

This stock pick of my Ivey value investing students would make Warren Buffett proud



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With the 2024-25 school year at its end, my Ivey value investing students submitted their final stock picks and analysis, which are a very important element of my value investing classes.

Their past picks have generally done well. The last one I reported on was TerraVest Industries Inc. in 2023, which at the time was \$27 and is now around \$128.

As has always been the case for young students/investors, it is much easier to find “deep value” stocks (those Ben Graham would have liked, normally lower quality small cap stocks that have low price-to-earnings and price-to-book ratios), than finding “quality” stocks (those that would appeal to Warren Buffett, with a high degree of competitive advantage and sustainability, which can still be found to be undervalued, even with a higher P/E, or market cap).

And so, all groups in my recently completed HBA value investing class chose to value Ben Graham-type stocks, except for one group whose stock pick got my attention. Grace Yu, Judy Zhu, Sneha Nahar, Inderjit Singh and Daniel Pang chose to study and value Advanced Drainage Systems

ADS failed all the Ben Graham benchmark tests. As of September 17, 2025, ADS had a P/B ratio of 5.83x, far exceeding the 1.4-1.5x benchmark, a P/E ratio of 23.06x, surpassing the 14-15x threshold, and market capitalization of \$10.9 billion, which was well above the US\$1.5-2.0 billion threshold. It was also covered by nine analysts (far exceeding the three-analyst benchmark). The stock was neither obscure, nor was it undesirable.

If one is looking for a deep-value play, this is not the stock to invest in. But if one looks for a Buffett-type stock of a company that is a market leader possessing durable

competitive advantage, allowing it to maintain pricing power and cost control through its product mix, distribution network, and scalability, then this is the stock for you.

Advanced Drainage Systems, founded in 1966, is the largest U.S. manufacturer of High-Density Polyethylene (HDPE) drainage pipes and related products. ADS operates across three main product lines: pipes, allied products, and infiltrator systems, serving residential, agricultural, and infrastructure markets primarily in the U.S. ADS's products cater to multiple end-markets, including commercial (44% of revenues), residential (36%), infrastructure (7%), agriculture (6%), and international (7%).

The Corrugated HDPE Pipes segment, ADS's core business, accounts for 60-65% of total revenue. It produces various pipes for drainage applications, with gross margins of 22-31%. The segment benefits from economies of scale and recycled HDPE use, but faces pressure from regional competitors and commodity price fluctuations, partially offset by proprietary designs with superior load-bearing capabilities.

The Allied Products segment (20-25% of revenue) offers high-value stormwater and septic solutions with 50-60% gross margins. This includes engineering products like StormTech Chambers and Nyloplast Structures. The Infiltrator segment (10-15% of revenue) specializes in advanced wastewater technologies (i.e. onsite septic systems and patented treatment units), achieving 50-65% margins. The segment benefits from strong intellectual property protections and recurring revenue streams from maintenance services.

ADS's HDPE pipes are gaining market share from concrete pipes in the stormwater segment due to their cost-effectiveness. The all-in costs for HDPE pipes are 30-40% lower than concrete, including price, installation, and reduced labour hours. As a result, HDPE pipes are incrementally capturing 1-2% market share from concrete annually.

The HDPE market is dominated by ADS with about 80% market share. Prinsco, the next largest competitor in HDPE, has only one-tenth of ADS's sales, followed by Lane Enterprises and various small local businesses.

For a manufacturing company, ADS has relatively high operating margins and return on assets, which have steadily increased over the past five years, averaging 21.4% and 11.5%, respectively. ADS's competitive edge stems from its comprehensive product mix, enabling turnkey drainage solutions that smaller competitors can't match. While competitors often offer only pipes, ADS provides complete site drainage systems, allowing them to charge a premium of 5% or more on commercial projects. Contractors choosing competitors must source additional components elsewhere, risking quality and delivery issues. ADS's policy of not selling individual components further solidifies its market advantage, creating a significant barrier for competitors.

Furthermore, other HDPE competitors lacked the resources to reach ADS's scale and develop the same product mix as ADS as there is a barrier to entry from high capital investment. It would take at least 10 years for the next competitor in line to reach ADS's scale and acquire the product mix since the equipment used is costly.

ADS is also the lowest cost producer in HDPE pipes. As opposed to using 100% virgin plastic, ADS mixes in 60% recycled plastic (which they vertically integrated into their supply chain through acquisition) that's 20% cheaper than virgin plastic and uses a special formula so the qualities are the same. Overall, this brings up the gross margin by 3%. ADS also owns their own fleet vs hiring third-party which further saves operating costs.

ADS's domination of the U.S. market helps the company secure loyalty from major distributors like Ferguson and Core & Main. This loyalty often results in exclusive sales of ADS products. Smaller competitors such as Prinsco and Lane rely on relationships with smaller distributors. ADS's ability to offer higher volume rebates makes it challenging for smaller HDPE competitors to erode this advantage.

ADS is 90.5% owned by institutions, with BlackRock being the largest shareholder, holding 9.6% of the shares. Company insiders hold only 1.29% of the stock.

The company's strong sales and marketing efforts, along with its differentiated product offerings, contribute to its resilience during economic slowdowns. Historically, the company has navigated downturns relatively well compared to other construction-related businesses, often maintaining an upper hand due to its unique positioning.

Additionally, the industry does not typically experience drastic margin declines during revenue downturns, suggesting the business has natural levers to manage profitability in challenging economic conditions.

Finally, ADS has durable competitive advantages as exemplified by its high and stable operating margins and its high market share.

Based on this, students assessed the company's business risk as medium. ADS has a target capital structure of 48.15% (10-year average), which places it in the medium financial risk category. This led students to assign an A rating to ADS. According to FactSet, A-rated companies average pre-tax cost of debt is 4.83% (risk-free rate of 4.07% plus the Bond Risk Premium of 0.76%). Adding an equity risk premium of 5% to the before tax cost of debt leads to a cost of equity of 9.83%. With the company's tax rate of 23.9%, the Cost of Capital (WACC) is estimated to be 6.86%. The company's adjusted Return on Invested Capital (ROIC) is 20.84%.

ADS has consistently shown real growth, beating inflation over several key metrics like EPS growth, EBIT/share growth, and revenue/share growth. Additionally, the adjusted Return on Invested Capital of 20.84% is greater than the Weighted Average Cost of Capital of 6.86%.

Lastly, ADS is one of the biggest and fastest-growing names in the industry, has high and stable operating margins and a strong management team. This led to the conclusion that not only does ADS have a competitive advantage, but its business model is also sustainable. These conditions enabled students to value ADS as a growth company.

Growth-based Earnings Power Value (EPV)/share was estimated to be \$97.95. Assuming a reasonable growth rate of 3.40%, students determined an intrinsic value of \$146.93.

Not willing to pay for growth, as value investors, leads to an entry price of US\$97.95. Since that lies below the current market price of US\$136 (as of Tuesday), students recommended not buying and waiting for a more favourable price level before initiating a position. ADS is a great company, but as of right now, there is not much of an upside.

George Athanassakos is a professor of finance and holds the Ben Graham Chair in Value Investing at the Ivey Business School, Western University. His latest book is Value Investing: From Theory to Practice.