depreciation and amortization	15,829	2,181	18,010
Equity in net loss of unconsolidated affiliates	(44)	(771)	(815)
Capital expenditures	10,496	705	11,201
For the three months ended September 30, 2015			
Net sales	$ 327,300	$ 56,029	$ 383,329
Gross profit	76,131	10,398	86,529
Segment Adjusted EBITDA	55,443	8,294	63,737

Interest expense	4,901	46	4,947
Income tax expense (benefit)	6,703	(1,516)	5,187
Depreciation and amortization	15,243	2,124	17,367
Equity in net loss of unconsolidated affiliates	(12)	(360)	(372)
Capital expenditures	8,028	1,971	9,999

	Domestic	International	Total
For the six months ended September 30, 2016			
Net sales	$ 624,536	$ 93,825	$ 718,361
Gross profit	167,462	19,656	187,118
Segment Adjusted EBITDA	121,754	15,655	137,409

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	Domestic	International	Total
Interest expense	9,109	221	9,330
Income tax expense	25,977	3,565	29,542
Depreciation and amortization	31,507	4,529	36,036
Equity in net loss of unconsolidated affiliates	(27)	(884)	(911)
Capital expenditures	21,991	1,805	23,796
For the six months ended September 30, 2015			
Net sales	$ 625,466	$ 106,987	$ 732,453
Gross profit	137,820	23,186	161,006
Segment Adjusted EBITDA	96,412	19,773	116,185
Interest expense	8,938	295	9,233
Income tax expense (benefit)	13,529	(463)	13,066
Depreciation and amortization	30,405	4,346	34,751
Equity in net income (loss) of unconsolidated affiliates	324	(342)	(18)
Capital expenditures	17,812	3,722	21,534

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

	Domestic	International (In thousands)	Eliminations	Total
As of September 30, 2016				
Investment in unconsolidated affiliates	$ 2,905	$ 9,646	$	$ 12,551
Total identifiable assets	920,835	147,930	(13,886)	1,054,879
As of March 31, 2016				
Investment in unconsolidated affiliates	$ 2,932	$ 10,256	$	$ 13,188
Total identifiable assets	949,286	147,814	(59,784)	1,037,316

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

	Three Months Ended September 30,			
	2016		2015	
	Domestic	International	Domestic	International
	(In thousands)			
Reconciliation of Segment Adjusted EBITDA:				
Net income	$ 21,049	$ 3,232	$ 8,641	$ 7,287
Depreciation and amortization	15,829	2,181	15,243	2,124
Interest expense	4,436	110	4,901	46
Income tax expense	13,824	1,524	6,703	(1,516)
Segment EBITDA	55,138	7,047	35,488	7,941
Derivative fair value adjustments	(4,153)		5,784	(11)
Foreign currency transaction losses (gains)		685		(151)
Loss on disposal of assets or businesses	512	225	289	6
Unconsolidated affiliates interest, tax, depreciation and amortization[(a)]	272	530	260	509

Contingent consideration remeasurement	33		45	
Stock-based compensation (benefit) expense	(2,908)		1,170	
ESOP deferred compensation	2,368		3,125	
Expense related to executive termination payments	79		82	
Loss related to BaySaver acquisition			490	
Restatement-related costs[b]	5,773		8,710	
Segment Adjusted EBITDA	**$ 57,114**	**$ 8,487**	**$ 55,443**	**$ 8,294**

(a) Includes the proportional share of interest, income taxes, depreciation and amortization related to the South American Joint Venture and the Tigre-ADS USA joint venture, which are accounted for under the equity method of accounting. In addition, these amounts include our proportional share of interest, income taxes, depreciation and amortization related to the BaySaver Joint Venture prior to the step acquisition of BaySaver on July 17, 2015, which was previously accounted for under the equity method of accounting.

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(b) Represents expenses recorded related to legal, accounting and other professional fees incurred in connection with the restatement of our prior period financial statements as reflected in the Annual Report on Form 10-K for the year ended March 31, 2015 (Fiscal 2015 Form 10-K) and the preparation of our fiscal year 2016 Forms 10-Q and 10-K that were delayed due to the restatement.

	Six Months Ended September 30,			
	2016		2015	
	Domestic	International	Domestic	International
	(In thousands)			
Reconciliation of Segment Adjusted EBITDA:				
Net income	$ 36,471	$ 7,231	$ 14,221	$ 14,489
Depreciation and amortization	31,507	4,529	30,405	4,346
Interest expense	9,109	221	8,938	295
Income tax expense (benefit)	25,977	3,565	13,529	(463)
Segment EBITDA	103,064	15,546	67,093	18,667
Derivative fair value adjustments	(9,060)		9,506	28
Foreign currency transaction (gains) losses		(1,077)		166
Loss (gain) on disposal of assets or businesses	782	157	1,341	(180)
Unconsolidated affiliates interest, tax, depreciation and amortization[(a)]	551	1,029	546	1,092
Contingent consideration remeasurement	57		100	
Stock-based compensation expense	6,112		2,212	
ESOP deferred compensation	5,105		6,250	
Expense related to executive termination payments	158		164	
Loss related to BaySaver acquisition			490	
Restatement-related costs[(b)]	14,985		8,710	
Segment Adjusted EBITDA	**$ 121,754**	**$ 15,655**	**$ 96,412**	**$ 19,773**

(a) Includes the proportional share of interest, income taxes, depreciation and amortization related to the South American Joint Venture and the Tigre-ADS USA joint venture, which are accounted for under the equity method of accounting. In addition, these amounts include our proportional share of interest, income taxes, depreciation and amortization related to the BaySaver Joint Venture prior to the step acquisition of BaySaver on July 17, 2015, which was previously accounted for under the equity method of accounting.

(b) Represents expenses recorded related to legal, accounting and other professional fees incurred in connection with the restatement of our prior period financial statements as reflected in the Fiscal 2015 Form 10-K and the preparation of our fiscal year 2016 Forms 10-Q and 10-K that were delayed due to the restatement.

12. SUBSEQUENT EVENTS

Subsequent Events Related to the Bank Term Loans and Senior Notes

In October 2016, the Company obtained consents from the lenders of the Bank Term Loans and Senior Notes. These consents had the effect of extending the time for delivery of our first quarter fiscal 2017 quarterly financial information to November 30, 2016 and our second quarter fiscal 2017 quarterly financial information to December 31, 2016, whereby an event of default was waived as long as those items are delivered within a 30 day grace period after those dates. In addition, the consents also permitted the Company s payment of a quarterly dividend of $0.06 per share on common shares in December 2016, as well as reaffirmed the annual dividend of $0.0195 per share to be paid on shares of preferred stock in March 2017.

In December 2016, the Company obtained additional consents from the lenders of the Bank Term Loans and Senior Notes. These consents had the effect of extending the time for delivery of our first quarter fiscal 2017 quarterly financial information to January 31, 2017.

Subsequent Event Related to the ADS Mexicana Revolving Credit Facility

During the period from November 3, 2014 to November 11, 2015, our joint venture, ADS Mexicana, made intercompany revolving loans to ADS, Inc. The maximum aggregate amount of the intercompany loans outstanding at any time was $6.9 million. Since November 11, 2015, there have been no other intercompany loans made, and no balance remains outstanding.

According to the terms of the ADS Mexicana Revolving Credit Facility, ADS Mexicana was not permitted to make such loans, triggering an Event of Default, and ADS Mexicana had an obligation to report such Event of Default. These events together were characterized as a Specified Default. On December 13, 2016, ADS Mexicana obtained a covenant waiver on the ADS Mexicana Revolving Credit Facility for the Specified Default from the lenders.

Subsequent Events Related to Dividends on Common Stock

During the third quarter of fiscal 2017, the Company declared a quarterly cash dividend of $0.06 per share of common stock. The third quarter dividend was payable on December 15, 2016 to stockholders of record at the close of business on December 1, 2016.

Other Subsequent Events

In the third quarter of fiscal 2017, the Company shortened the remaining useful life of certain assets related to three manufacturing facilities resulting in anticipated accelerated depreciation expense of less than $2 million. One of these facilities closed in the third quarter of fiscal 2017, and ADS committed to a plan to reduce production at the other facilities in the third quarter of fiscal 2017.

In December 2016, a fire destroyed approximately $1.1 million of finished goods inventory at the Company s South American Joint Venture. The Company s portion of the loss will be recorded in Equity in net loss of unconsolidated affiliates. While the Company expects that the loss is recoverable through insurance proceeds, the amount of the recovery is not currently determinable. Once the amount of recovery is determinable, the Company s portion will be recorded in Equity in net loss of unconsolidated affiliates.

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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, 2017 refers to fiscal 2017, which is the period from April 1, 2016 to March 31, 2017.

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 2016 Form 10-K/A, as filed with the Securities and Exchange Commission (the SEC) on January 10, 2017. In addition to historical condensed consolidated financial information, the following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. This discussion contains forward-looking statements that are based on the beliefs of our management, as well as assumptions made by, and information currently available to, our management. Our actual results could differ materially from those discussed in the forward-looking statements. For more information, see the section below entitled Forward Looking Statements.

We consolidate all of our joint ventures for purposes of GAAP, except for our South American Joint Venture and our 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 underground construction and infrastructure marketplace. Our innovative products are used across a broad range of end markets and applications, including non-residential, residential, agriculture and infrastructure applications. We have established a leading position in many of these end markets by leveraging our national sales and distribution platform, our overall product breadth and scale and our manufacturing excellence. In the United States, our national footprint combined with our strong local presence and broad product offering make us the leader in an otherwise highly fragmented sector comprised of many smaller competitors. We believe the markets we serve in the United States represent approximately $10.8 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 materials as contractors, civil design engineers and municipal agencies increasingly acknowledge the superior physical attributes and compelling value proposition of our thermoplastic products. In addition, we believe that overall demand for our products will benefit as the regulatory environment continues to evolve.

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

Results of Operations

Three Months Ended September 30, 2016 Compared With Three Months Ended September 30, 2015

The following table summarizes our operating results as a percentage of net sales that have been derived from our condensed consolidated financial statements for the three months ended September 30, 2016 and 2015. We believe this presentation is useful to investors in comparing historical results.

	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015
Consolidated Statements of Operations data:		
Net sales	100.0%	100.0%
Cost of goods sold	74.9%	77.4%
Gross profit	25.1%	22.6%

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	Three Months Ended September 30, 2016	Three Months Ended September 30, 2015
Selling expenses	6.4%	5.9%
General and administrative expenses	5.9%	6.7%
Loss on disposal of assets or businesses	0.2%	0.1%
Intangible amortization	0.6%	0.6%
Income from operations	12.0%	9.3%
Interest expense	1.3%	1.3%
Derivative (gains) losses and other (income) expense, net	(0.5%)	2.4%
Income before income taxes	11.2%	5.6%
Income tax expense	4.3%	1.4%
Equity in net loss of unconsolidated affiliates	0.2%	0.1%
Net income	6.7%	4.2%
Less net income attributable to noncontrolling interest	0.2%	0.9%
Net income attributable to ADS	6.6%	3.2%

Net sales. Net sales totaled $360.8 million in the three months ended September 30, 2016, decreasing $22.5 million, or 5.9%, over the comparable period in fiscal year 2016.

	Three Months Ended September 30,		
	2016	2015	% Variance
	(In thousands)		
Domestic			
Pipe	$ 222,026	$ 238,291	(6.8%)
Allied Products	89,747	89,009	0.8%
Total domestic	**311,773**	**327,300**	(4.7%)
International			
Pipe	38,910	44,542	(12.6%)
Allied Products	10,102	11,487	(12.1%)
Total international	**49,012**	**56,029**	(12.5%)
Total net sales	**$ 360,785**	**$ 383,329**	(5.9%)

Domestic net sales decreased $15.5 million, or 4.7%, in the three months ended September 30, 2016, over the comparable period in the previous fiscal year. Our domestic pipe sales decreased by $16.3 million, or 6.8%, which was a result of net volume decreases of $12.5 million, primarily in our agriculture end markets, as well as a decrease resulting from lower prices. Allied product sales increased $0.8 million, or 0.8%, which included the impact of the acquisition of BaySaver.

International net sales decreased $7.0 million, or 12.5%, in the three months ended September 30, 2016 over the comparable period in the previous fiscal year. The decrease was primarily attributable to pipe volume decreases of $5.3 million in our international markets and a decrease in Allied products sales of $1.4 million.

Cost of goods sold and Gross profit. Cost of goods sold decreased by $26.5 million, or 8.9%, and gross profit increased by $4.0 million, or 4.6%, in the three months ended September 30, 2016 over the comparable period in the previous fiscal year.

	Three Months Ended September 30,			
	2016	**2015**	**$ Variance**	**% Variance**
	(In thousands)			
Gross Profit				
Domestic	$ 79,736	$ 76,131	$ 3,605	4.7%
International	10,776	10,398	378	3.6%
Total	$ 90,512	$ 86,529	$ 3,983	4.6%

The increase in domestic gross profit of $3.6 million, or 4.7%, was primarily the result of lower raw material costs, as well as decreases in diesel fuel prices and other transportation and manufacturing costs, which more than offset the impact of the decrease in domestic net sales of 4.7% over the comparable fiscal year 2016 period.

International gross profit increased $0.4 million, or 3.6%, in the second quarter of fiscal year 2017 compared to the same period in fiscal year 2016, largely due to the impact of lower raw material costs more than offsetting the impact of the decrease in international net sales of 12.5% over the comparable fiscal year 2016 period.

Selling expenses. Selling expenses for the three months ended September 30, 2016 increased $0.6 million, or 2.7%, over the prior year. The increase was primarily the result of increases in variable selling expenses including an increase in bad debt expense and investments in additional sales coverage. As a percentage of net sales, selling expenses increased to 6.4% in the second quarter of fiscal 2017 as compared to 5.9% in the prior year.

General and administrative expenses. General and administrative expenses for the three months ended September 30, 2016 decreased $4.5 million from the prior year period. The decrease was primarily due to a decrease in expenses for audit, tax, legal and other professional fees related to the restatement of prior period financial statements as reflected in the Fiscal 2015 Form 10-K and the preparation of our fiscal year 2016 Forms 10-Q and 10-K that were delayed due to the restatement from $8.7 million for the three months ending September 30, 2015 to $5.8 million for the three months ended September 30, 2016. In addition, stock-based compensation decreased from an expense of $1.2 million in the second quarter of fiscal 2016 to a benefit of $2.7 million for the second quarter of fiscal 2017. Those decreases were partially offset by increased staff levels and increased use of outside consultants in various corporate functions.

Loss on disposal of assets or businesses. There were no large or unusual disposals of assets or businesses.

Intangible amortization. Intangible amortization remained relatively flat.

Interest expense. Our average overall outstanding debt was down by $71.0 million, or 16.4%, for the quarter ending September 30, 2016 compared to the average balance outstanding for the quarter ending September 30, 2015, which was the primary reason for the decrease in interest expense. That impact was partially offset by higher average capital lease obligations for the quarter ending September 30, 2016 compared to the quarter ending September 30, 2015.

Derivative (gains) losses and other (income) expense, net. Derivative (gains) losses and other (income) expense, net improved from losses of $9.2 million for the three months ended September 30, 2015 to gains of $1.7 million for the three months ended September 30, 2016. During the quarter ended September 30, 2016, we benefited from unrealized gains on swaps for propylene raw material of $3.3 million compared to unrealized losses of $4.5 million in the comparable period last year. In addition, a $1.4 million decrease in hedging losses were recognized compared to the prior year, primarily in connection with realized losses on propylene material swaps. In addition, the three months ended September 30, 2015 included a loss of $0.5 million recognized for the fair value remeasurement of the Company s original investment in BaySaver at the time the Company acquired a controlling interest in July 2015, whereas there was no comparable amount in the current year period. The remainder of the change is primarily related to foreign exchange gains.

Income tax expense. For the three months ended September 30, 2016 and 2015, the Company had effective tax rates of 37.9% and 24.1%, respectively. For the three months ended September 30, 2015, uncertain tax positions related to foreign jurisdictions were released due to the lapse of statute of limitations.

Equity in net loss of unconsolidated affiliates. Equity in net loss of unconsolidated affiliates represents our proportionate share of income or loss attributed to two unconsolidated joint ventures in which we have significant influence, but not control, over operations as well as our proportional share of BaySaver earnings up until the July 17, 2015 step acquisition. Equity in net loss of unconsolidated affiliates remained relatively flat.

Net income attributable to noncontrolling interest. Net income attributable to noncontrolling interest decreased from $3.6 million for the three months ended September 30, 2015 to $0.5 million for the three months ended September 30, 2016. The change is primarily attributable to a decrease in the profitability of ADS Mexicana.

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Six Months Ended September 30, 2016 Compared With Six Months Ended September 30, 2015

The following table summarizes our operating results as a percentage of net sales that have been derived from our condensed consolidated financial statements for the six months ended September 30, 2016 and 2015. We believe this presentation is useful to investors in comparing historical results.

	Six Months Ended September 30, 2016	Six Months Ended September 30, 2015
Consolidated Statements of Operations data:		
Net sales	100.0%	100.0%
Cost of goods sold	74.0%	78.0%
Gross profit	26.0%	22.0%
Selling expenses	6.6%	6.0%
General and administrative expenses	7.8%	6.1%
Loss on disposal of assets or businesses	0.1%	0.2%
Intangible amortization	0.6%	0.7%
Income from operations	11.0%	9.1%
Interest expense	1.3%	1.3%
Derivative (gains) losses and other (income) expense, net	(0.7%)	2.2%
Income before income taxes	10.3%	5.7%
Income tax expense	4.1%	1.8%
Equity in net loss of unconsolidated affiliates	0.1%	-%
Net income	6.1%	3.9%
Less net income attributable to noncontrolling interest	0.2%	0.6%
Net income attributable to ADS	5.8%	3.3%

Net sales. Net sales totaled $718.4 million in the six months ended September 30, 2016, decreasing $14.1 million, or 1.9%, over the comparable period in fiscal year 2016.

	Six Months Ended September 30,		
	2016	2015	% Variance
	(In thousands)		
Domestic			
Pipe	$ 445,336	$ 458,826	(2.9%)
Allied Products	179,200	166,640	7.5%
Total domestic	**624,536**	**625,466**	(0.1%)
International			

Pipe	73,282	86,917	(15.7%)
Allied Products	20,543	20,070	2.4%
Total international	**93,825**	**106,987**	(12.3%)
Total net sales	**$ 718,361**	**$ 732,453**	(1.9%)

Domestic net sales decreased $0.9 million, or 0.1%, in the six months ended September 30, 2016, over the comparable period in the previous fiscal year. Our domestic pipe sales decreased by $13.4 million, or 2.9%, which was primarily a result of net price decreases of $4.7 million and decreases of $5.1 million in net volume primarily due to a decline in our agriculture end markets, partially offset by improvements in non-residential end markets. Allied product sales increased $12.6 million, or 7.5%, which included the impact of the acquisition of BaySaver of $5.3 million, as well as increased sales volume of products sold primarily into the non-residential and infrastructure end markets.

International net sales decreased $13.2 million, or 12.3%, in the six months ended September 30, 2016 over the comparable period in the previous fiscal year. The decrease was primarily attributable to the negative impact in Mexico of pipe volume decreases of $12.8 million and net price decreases of $2.6 million, along with a decrease of $2.1 million from weaker exchange rates between the U.S. Dollar and the Canadian and Mexican currencies, offset by a modest increase in Allied products sales.

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Cost of goods sold and Gross profit. Cost of goods sold decreased by $40.2 million, or 7.0%, and gross profit increased by $26.1 million, or 16.2%, in the six months ended September 30, 2016 over the comparable period in the previous fiscal year.

	Six Months Ended September 30,			
	2016	2015	$ Variance	% Variance
	(In thousands)			
Gross Profit				
Domestic	$ 167,462	$ 137,820	$ 29,642	21.5%
International	19,656	23,186	(3,530)	(15.2%)
Total	$ 187,118	$ 161,006	$ 26,112	16.2%

The increase in domestic gross profit of $29.6 million, or 21.5%, was primarily the result of lower raw material costs, as well as lower diesel fuel prices, which more than offset the impact of the relatively flat domestic net sales. Growth in sales of higher margin Allied Products also contributed to the overall increase in gross profit.

International gross profit decreased $3.5 million, or 15.2%, in the first half of fiscal year 2017 compared to the same period in fiscal year 2016, largely due to decreases in sales volume, partially offset by lower raw material costs.

Selling expenses. Selling expenses for the six months ended September 30, 2016 increased $3.6 million, or 8.3% over the prior year. The increase was primarily the result of increases in variable selling expenses, including an increase in bad debt expense of $2.8 million resulting from the deterioration of certain customer accounts and the investment in additional sales coverage. As a percentage of net sales, selling expenses increased to 6.6% in the first half of fiscal 2017 as compared to 6.0% in the prior year period.

General and administrative expenses. General and administrative expenses for the six months ended September 30, 2016 increased $11.4 million over the prior year. The increase was primarily due to an increase in expenses for audit, tax, legal and other professional fees related to the restatement of prior period financial statements as reflected in the Fiscal 2015 Form 10-K and the preparation of our fiscal year 2016 Forms 10-Q and 10-K that were delayed due to the restatement from $8.7 million for the six months ending September 30, 2015 to $15.0 million for the six months ended September 30, 2016. In addition, stock-based compensation expense increased from $2.2 million for the first half of fiscal 2016 to $5.9 million for first half of fiscal 2017. The increased staff levels and increased use of outside consultants in various corporate functions also contributed to the overall increase.

Loss on disposal of assets or businesses. There were no large or unusual disposals of assets or businesses.

Intangible amortization. Intangible amortization remained relatively flat.

Interest expense. While our average overall outstanding debt was down by $61.3 million, or 14.9%, for the six months ending September 30, 2016 compared to the average balance outstanding for the six months ending September 30, 2015 the impact of that on interest expense was more than offset by higher average capital lease obligations for the first half of fiscal 2017 compared to the first half of fiscal 2016, which resulted in relatively flat interest expense.

Derivative (gains) losses and other (income) expense, net. Derivative (gains) losses and other (income) expense, net improved from losses of $15.8 million for the six months ended September 30, 2015 to gains of $4.8 million for the six months ended September 30, 2016. During the six months ended September 30, 2016, we benefited from unrealized gains on swaps for propylene raw material of $6.6 million compared to unrealized losses of $9.5 million in the comparable period last year. In addition, a $0.7 million decrease in hedging losses were recognized compared to the prior year period, primarily in connection with realized losses on propylene material swaps. In addition, the six months ended September 30, 2015 included a loss of $0.5 million recognized for the fair value remeasurement of the Company s original investment in BaySaver at the time the Company acquired a controlling interest in July 2015, whereas there was no comparable amount in the current year period. The remainder of the change is primarily related to foreign exchange gains.

Income tax expense. For the six months ended September 30, 2016 and 2015, the Company had effective tax rates of 39.8% and 31.3%, respectively. The current year rate is higher than the federal statutory rate of 35% due principally to state and local income taxes and non-deductible expenses, partially offset by foreign income taxed at lower rates. For the six months ended September 30, 2015, uncertain tax positions related to foreign jurisdictions were released due to the lapse of statute of limitations.

Equity in net loss of unconsolidated affiliates. Equity in net loss of unconsolidated affiliates represents our proportionate share of income or loss attributed to two unconsolidated joint ventures in which we have significant influence, but not control, over operations as well as our proportional share of BaySaver earnings up until the July 17, 2015 step acquisition. Our proportional share of BaySaver earnings was $0.3 million for the six months ended September 30, 2015, whereas there was no comparable amount in the six months ended September 30, 2016.

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Net income attributable to noncontrolling interest. Net income attributable to noncontrolling interest decreased from $4.7 million for the six months ended September 30, 2015 to $1.7 million for the six months ended September 30, 2016. The change is primarily attributable to a decrease in the profitability of ADS-Mexicana.

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, Adjusted Earnings Per Fully Converted Share and Free Cash Flow. These non-GAAP financial measures are used in addition to and in conjunction with results presented in accordance with GAAP. However, these measures are not intended to be a substitute for those reported in accordance with GAAP. These measures may be different from non-GAAP financial measures used by other companies, even when similar terms are used to identify such measures.

Adjusted EBITDA (Non-GAAP). Adjusted EBITDA is a non-GAAP financial measure that is a key metric used by management and our Board of Directors to assess our financial performance. 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. Our definition of Adjusted EBITDA may differ from similar measures used by other companies, even when similar terms are used to identify such measure. The following table presents a reconciliation of Adjusted EBITDA to Net income, the most comparable GAAP measure, for each of the periods indicated:

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
	(In thousands)			
Net income	**$ 24,281**	**$ 15,928**	**$ 43,702**	**$ 28,710**
Depreciation and amortization	18,010	17,367	36,036	34,751
Interest expense	4,546	4,947	9,330	9,233
Income tax expense	15,348	5,187	29,542	13,066
EBITDA	62,185	43,429	118,610	85,760
Derivative fair value adjustments	(4,153)	5,773	(9,060)	9,534
Foreign currency transaction (gains) losses	685	(151)	(1,077)	166
Loss on disposal of assets or businesses	737	295	939	1,161
Unconsolidated affiliates interest, tax, depreciation and amortization[a]	802	769	1,580	1,638
Contingent consideration remeasurement	33	45	57	100
Stock-based compensation expense (benefit)	(2,908)	1,170	6,112	2,212
ESOP deferred stock-based compensation	2,368	3,125	5,105	6,250
Expense related to executive termination payments	79	82	158	164
Loss related to BaySaver acquisition		490		490
Restatement-related costs[b]	5,773	8,710	14,985	8,710
Adjusted EBITDA	**$ 65,601**	**$ 63,737**	**$ 137,409**	**$ 116,185**

(a) Includes our proportional share of interest, income taxes, depreciation and amortization related to our South American Joint Venture and our Tigre-ADS USA joint venture, which are accounted for under the equity method of accounting. In addition, these amounts include our proportional share of interest, income taxes, depreciation and amortization related to our BaySaver Joint Venture prior to our step acquisition of BaySaver on July 17, 2015, which was previously accounted for under the equity method of accounting.

(b) Represents expenses recorded related to legal, accounting and other professional fees incurred in connection with the restatement of our prior period financial statements as reflected in the Fiscal 2015 Form 10-K and the preparation of our fiscal year 2016 Forms 10-Q and 10-K that were delayed due to the restatement.

System-Wide Net Sales (Non-GAAP). System-Wide Net Sales is a non-GAAP measure we use 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 Tigre-ADS USA joint venture and our BaySaver joint venture are managed as integral parts of our Domestic segment. System-Wide Net Sales is prepared as if our South American Joint Venture, our Tigre-ADS USA joint venture, and our BaySaver joint venture (prior to its acquisition on July 17, 2015) were accounted for as consolidated subsidiaries for all periods. The reconciliation of our System-Wide Net Sales to Net sales is as follows:

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	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
	(In thousands)			
Net sales	**$ 360,785**	**$ 383,329**	**$ 718,361**	**$ 732,453**
Net sales associated with our unconsolidated affiliates				
South American Joint Venture	10,881	13,492	22,246	27,769
BaySaver joint venture[a]		485		3,611
Tigre-ADS USA joint venture	4,975	4,031	10,174	8,637
System-Wide Net Sales	**$ 376,641**	**$ 401,337**	**$ 750,781**	**$ 772,470**

(a) As of July 17, 2015, we increased our ownership in BaySaver to 65% and have consolidated BaySaver since that date. As such Net Sales from our BaySaver joint venture prior to July 17, 2015 are included in this line item.

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. Adjusted Earnings Per Fully Converted Share (Non-GAAP) is a key metric used by management and our board of directors to assess our financial performance as if all shares held by the ESOP were to be converted to common shares. This information is useful to investors as the preferred shares held by the ESOP are required to be distributed to our employees over time, which is done in the form of common stock after the conversion of the preferred shares. As such, this measure is included in this report because it provides the investors with information to understand the impact on the financial statements once all preferred shares are converted and distributed. 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. We calculate Adjusted Earnings Per Fully Converted Share (Non-GAAP) by adjusting Net income per share Basic, Net income available to common stockholders 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 share of redeemable convertible preferred stock for every 0.7692 share of common stock as of the beginning of each period presented.

To effect this adjustment with respect to Net income available to common stockholders - Basic, we have (1) added back the accretion of Redeemable noncontrolling interest in subsidiaries, (2) added back the dividends to Redeemable convertible preferred stockholders and dividends paid to unvested restricted stockholders, (3) added back the amount allocated to participating securities under the two class earnings per share computation method, and (4) added back ESOP deferred compensation attributable to the shares of Redeemable convertible preferred stock allocated to employee ESOP accounts during the applicable period, which is a non-cash charge to our earnings. We have also made adjustments to the Weighted average common shares outstanding Basic to (1) assume share conversion of the outstanding shares of redeemable convertible preferred stock to common stock and (2) add shares of outstanding unvested restricted stock.

The following table presents a reconciliation of Adjusted Net Income (Non-GAAP), Weighted Average Common Shares Outstanding Fully Converted (Non-GAAP) and Adjusted Earnings Per Fully Converted Share (Non-GAAP) to Net income available to common stockholders - Basic, Weighted average common shares outstanding Basic and Net income per share - Basic, the most comparable GAAP measures, respectively, for each of the periods indicated.

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	**2015**	**2016**	**2015**
	(in thousands, except per share data)			
Net income available to common stockholders - Basic	**$ 20,875**	**$ 10,741**	**$ 36,808**	**$ 21,089**
Adjustments to Net income available to common stockholders - Basic:				
Accretion of Redeemable noncontrolling interest in subsidiaries	380	257	742	257
Dividends to Redeemable convertible preferred stockholders	415	362	840	733
Dividends paid to unvested restricted stockholders	24	6	54	12
Undistributed income allocated to participating securities	2,040	980	3,563	1,949
Net income attributable to ADS	23,734	12,346	42,007	24,040
Fair value of ESOP compensation related to Redeemable convertible preferred stock	2,368	3,125	5,105	6,250
Adjusted Net Income (Non-GAAP)	**$ 26,102**	**$ 15,471**	**$ 47,110**	**$ 30,290**

	Three Months Ended September 30,		Six Months Ended September 30,	
	2016	2015	2016	2015
Weighted average common shares outstanding Basic	**54,429**	**53,882**	**54,250**	**53,753**
Adjustments to Weighted average common shares outstanding - Basic:				
Unvested restricted shares	56	117	67	132
Redeemable convertible preferred shares	18,901	19,504	18,983	19,598
Weighted Average Common Shares Outstanding Fully Converted (Non-GAAP)	**73,386**	**73,503**	**73,300**	**73,483**
Net income per share - Basic	**$ 0.38**	**$ 0.20**	**$ 0.68**	**$ 0.39**
Adjusted Earnings per Fully Converted Share (Non-GAAP)	**$ 0.36**	**$ 0.21**	**$ 0.64**	**$ 0.41**

Free Cash Flow (Non-GAAP). Free Cash Flow is a non-GAAP financial measure used by management and the Company s board of directors to assess the Company s ability to generate cash. Management believes that Free Cash Flow provides useful information to investors and others in understanding and evaluating our ability to generate cash flow from operations after capital expenditures. Free Cash Flow should not be considered as an alternative to cash flow from operating activities as a measure of liquidity or any other liquidity measure derived in accordance with GAAP. Our measure of Free Cash Flow is not necessarily comparable to other similarly titled captions of other companies due to different methods of calculation. The following table presents a reconciliation of Free Cash Flow to Cash flow from operating activities, the most comparable GAAP measure, for each of the periods indicated.

	Six Months Ended September 30,	
	2016	2015
	(in thousands)	
Cash flow from operating activities	**$ 45,576**	**$ 16,924**
Capital expenditures	(23,796)	(21,534)
Free Cash Flow	**$ 21,780**	**$ (4,610)**

Liquidity and Capital Resources

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

As of September 30, 2016, we had $3.3 million in cash that was held by our foreign subsidiaries. Our intent is to indefinitely reinvest our earnings in foreign subsidiaries with the exception of cash dividends paid by our ADS Mexicana joint venture. 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 six months ended September 30, 2016, our source of funds was primarily driven by operating earnings and seasonal borrowings on our Revolving Credit Facility. During the six months ended September 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 both the periods ended September 30, 2016 and 2015, our use of cash was primarily driven by seasonal increases in accounts receivable and capital expenditures, as well as payments on Senior Notes for the six months ended September 30, 2016.

As of September 30, 2016, we had $132.2 million in liquidity, including $8.8 million of cash and $123.4 million in borrowings available under our Revolving Credit Facility, described below. We believe that our cash on hand, together with the availability of borrowings under our Revolving Credit Facility and other financing arrangements and cash generated from operations, will be sufficient to meet our working capital requirements, anticipated capital expenditures, scheduled interest payments on our indebtedness and the dividend payment requirement for our convertible preferred stock for at least the next twelve months.

As of September 30, 2016, we had total consolidated net indebtedness of approximately $420.2 million. This amount includes capital lease obligations and is net of cash.

Working Capital. Working capital increased to $215.3 million as of September 30, 2016, from $187.4 million as of March 31, 2016, primarily due to the increases in account receivable of $28.4 million resulting from sales increases and a decrease of $7.2 million in inventory for planned sales increases. As disclosed in Note 1, the change in working capital is also impacted by the reduction of net current deferred tax assets from $11.7 million as of March 31, 2016 to $0 as of September 30, 2016 as all deferred tax assets and liabilities as of September 30, 2016 are now classified as non-current due to the adoption of an accounting standards update as described in Note 1. Background and Significant Accounting Policies.

Operating Cash Flows. Cash flows from operating activities for the six months ended September 30, 2016 was $45.6 million as compared with cash from operating activities of $16.9 million for the six months ended September 30, 2015. Cash flows from operating activities during the six months ended September 30, 2016 was impacted by higher net income as a result of lower resin costs and lower working capital levels, partially offset by higher restatement costs.

Investing Cash Flows. During the six months ended September 30, 2016 and 2015, cash used for investing activities was $24.4 million and $25.1 million, respectively, primarily due to capital expenditures in support of operations.

Financing Cash Flows. During the six months ended September 30, 2016, cash used for financing activities was $18.8 million, due to payments on our Senior Notes, Term Loan and capital lease obligations, partially offset by increased borrowings on our Revolving Credit facility to support our typical seasonal demand increase following the winter months. During the six months ended September 30, 2015, cash provided by financing activities was $7.7 million, utilizing borrowings on our Revolving Credit Facility to support our typical seasonal demand increase and proceeds from notes, mortgages, and other debt.

Capital Expenditures

Capital expenditures totaled $23.8 million and $21.5 million for the six months ended September 30, 2016 and September 30, 2015, respectively. Our capital expenditures for the six months ended September 30, 2016 were used primarily to support facility expansions, equipment replacements, our recycled resin initiatives and capitalized software.

We currently anticipate that we will make capital expenditures of approximately $50 million to $55 million in fiscal year 2017. Such capital expenditures are expected to be financed using funds generated by operations. As of September 30, 2016, there were no material contractual obligations or commitments related to these planned capital expenditures.

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, which is more fully described in our Fiscal 2016 Form 10-K/A.

As of September 30, 2016, the outstanding principal drawn on the Revolving Credit Facility was $191.0 million, with $123.4 million available to be drawn on the U.S. facility. As of September 30, 2016, the outstanding principal balance of the Term Loan was $77.5 million.

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. According to the terms of the ADS Mexicana Revolving Credit Facility, ADS Mexicana is not permitted to make loans to ADS, Inc.

As of September 30, 2016, the outstanding balance on the Revolving Credit Facility was $2.7 million, which $9.3 million available to be drawn.

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, which is more fully described in our Fiscal 2016 Form 10-K/A.

We have $25.0 million available for issuance of senior notes under the private shelf agreement. At September 30, 2016, the outstanding principal balance on these notes was $75.0 million.

October and December 2016 Consents Related to the Bank Term Loans and Senior Notes

In October 2016, the Company obtained consents from the lenders of the Bank Term Loans and Senior Notes. These consents had the effect of extending the time for delivery of our first quarter fiscal 2017 quarterly financial information to November 30, 2016 and our second quarter fiscal 2017 quarterly financial information to December 31, 2016, whereby an event of default was waived as long as those items are delivered within a 30 day grace period after those dates. In addition, the consents also permitted the Company s payment of a quarterly dividend of $0.06 per share on common shares in December 2016, as well as reaffirmed the annual dividend of $0.0195 per share to be paid on shares of preferred stock in March 2017.

In December 2016, the Company obtained additional consents from the lenders of the Bank Term Loans and Senior Notes. These consents had the effect of extending the time for delivery of our first quarter fiscal 2017 quarterly financial information to January 31, 2017.

Covenant Compliance

Our outstanding debt agreements and instruments contain various restrictive financial covenants including, but not limited to, limitations on additional indebtedness and capital distributions, including dividend payments. The two primary debt covenants include a Leverage Ratio and a Fixed Charge Coverage Ratio maintenance covenant. For any relevant period of determination, the Leverage Ratio is calculated by dividing Total Consolidated Indebtedness (funded debt plus guarantees) by Consolidated EBITDA, as defined by the credit facility. The current upper limit is 4.0 times. The Fixed Charge Coverage 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 2016 Form 10-K/A. We were in compliance with our debt covenants as of September 30, 2016, with the exception of the determination in December 2016 that certain intercompany loans between ADS Mexicana and ADS, Inc. had occurred between November 2014 and November 2015 that triggered an event of default according to the terms of the ADS Mexicana Revolving Credit Facility. On December 13, 2016, ADS Mexicana obtained a covenant waiver from the lenders.

Off-Balance Sheet Arrangements

Excluding the guarantee of 50% of certain debt of our unconsolidated South American Joint Venture, as further discussed in Note 4. Related Party Transactions to the Condensed Consolidated Financial Statements, we do not have any other off-balance sheet arrangement. As of September 30, 2016, our South American Joint Venture had approximately $17.1 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 2016 Form 10-K/A.

Forward-Looking Statements

This Quarterly Report on Form 10-Q (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, co projects, estimates, anticipates or other comparable terms. These forward-looking statements include all matters that are not related to present facts or current conditions or that are not historical facts. They appear in a number of places throughout this Form 10-Q and include statements regarding our intentions, beliefs or current expectations concerning, among other things, our consolidated results of operations, financial condition, liquidity, prospects, growth strategies, and the industries in which we operate and include, without limitation, statements relating to our future performance.

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

- fluctuations in the price and availability of resins and other raw materials and our ability to pass any increased costs of raw materials on to our customers in a timely manner;
- volatility in general business and economic conditions in the markets in which we operate, including without limitation, factors relating to availability of credit, interest rates, fluctuations in capital and business and consumer confidence;
- 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.

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

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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 $2.6 million based on our borrowings as of September 30, 2016. 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 $4.0 million per year.

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 high density polyethylene and polypropylene resins. As these resins are hydrocarbon-based materials, changes in the price of feedstocks, such as crude oil derivatives and natural gas liquids, 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 a timely and efficient manner contributes to the management of our overall risk and the potential impact on our results of operations.

We have a resin price risk management program that includes the use of physical fixed price contracts as well as financial hedge contracts related to our virgin resin purchases. We also maintain supply agreements with our major resin suppliers that provide multi-year terms and volumes that are in excess of our projected consumption. These supply agreements generally do not 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. To manage this risk for our polypropylene virgin resin price exposure, we utilize financial hedges of propylene as a proxy for polypropylene. Historically, the month to month change in market based pricing has been very similar between propylene and polypropylene.

We began a diesel hedging program in 2008 which is executed through several financial swaps covering future months demand for diesel fuel and are designed to decrease our exposure to changing fuel costs. These hedges cover the diesel fuel consumed by the truck fleet that we operate to deliver products to our customers. Our objective is to hedge approximately 50% of our overall annual fuel consumption.

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.

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 manufacture 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 Statements of Comprehensive Income.

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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 2016 Form 10-K/A, we concluded that our internal control over financial reporting was not effective based upon certain material weaknesses identified as of March 31, 2016. See Item 9A Controls and Procedures in our Fiscal 2016 Form 10-K/A. Our CEO and CFO have concluded that those material weaknesses previously identified in the Fiscal 2016 Form 10-K/A were still present as of September 30, 2016 (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 September 30, 2016, and, other than those remediation efforts described in Remediation Process in Item 9A of our Fiscal 2016 Form 10-K/A, 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 September 30, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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.

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 2016 Form 10-K/A. These factors are further supplemented by those discussed in Part II, Item 7A Quantitative and Qualitative Disclosures about Market Risk of our Fiscal 2016 Form 10-K/A 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.

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Item 6. Exhibits

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

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SIGNATURES

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

Date: January 20, 2017

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

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EXHIBIT INDEX

Exhibit Number	Exhibit Description
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.

* Filed herewith