Advanced Emissions Solutions, Inc.
Form 10-Q
August 06, 2018

United States
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
or
¨TRANSITION REPORT PURSUANT TO 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-37822

Advanced Emissions Solutions, Inc.
(Exact name of registrant as specified in its charter)

Delaware	27-5472457
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

640 Plaza Drive, Suite 270, Highlands Ranch, CO	80129
(Address of principal executive offices)	(Zip Code)

(720) 598-3500
(Registrant’s telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 x 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 x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o	Smaller reporting company	¨
		Emerging growth company	¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at August 1, 2018
Common stock, par value $0.001 per share	20,112,343

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Part I. – FINANCIAL INFORMATION
Item 1. Consolidated Financial Statements
Advanced Emissions Solutions, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(Unaudited)

(in thousands, except share data)	As of June 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$32,179	$ 30,693
Receivables, net	1,087	1,113
Receivables, related parties, net	3,523	3,247
Prepaid expenses and other assets	2,211	1,835
Total current assets	39,000	36,888
Property and equipment, net of accumulated depreciation of $1,074 and $1,486, respectively	269	410
Equity method investments	5,043	4,351
Deferred tax assets	38,517	38,661
Other long-term assets	2,043	2,308
Total Assets	$84,872	$ 82,618
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,323	$ 1,000
Accrued payroll and related liabilities	1,536	1,384
Billings in excess of costs on uncompleted contracts	—	1,830
Other current liabilities	1,100	2,664
Total current liabilities	3,959	6,878
Other long-term liabilities	293	2,285
Total Liabilities	4,252	9,163
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Preferred stock: par value of $.001 per share, 50,000,000 shares authorized, none outstanding	—	—
Common stock: par value of $.001 per share, 100,000,000 shares authorized, 22,627,635 and 22,465,821 shares issued, and 20,088,451 and 20,752,055 shares outstanding at June 30, 2018 and December 31, 2017, respectively	23	22
Treasury stock, at cost: 2,539,184 and 1,713,766 shares as of June 30, 2018 and December 31, 2017, respectively	(25,508)	(16,397)
Additional paid-in capital	95,680	105,308
Retained earnings (deficit)	10,425	(15,478)
Total stockholders' equity	80,620	73,455
Total Liabilities and Stockholders' Equity	$84,872	$ 82,618

See Notes to the Condensed Consolidated Financial Statements.

Advanced Emissions Solutions, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except per share data)	2018	2017	2018	2017
Revenues:				
Chemicals	$726	$846	$1,347	$3,127
License royalties, related party	3,523	1,866	6,753	3,621
Equipment sales	24	24,619	72	29,727
Total revenues	4,273	27,331	8,172	36,475
Operating expenses:				
Chemicals cost of revenue, exclusive of depreciation and amortization	902	645	1,613	2,403
Equipment sales cost of revenue, exclusive of depreciation and amortization	(198)	22,650	(346)	26,793
Payroll and benefits	2,759	2,033	4,973	4,215
Rent and occupancy	248	255	516	300
Legal and professional fees	1,213	1,219	2,761	2,254
General and administrative	846	395	1,748	1,850
Depreciation and amortization	72	118	188	600
Total operating expenses	5,842	27,315	11,453	38,415
Operating (loss) income	(1,569)	16	(3,281)	(1,940)
Other income (expense):				
Earnings from equity method investments	15,889	10,155	28,142	23,969
Interest expense	(412)	(628)	(748)	(1,321)
Other	34	507	60	3,416
Total other income	15,511	10,034	27,454	26,064
Income before income tax (benefit) expense	13,942	10,050	24,173	24,124
Income tax (benefit) expense	(1,349)	3,642	1,220	9,028
Net income	$15,291	$6,408	$22,953	$15,096
Earnings per common share (Note 1):				
Basic	$0.76	$0.29	$1.13	$0.68
Diluted	$0.75	$0.29	$1.12	$0.68
Weighted-average number of common shares outstanding:				
Basic	20,062	21,866	20,275	21,961
Diluted	20,195	21,880	20,386	21,981
Cash dividends declared per common share outstanding:	$0.25	$0.25	$0.50	$0.25

See Notes to the Condensed Consolidated Financial Statements.

Advanced Emissions Solutions, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six Months Ended June 30,	
(in thousands)	2018	2017
Cash flows from operating activities		
Net income	$22,953	$15,096
Adjustments to reconcile net income to net cash used in operating activities:		
Deferred tax benefit from release of valuation allowance	(498)	—
Depreciation and amortization	188	600
Provision for bad debt expense	153	—
Stock-based compensation expense	1,010	1,173
Earnings from equity method investments	(28,142)	(23,969)
Other non-cash items, net	39	509
Changes in operating assets and liabilities:		
Receivables	(64)	6,758
Prepaid expenses and other assets	(375)	(453)
Costs incurred on uncompleted contracts	15,945	25,634
Deferred tax asset, net	(246)	8,106
Other long-term assets	—	(767)
Accounts payable	323	(303)
Accrued payroll and related liabilities	152	(987)
Other current liabilities	(1,505)	(1,227)
Billings on uncompleted contracts	(15,945)	(28,671)
Other long-term liabilities	(135)	164
Legal settlements and accruals	—	(10,685)
Distributions from equity method investees, return on investment	2,700	2,875
Net cash used in operating activities	(3,447)	(6,147)
Cash flows from investing activities		
Distributions from equity method investees in excess of cumulative earnings	25,500	22,313
Acquisition of property, equipment and intangibles, net	(131)	(247)
Contributions to equity method investees	(750)	—
Net cash provided by investing activities	24,619	22,066
Cash flows from financing activities		
Dividends paid	(10,216)	—
Repurchase of common shares	(9,111)	(12,973)
Repurchase of common shares to satisfy tax withholdings	(359)	(517)
Borrowings on Line of Credit	—	808
Repayments on Line of Credit	—	(808)
Net cash used in financing activities	(19,686)	(13,490)
Increase in Cash and Cash Equivalents and Restricted Cash	1,486	2,429
Cash and Cash Equivalents and Restricted Cash, beginning of period	30,693	26,944
Cash and Cash Equivalents and Restricted Cash, end of period	$32,179	$29,373
Supplemental disclosure of cash flow information:		
Cash paid for interest	$660	$1,791
Cash paid for income taxes	$2,349	$839
Supplemental disclosure of non-cash investing and financing activities:		
Dividends declared, not paid	$63	$5,268

See Notes to the Condensed Consolidated Financial Statements.

Advanced Emissions Solutions, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1 - Basis of Presentation

Nature of Operations

Advanced Emissions Solutions, Inc. ("ADES" or the "Company") is a Delaware corporation with its principal office located in Highlands Ranch, Colorado. The Company is principally engaged in emissions control ("EC") technologies and associated consumables, equipment and services. The Company's proprietary environmental technologies enable customers to reduce emissions of mercury and other pollutants, maximize utilization levels and improve operating efficiencies to meet the challenges of existing and pending EC regulations. The Company generates substantial earnings and tax credits under Section 45 ("Section 45 tax credits") of the Internal Revenue Code ("IRC") from its equity investments in certain entities and royalty payments related to technologies that are licensed to Tinuum Group, LLC, a Colorado limited liability company ("Tinuum Group"). Such technologies allow Tinuum Group to provide its customers with various solutions to enhance combustion and reduce emissions of nitrogen oxide ("NO_x") and mercury from coal burned to generate electrical power. The Company’s sales occur principally throughout the United States. See Note 10 for additional information regarding the Company's operating segments.

Basis of Presentation

The accompanying Condensed Consolidated Financial Statements of ADES are unaudited and have been prepared in conformity with accounting principles generally accepted in the United States ("U.S. GAAP") and with Article 10 of Regulation S-X of the Securities and Exchange Commission. In compliance with those instructions, certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted.

The unaudited Condensed Consolidated Financial Statements of ADES in this quarterly report ("Quarterly Report") are presented on a consolidated basis and include ADES and its wholly-owned subsidiaries (collectively, the "Company"). Also included within the unaudited Condensed Consolidated Financial Statements are the Company's unconsolidated equity investments, Tinuum Group, Tinuum Services, LLC ("Tinuum Services"), and GWN Manager, LLC ("GWN Manager"), which are accounted for under the equity method of accounting, and Highview Enterprises Limited (the "Highview Investment"), which is accounted for in accordance with U.S. GAAP applicable to equity investments that do not qualify for the equity method of accounting.

Results of operations and cash flows for the interim periods are not necessarily indicative of the results that may be expected for the entire year. All significant intercompany transactions and accounts were eliminated for all periods presented in this Quarterly Report.

In the opinion of management, these Condensed Consolidated Financial Statements include all normal and recurring adjustments considered necessary for a fair presentation of the results of operations, financial position and cash flows for the interim periods presented. These Condensed Consolidated Financial Statements of ADES should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (the "2017 Form 10-K"). Except for accounting for revenue from contracts with customers, which is discussed in Note 2, significant accounting policies disclosed therein have not changed.

Earnings Per Share

Basic earnings per share is computed using the two-class method, which is an earnings allocation formula that determines earnings per share for common stock and any participating securities according to dividend and participating rights in undistributed earnings. The Company's restricted stock awards ("RSA's") granted prior to December 31, 2016 contain non-forfeitable rights to dividends or dividend equivalents and are deemed to be participating securities. RSA's granted subsequent to December 31, 2016 do not contain non-forfeitable rights to dividends and are not deemed to be participating securities.

Under the two-class method, net income for the period is allocated between common stockholders and the holders of the participating securities based on the weighted-average number of common shares outstanding during the period, excluding participating, unvested RSA's ("common shares"), and the weighted-average number of participating unvested RSA's outstanding during the period, respectively. The allocated, undistributed income for the period is then divided by the weighted-average number of common shares and participating, unvested RSA's outstanding during the period to arrive at basic earnings per common share and participating security for the period, respectively. Pursuant to U.S. GAAP, the Company has elected not to separately present basic or diluted earnings per share attributable to participating securities in the Condensed Consolidated Statements of Operations.

Diluted earnings per share is computed in a manner consistent with that of basic earnings per share, while considering other potentially dilutive securities. Potentially dilutive securities consist of both unvested, participating and non-participating RSA's, as well as outstanding options to purchase common stock ("Stock Options") and contingent performance stock units ("PSU's") (collectively, "Potential dilutive shares"). The dilutive effect, if any, for non-participating RSA's, Stock Options and PSU's is determined using the greater of dilution as calculated under the treasury stock method or the two-class method. Potential dilutive shares are excluded from diluted earnings per share when their effect is anti-dilutive. When there is a net loss for a period, all Potential dilutive shares are anti-dilutive and are excluded from the calculation of diluted loss per share for that period.

Each PSU represents a contingent right to receive shares of the Company’s common stock, and the number of shares may range from zero to two times the number of PSU's granted on the award date depending upon the price performance of the Company's common stock as measured against a general index and a specific peer group index over requisite performance periods. The number of Potential dilutive shares related to PSU's is based on the number of shares of the Company's common stock, if any, that would be issuable at the end of the respective reporting period, assuming that the end of the reporting period is the end of the contingency period applicable to such PSU's. See Note 7 for additional information related to PSU's.

The following table sets forth the calculations of basic and diluted earnings per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except per share amounts)	2018	2017	2018	2017
Net income	$15,291	$6,408	$22,953	$15,096
Less: Dividends and undistributed income allocated to participating securities	51	45	77	140
Income attributable to common stockholders	$15,240	$6,363	$22,876	$14,956
Basic weighted-average common shares outstanding	20,062	21,866	20,275	21,961
Add: dilutive effect of equity instruments	133	14	111	20
Diluted weighted-average shares outstanding	20,195	21,880	20,386	21,981
Earnings per share - basic	$0.76	$0.29	$1.13	$0.68
Earnings per share - diluted	$0.75	$0.29	$1.12	$0.68

For the three and six months ended June 30, 2018 and 2017, RSA's and Stock Options convertible to 0.3 million and 0.2 million shares, respectively, and 0.4 million and 0.2 million shares, respectively, of common stock for each of the periods presented were outstanding but were not included in the computation of diluted net income per share because the effect would have been anti-dilutive. For the six months ended June 30, 2018, Stock Options to purchase 0.1 million shares were outstanding, but not included in the computation of diluted net income per share for a portion of the period because they were determined not to be contingently issuable. For the three and six months ended June 30, 2017, Stock Options to purchase 0.4 million and 0.4 million shares, respectively, of common stock, which vest based on the Company achieving specified performance targets, were outstanding, but not included in the computation of diluted net income per share because they were determined not to be contingently issuable.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to makes estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. There have been no changes in the Company’s critical accounting estimates from those that were disclosed in the 2017 Form 10-K, except upon the adoption of ASC 606 - Revenue from Contracts with Customers ("ASC 606"), effective January 1, 2018, which affected revenue recognition and warranty estimates accruals related to the Company's extended equipment contracts as well as the estimate related to the Royalty Award are no longer considered significant estimates. Actual results could differ from these estimates.

Risks and Uncertainties

The Company’s earnings are significantly affected by equity earnings it receives from Tinuum Group. As of June 30, 2018, Tinuum Group has 18 invested RC facilities of which 11 are leased to a single customer. A majority of these leases are periodically renewed and the loss of this customer by Tinuum Group would have a significant adverse impact on its financial position, results of operations and cash flows, which in turn would have material adverse impact on the Company’s financial position, results of operations and cash flows.

Reclassifications
Certain balances have been reclassified from the prior year to conform to the current year presentation. No reclassifications have any impact to income before income taxes or net income.
New Accounting Guidance
In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) ("ASU 2016-02"), which requires lessees to recognize a right of use asset and related lease liability for those leases classified as operating leases at the commencement date and have lease terms of more than 12 months. This topic retains the distinction between finance leases and operating leases. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, and interim periods within those years, and must be applied under a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. In July 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements ("ASU 2018-11"). The amendments in ASU 2018-11 provide entities with an additional (and optional) transition method to adopt the new lease requirements by allowing entities to initially apply the requirements by recognizing a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity's reporting for the comparative periods presented in the financial statements in which the entity adopts the new lease requirements would continue to be in accordance with current GAAP (Topic 840). An entity electing this additional (and optional) transition method must provide the required Topic 840 disclosures for all periods that continue to be in accordance with Topic 840. The amendments do not change the existing disclosure requirements in Topic 840. The Company intends to adopt ASC 2016-02 effective January 1, 2019 using the additional (and optional) transition method provided under ASU 2018-11.
During the quarter ended June 30, 2018, the Company continued its assessment of ASC 2016-02 for the impact to the financial statements as of the adoption date, commenced a detailed review of individual customer contracts, commenced review of controls and procedures that may need to be revised or added from the adoption of the standard, developed a timeline for completion of the various phases of the Company's implementation plan for the standard, including documentation of the standard's financial statement impact at adoption, financial statement presentation and disclosure changes and reviews over potential changes to existing revenue recognition policies, controls and procedures. As a result of these actions, the Company does not believe ASC 2016-02 will have a material impact on the Company's financial statements and disclosures.
In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"). The main objective of ASU 2016-13 is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. To achieve this objective, the amendments in ASU 2016-13 replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those years, and must be adopted under a modified retrospective method approach. Entities may adopt ASU 2016-13 earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those years. The Company is currently evaluating the provisions of this guidance and assessing its impact on the Company's financial statements and disclosures. The Company does not believe this standard will have a material impact on the Company's financial statements and disclosures.
Note 2 - Revenues
Adoption of ASC 606
On January 1, 2018, the Company adopted ASC 606 using the modified retrospective method applied to those contracts that were not completed as of January 1, 2018. The Company recognized the cumulative effect of initially applying ASC 606 to the opening balance of the Accumulated deficit. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.
The financial statement impact from the adoption of ASC 606 as of January 1, 2018 was primarily due to the following:
•

The recognition of revenues and related cost of revenue from Equipment Sales for three uncompleted dry sorbent injection (“DSI”) equipment systems (the “DSI Systems”) as of December 31, 2017, which were accounted for under the guidance in ASC 605-35, Revenue Recognition - Construction-Type and Production-Type Contracts (“ASC 605-35”). Under ASC 605-35, the Company accounted for revenues and associated cost of revenue for equipment systems from inception of the contract under the completed contract method and recognized revenue and cost of revenue when the equipment systems were deemed substantially complete. As of December 31, 2017, none of the DSI Systems had met the revenue recognition criteria under the completed contract method. As of January 1, 2018, the Company has determined that the performance obligation associated with each DSI System has been satisfied under ASC 606 guidance.

- The recognition of revenues and related cost of revenue for a licensing arrangement (the "Licensing Arrangement") in which the Company satisfied its performance obligation under ASC 606 as of January 1, 2018.

As a result, the Company's deferred revenue and related deferred project costs on the three DSI Systems and the Licensing Arrangement, and the resultant income tax effects, were recognized through a cumulative effect adjustment to the Accumulated deficit as of January 1, 2018. In addition, the Company recorded a contract asset in the amount of $0.3 million related to one DSI System contract for which the Company has completed its performance obligations but is not contractually able to bill the customer until the end of the warranty period.

The cumulative effect of the change from the adoption of ASC 606 to the Consolidated Balance Sheet as of January 1, 2018 is shown in the table that follows:

(in thousands)	Balance as of December 31, 2017	Impact of Adoption	Balance as of January 1, 2018
Balance Sheet			
Receivables, net	$ 1,113	$ 339	$ 1,452
Deferred tax assets	$ 38,661	$ (889)	$ 37,772
Other long-term assets	$ 2,308	$ (322)	$ 1,986
Billings in excess of costs on uncompleted contracts	$ 1,830	$ (1,830)	$ —
Other current liabilities	$ 2,664	$ 9	$ 2,673
Other long-term liabilities	$ 2,285	$ (2,000)	$ 285
Accumulated deficit	$ (15,478)	$ 2,950	$ (12,528)

The following tables show the impact of the adoption of ASC 606 on the Condensed Consolidated Balance Sheet and Condensed Consolidated Statement of Operations as of and for the three and six months ended June 30, 2018, respectively:

(in thousands)	Balance as Reported June 30, 2018	Impact of Adoption	Balance as Adjusted June 30, 2018
Balance Sheet			
Receivables, net	$ 1,087	$ (159)	$ 928
Deferred tax assets	$ 38,517	$ 889	$ 39,406
Other long-term assets	$ 2,043	$ 322	$ 2,365
Billings in excess of costs on uncompleted contracts	$ —	$ 2,009	$ 2,009
Other current liabilities	$ 1,100	$ —	$ 1,100
Other long-term liabilities	$ 293	$ 2,000	$ 2,293
Retained earnings (deficit)	$ 10,425	$ (2,957)	$ 7,468

	For the three months ended		
(in thousands)	As Reported June 30, 2018	Impact of Adoption	As Adjusted June 30, 2018
Statement of Operations			
Revenues:			
Equipment sales	$24	$7,532	$7,556
License royalties, related party	$3,523	$(3,523)	$—
Total revenues	$4,273	$4,009	$8,282
Operating expenses:			
Equipment sales cost of revenue	$(198)	$7,525	$7,327
Total operating expenses	$5,842	$7,525	$13,367
Operating loss	$(1,569)	$(3,516)	$(5,085)
Other income (expense)			
Royalties, related party	$—	$3,523	$3,523
Total other income (expense)	$15,511	$3,523	$19,034
Income before income tax expense	$13,942	$7	$13,949

	For the six months ended		
(in thousands)	As Reported June 30, 2018	Impact of Adoption	As Adjusted June 30, 2018
Statement of Operations			
Revenues:			
Equipment sales	$72	$7,532	$7,604
License royalties, related party	$6,753	$(6,753)	$—
Total revenues	$8,172	$779	$8,951
Operating expenses:			
Equipment sales cost of revenue	$(346)	$7,525	$7,179
Total operating expenses	$11,453	$7,525	$18,978
Operating loss	$(3,281)	$(6,746)	$(10,027)
Other income (expense)			
Royalties, related party	$—	$6,753	$6,753
Total other income (expense)	$27,454	$6,753	$34,207
Income before income tax expense	$24,173	$7	$24,180

As of and for the three and six months ended June 30, 2018, the significant difference between the financial statement balances reported compared to the financial statement balances without the adoption of ASC 606 were as follows:
Equipment sales -As of adoption, the Company derecognized contract assets of $16.5 million and contract liabilities of $18.3 million and recorded a contract asset of $0.3 million related to the three DSI Systems contracts that met the revenue recognition requirements under ASC 606. After tax, the net adjustment for the three DSI Systems was $1.7 million. Under revenue recognition guidance in effect prior to the adoption of ASC 606, one DSI Systems contract would have met revenue recognition criteria as of June 30, 2018, and the Company would have recorded $7.5 million of Equipment sales and Equipment sales cost of revenue, respectively, for both the three and six months ended June 30, 2018. During the three months ended June 30, 2018, the Company billed the customer of a second DSI Systems contract $0.2 million, which under ASC 606 reduced the related contract asset by this amount. Under revenue recognition guidance in effect prior to the adoption of ASC 606, this customer billing would have increased billings in

excess of costs on uncompleted contracts by $0.2 million, with no impact to revenues recognized.

- Licensing Arrangement - As of adoption, the Company derecognized a contract liability of $2.0 million and a contract asset of $0.3 million related to the Licensing Arrangement, which met the revenue recognition requirements under ASC 606. After tax, the net adjustment for this contract was $1.3 million. Under revenue recognition guidance in effect prior to the adoption of ASC 606, this contract would not have met revenue recognition criteria as of June 30, 2018.
- Royalties, related party - As of adoption, and based on guidance provided in ASC 606 related to licensing arrangements where royalties are earned on a usage-based royalty arrangement, for the three and six months ended June 30, 2018, as well as the corresponding periods from the prior year, the Company has reported license royalties earned from Tinuum Group as revenues rather than as non-operating income under financial statement presentation guidance in effect prior to the adoption of ASC 606. This reclassification had no impact to the Company's income before income tax expense or net income for all periods presented.

Revenue Recognition

The Company recognizes revenue from a contract with a customer when a performance obligation under the terms of a contract with a customer is satisfied, which is when the customer controls the promised goods or services that are transferred in satisfaction of the performance obligation. Revenue is measured as the amount of consideration that is expected to be received in exchange for transferring goods or providing services, and the transaction price is generally fixed and generally does not contain variable or noncash consideration. In addition, the Company's contracts with customers generally do not contain customer refund or return provisions or other similar obligations. Transfer of control and satisfaction of performance obligations are further discussed in each of the revenue components listed below.

The Company uses estimates and judgments in determining the nature and timing of satisfaction of performance obligations, the standalone selling price ("SSP") of performance obligations and the allocation of the transaction price to multiple performance obligations.

The Company's principal revenue components are Chemical Sales and License Royalties.

Chemicals

The Company recognizes revenue for direct sales of proprietary chemicals and other ancillary items when the customer obtains control, which is generally at the point in time that delivery to and acceptance by the customer has occurred. Customer contracts for sales of chemicals are short duration and performance obligations generally do not extend beyond one year.

Certain chemical customer contracts are comprised of evaluation tests of the Company's chemicals' effectiveness and efficiency in reducing emissions. These contracts entail the delivery of chemicals to the customer and the Company's evaluation of results of emissions reduction over the term of the contract. Under these types of arrangements, which are generally for durations that are short term, the Company has determined that the customer is simultaneously receiving benefits of emissions reduction from the consumption of the chemicals over the testing period and this represents a single performance obligation that is satisfied over time. This determination may require significant judgment. The Company recognizes revenue over time using an input model that is generally based on the cost of chemicals consumed by the customer during the testing period. The use of an input model and the use of total costs as the measure of progress in the satisfaction of the performance obligations may require significant judgment. In addition, under these types of contracts, the Company has determined that the services performed and related costs incurred by the Company during the testing period represent costs to fulfill a contract.

License Royalties

The Company generates revenues from royalties ("M-45 Royalties") earned under a licensing arrangement ("M-45 License") of its M-45™ and M-45-PC™ emissions control technologies ("M-45 Technology") between the Company and Tinuum Group. The Company recognizes M-45 Royalties at a point in time based on the use of the M-45 Technology at certain RC facilities or through Tinuum Group's use of licensed technology for rates in excess of amounts allowed for RC application. The amount of M-45 Royalties recognized is generally based on a percentage of pre-tax margins (as defined in the M-45 License) of the RC facilities using the M-45 Technology.

Arrangements with Multiple Performance Obligations

Contracts with customers may include multiple performance obligations, which are comprised of the sale of chemicals, equipment and services performed as part of an emissions reduction arrangement. For such arrangements, the Company allocates revenue to each performance obligation based on its relative SSP. When a directly observable SSP for a performance obligation is not available, the Company primarily estimates SSPs based on the expected cost plus a margin method. These estimates as well as the timing of the satisfaction of performance obligations associated with the services component represent significant judgments made by the Company. These arrangements are generally short duration and performance obligations generally do not extend beyond one year.

Contract Assets and Liabilities

Contract assets are comprised of unbilled receivables and are included in Receivables, net in the Condensed Consolidated Balance Sheet. Unbilled receivables represent a conditional right to consideration in exchange for goods or services transferred to a customer.

Trade receivables represent an unconditional right to consideration in exchange for goods or services transferred to a customer. The Company invoices its customers in accordance with the terms of the contract. Credit terms are generally net 30 from the date of invoice. The timing between the satisfaction of performance obligations and when payment is due from the customer is generally not significant. The Company records allowances for doubtful trade receivables when it is probable that the balances will not be collected.

Contract liabilities are comprised of deferred revenue, which represents an obligation to transfer goods or services to a customer for which the Company has received consideration from the customer and, if deliverable within one year or less, is included in Other current liabilities in the Condensed Consolidated Balance Sheet and, if deliverable outside of one year, is included in Other long-term liabilities in the Condensed Consolidated Balance Sheet.

Disaggregation of Revenue

During the three and six months ended June 30, 2018, all performance obligations related to revenues recognized were satisfied at a point in time. The Company disaggregates its revenues by its major components as well as between its two operating segments, which are further discussed in Note 10 to the condensed consolidated financial statements.

The following tables disaggregate revenues by major source for the three and six months ended June 30, 2018 (in thousands):

	Three Months Ended June 30, 2018		
	Segment		
	EC	RC	Total
Revenue component			
Chemical sales	$726	$—	$726
License royalties, related party	—	3,523	3,523
Equipment sales	24	—	24
Revenues from customers	750	3,523	4,273
Earnings from equity method investments	—	15,889	15,889
Segment revenues	$750	$19,412	$20,162

	Six Months Ended June 30, 2018		
	Segment		
	EC	RC	Total
Revenue component			
Chemical sales	$1,347	$—	$1,347
License royalties, related party	—	6,753	6,753
Equipment sales	72	—	72
Revenues from customers	1,419	6,753	8,172
Earnings from equity method investments	—	28,142	28,142
Segment revenues	$1,419	$34,895	$36,314

Practical Expedients and Exemptions

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

Sales and other taxes that are collected concurrently with revenue-producing activities are excluded from revenue.

The Company has also elected to account for freight costs as activities to fulfill the promise to transfer the goods, and therefore these activities are also not assessed as a separate service to customers.
The Company accounts for all shipping and handling activities that occur after control of the related good transfers as fulfillment activities. These activities are included in Cost of Revenue line items of the Condensed Consolidated Statement of Operations.
The Company generally expenses sales commissions when incurred because the amortization period of the asset that the Company would have recognized is one year or less. These costs are recorded within sales and marketing expenses within the General and administrative line item of the Condensed Consolidated Statement of Operations.
Note 3 - Equity Method Investments
Tinuum Group, LLC
The Company's ownership interest in Tinuum Group was 42.5% as of June 30, 2018 and December 31, 2017. Tinuum Group supplies technology equipment and technical services at select coal-fired generators, but its primary purpose is to put into operation facilities that produce and sell RC that lower emissions and therefore qualify for Section 45 tax credits. Tinuum Group has been determined to be a variable interest entity ("VIE"); however, the Company does not have the power to direct the activities that most significantly impact Tinuum Group's economic performance and has therefore accounted for the investment under the equity method of accounting. The Company determined that the voting partners of Tinuum Group have identical voting rights, equity control interests and board control interests, and therefore, concluded that the power to direct the activities that most significantly impact Tinuum Group's economic performance was shared.
The following table summarizes the results of operations of Tinuum Group:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2018	2017	2018	2017
Gross profit	$28,683	$25,027	$55,096	$47,083
Operating, selling, general and administrative expenses	5,491	4,327	11,498	9,801
Income from operations	23,192	20,700	43,598	37,282
Other expenses	(355)	(359)	(2,224)	(947)
Class B preferred return	—	(505)	(12)	(1,142)
Loss attributable to noncontrolling interest	10,244	7,926	21,019	17,287
Net income available to members	$33,081	$27,762	$62,381	$52,480
ADES equity earnings from Tinuum Group	$14,450	$9,138	$25,500	$22,313

As of June 30, 2018 and December 31, 2017, the amount of Tinuum Group's temporary Class B preferred equity was zero and $0.8 million, respectively.
The difference between the Company's proportionate share of Tinuum Group's net income available to members (at its equity interest of 42.5%) as presented in the table below and the Company's earnings from its Tinuum Group equity method investment as reported in the Condensed Consolidated Statements of Operations relates to the Company receiving distributions in excess of the carrying value of the equity investment, and therefore recognizing such excess distributions as equity method earnings in the period the distributions occur, as discussed below.
As shown in the tables below, the Company's carrying value in Tinuum Group was reduced to zero for the three and six months ended June 30, 2018, as cumulative cash distributions received from Tinuum Group exceeded the Company's pro-rata share of cumulative earnings in Tinuum Group. The carrying value of the Company's investment in Tinuum Group shall remain zero as long as the cumulative amount of distributions received from Tinuum Group continues to exceed the Company's cumulative pro-rata share of Tinuum Group's net income available to its members. For periods during which the ending balance of the Company's investment in Tinuum Group is zero, the Company only recognizes equity earnings from Tinuum Group to the extent that cash distributions are received from Tinuum Group during the period. For periods during which the ending balance of the Company's investment is greater than zero (e.g., when the cumulative earnings in Tinuum Group exceeds cumulative cash distributions received), the Company recognizes its pro-rata share of Tinuum Group's net income available to its members for the period, less any amount necessary to recover the cumulative earnings short-fall balance as of the end of the immediately preceding

period. During the three and six months ended June 30, 2018, the Company's cumulative amount of distributions received from Tinuum Group exceeded the Company's cumulative pro-rata share of Tinuum Group's net income available to its members. As such, the Company recognized equity earnings from Tinuum Group for the three and six months ended June 30, 2018 of $14.5 million and $25.5 million, respectively. During the three and six months ended June 30, 2017, the Company recognized equity earnings from Tinuum Group in the amount of $9.1 million and $22.3 million, respectively. As of June 30, 2018 and 2017, the Company's carrying value in Tinuum Group was zero and zero, respectively.

Thus, the amount of equity earnings or loss reported on the Company's Condensed Consolidated Statement of Operations may differ from a mathematical calculation of net income or loss attributable to the equity interest based upon the factor of the equity interest and the net income or loss attributable to members as shown on Tinuum Group's statement of operations. Additionally, for periods during which the carrying value of the Company's investment in Tinuum Group is greater than zero, distributions from Tinuum Group are reported on the Condensed Consolidated Statements of Cash Flows as "Distributions from equity method investees, return on investment" within Operating cash flows. For periods during which the carrying value of the Company's investment in Tinuum Group is zero, such cash distributions are reported on the Condensed Consolidated Statements of Cash Flows as "Distributions from equity method investees in excess of investment basis" within Investing cash flows.

The following tables present the Company's investment balance, equity earnings and cash distributions in excess of the investment balance for the three and six months ended June 30, 2018 and 2017 (in thousands):

Description	Date(s)	Investment balance	ADES equity earnings (loss)	Cash distributions	Memorandum Account: Cash distributions and equity earnings in (excess) of investment balance
Beginning balance	12/31/2017	$ —	$ —	$ —	$ (12,218)
ADES proportionate share of income from Tinuum Group [(1)]	First Quarter	12,458	12,458	—	—
Recovery of prior cash distributions in excess of investment balance (prior to cash distributions)	First Quarter	(12,218)	(12,218)	—	12,218
Cash distributions from Tinuum Group	First Quarter	(11,050)	—	11,050	—
Adjustment for current year cash distributions in excess of investment balance	First Quarter	10,810	10,810	—	(10,810)
Total investment balance, equity earnings (loss) and cash distributions	3/31/2018	$ —	$ 11,050	$ 11,050	$ (10,810)
ADES proportionate share of income from Tinuum Group [(1)]	Second Quarter	$ 14,059	$ 14,059	$ —	$ —
Recovery of prior cash distributions in excess of investment balance (prior to cash distributions)	Second Quarter	(10,810)	(10,810)	—	10,810
Cash distributions from Tinuum Group	Second Quarter	(14,450)	—	14,450	—
Adjustment for current year cash distributions in excess of investment balance	Second Quarter	11,201	11,201		(11,201)
Total investment balance, equity earnings (loss) and cash distributions	6/30/2018	$ —	$ 14,450	$ 14,450	$ (11,201)

Description	Date(s)	Investment balance	ADES equity earnings (loss)	Cash distributions	Memorandum Account: Cash distributions and equity earnings in (excess) of investment balance
Beginning balance	12/31/2016	$ —	$ —	$ —	$ (9,894)
ADES proportionate share of income from Tinuum Group (1)	First Quarter	10,457	10,457	—	—
Recovery of prior cash distributions in excess of investment balance (prior to cash distributions)	First Quarter	(9,894)	(9,894)	—	9,894
Cash distributions from Tinuum Group	First Quarter	(13,175)	—	13,175	—
Adjustment for current year cash distributions in excess of investment balance	First Quarter	12,612	12,612	—	(12,612)
Total investment balance, equity earnings (loss) and cash distributions	3/31/2017	$ —	$ 13,175	$ 13,175	$ (12,612)
ADES proportionate share of income from Tinuum Group (1)	Second Quarter	$ 11,761	$ 11,761	$ —	$ —
Recovery of prior cash distributions in excess of investment balance (prior to cash distributions)	Second Quarter	(11,761)	(11,761)	—	11,761
Cash distributions from Tinuum Group	Second Quarter	(9,138)	—	9,138	—
Adjustment for current year cash distributions in excess of investment balance	Second Quarter	9,138	9,138	—	(9,138)
Total investment balance, equity earnings (loss) and cash distributions	6/30/2017	$ —	$ 9,138	$ 9,138	$ (9,989)

(1) For the three and six months ended June 30, 2018 and 2017, the amounts of the Company's 42.5% proportionate share of net income available to members as shown in the table above differ from mathematical calculations of the Company's 42.5% equity interest in Tinuum Group multiplied by the amounts of net income available to members as shown in the table above of Tinuum Group results of operations due to adjustments related to the Class B preferred return.

Tinuum Services, LLC

The Company has a 50% voting and economic interest in Tinuum Services, which is equivalent to the voting and economic interest of NexGen Refined Coal, LLC ("NexGen"). The Company has determined that Tinuum Services is not a VIE and has evaluated its consolidation analysis under the voting interest model. Because the Company does not own greater than 50% of the outstanding voting shares, either directly or indirectly, it has accounted for its investment in Tinuum Services under the equity method of accounting. The Company's investment in Tinuum Services as of June 30, 2018 and December 31, 2017 was $5.0 million and $4.3 million, respectively. During the three months ended June 30, 2018, the Company funded a capital call of $0.8 million, which increased its investment balance in Tinuum Services.

The following table summarizes the results of operations of Tinuum Services:

Three
Months
Ended
June 30,