

# **Arq, Inc. (ARQ) Q2 2024 Earnings Call Transcript**

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**Body**

Arq, Inc. (ARQ)

Q2 2024 Results Earnings Conference Call

August 13, 2024, 09:00 AM ET

Company Participants

Anthony Nathan - Investor and Corporate Relations

Robert Rasmus - Chief Executive Officer

Stacia Hansen - Chief Accounting Officer

Conference Call Participants

Gerry Sweeney - ROTH MKM

Graham Mattison - Water Tower Research

Presentation

Operator

Greetings and welcome to the Arq Second Quarter 2024 Earnings Call. At this time, all participants are in a listen-only mode. [Operator Instructions]. As a reminder, this conference is being recorded.

I would now like to turn the conference over to Mr. Anthony Nathan, Head of Investor Relations for Arq. Thank you. You may begin.

Anthony Nathan

Thank you, operator. Good morning everyone, and thank you for joining us today for our second quarter 2024 earnings results call. With me on the call today are Bob Rasmus, Arq's Chief Executive Officer and President; as well as Stacia Hansen, Arq's Treasurer and Chief Accounting Officer.

This conference call is being webcasted live within the Investors section of our website and a downloadable version of today's presentation is available there as well. A webcast replay will also be available on our site and you can contact Arq's Investor Relations team at investor@arq.com.

Let me remind you that the presentation and remarks made today include forward-looking statements as defined in Section 21E of the Securities Exchange Act. These statements are based on information currently available to us and involve risks and uncertainties that could cause actual future results, performance and business prospects and opportunities to differ materially from those expressed in or implied by these statements.

These risks and uncertainties include, but are not limited to, those factors identified on slide 2 of today's slide presentation, in our Form 10-Q for the year ended June 30, 2024 and other filings with the Securities and Exchange Commission. Except as expressly required by securities laws, the company undertakes no obligation to update those factors or any forward-looking statements to reflect future events developments or changed circumstances or for any other reason.

In addition, it is especially important to review the presentation in today's remarks in conjunction with the GAAP references in the financial statements.

With that, I would like to turn the call over to Bob.

Robert Rasmus

Thank you, Anthony. And thanks to everyone for joining us this morning. To start today's call, I'd like to share a high-level review of our second quarter divided into four key sections – our financial results, progress on GAC contracting, progress on our strategic growth projects, and an update on our capital position.

First, driven by our ongoing strategic evolution and transformation, we reported another quarter of strong and sustainably enhanced financial performance. Once again, revenue improved over the prior year, reflecting an annual increase of 24% to $25.4 million. This was driven in part by our fifth consecutive quarter of double-digit year-over-year percentage growth in average selling price.

We realized attractive gross margins of 32%, reflecting an improvement of more than 700 basis points over the same period last year as we continue to sustainably drive costs down across our business and focus on optimizing our PAC portfolio.

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We generated positive EBITDA during the quarter of approximately $450,000, marking the first consecutive quarter of year-over-year improvement and evidencing the benefits of our initiatives to drive greater profitability in our foundational PAC business. This positive adjusted EBITDA performance is very much in line with our expectations and demonstrates the positive directional trend of our legacy business.

Importantly, these results were achieved despite a strategic acceleration of certain of our biennial maintenance activities in April, which accounted for approximately $1.4 million of cost during the quarter. Of note, if we were to exclude this cost out of our cost of goods sold, gross margin would have been even better.

Our plant shutdown activities and expenses related to physically connecting the GAC facility to our legacy Red River plant will enable us to capture multiple operational synergies. The next scheduled full plant maintenance will now occur in 2026 versus 2025 as would have been the case without our strategic decision to accelerate this year.

As a reminder, the first two quarters of the year generally reflect seasonally weak periods, but we were encouraged at the strong and improving activity we saw during the second quarter, which provides strong momentum as we head into our seasonally stronger quarters during the second half.

We continue to expect our PAC business to be cash flow generative for the full year, creating a solid foundation on which to layer our accretive, higher margin GAC revenues and cash flows.

Second, we're following through on our commitment to secure additional contracts at our Red River GAC facility. We are now 52% contracted on our nameplate capacity with roughly six months left to initial production, evidencing the strong demand for our differentiated products and solutions.

Our agreements continue to reflect attractive pricing for products that are materially accretive to our foundational PAC portfolio, further supporting the capital we're investing in this exciting growth portion of our business.

Third, our key growth projects are on track. At our Corbin facility, we commenced commissioning early during the second quarter and began producing initial purified bituminous coal waste feedstock for quality control and specification testing, which will ramp up ahead of our first production at Red River. And at our Red River GAC facility, we remain on track for Q4 commissioning as well as first deliveries in Q1 of 2025.

Today, we are reiterating our full 2024 capital investment forecast of $60 to $70 million. We expect our investment in these projects will generate payback in approximately three years.

Fourth, we continue to bolster our capital position while strategically investing in our ongoing transformation. This includes an opportunistic capital raise completed in May with a $15 million pipe raise completed with an institutional investor. This unsolicited investment further bolstered our liquidity position as we continue to invest in transformational projects with highly attractive expected returns.

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And related to our previously discussed refinancing, we announced today that we recently signed a nonbinding term sheet that would materially expand the size of the facility while further enhancing liquidity. More on that in just a bit.

I'd now like to hit on a few other notable recent events. We were pleased to recently announce that Arq has been added to both the broad market Russell 3000 index and the Russell 2000 index. This inclusion is a significant achievement for us and reflects the hard work and dedication of our entire team. Being part of these widely recognized and respected benchmarks for US stock market performance is a testament to our company's growth and evolution. It underscores the success of our strategic initiatives and our ongoing transformation into a leading environmental technology company.

As you are likely aware, Russell indexes are widely used by investment managers and institutional investors for index funds and as benchmarks for active investment strategies. We anticipate that our inclusion in the Russell family of indices will bring several benefits including broadened exposure to the investment community and greater liquidity in our stock.

During our first quarter earnings call in May, we were proud to announce our inaugural GAC supply contract, marking a tremendous milestone in our strategic evolution. In the months since our last earnings call, we have continued to make progress in our commitment of entering into additional contracts for our GAC supply at our Red River facility.

As I noted earlier, we have recently secured significant additional contracted volumes for GAC supply, bringing up our total contracted demand of 13 million pounds per annum when fully scaled up. This represents 52% of our expanded nameplate capacity of 25 million pounds at Red River.

It's worth noting that we've achieved this milestone roughly six months ahead of our first deliveries, which remain on target for Q1 2025. These GAC contracts have attractive pricing, especially compared to our legacy PAC products and not only a firm strong market demand, but validate our GAC products and strategy. They also reflect the market's recognition of the potential of our superior offerings and environmental technology.

These GAC sales are set to significantly grow our total revenue base and expand our margins. Given the limited supply of high quality, fully integrated, domestically produced, granular activated carbon in the market and our ongoing customer discussions, we're confident in our ability to fully contract our remaining nameplate capacity before production begins, demonstrating how our unique high quality environmentally friendly feedstock resonates with the market. As we advance even closer to the financial opportunity represented by our growth into GAC products, it's perhaps worth discussing further how we view the sector.

As we flagged in our first quarter results, we believe the regulatory changes put in place by the EPA in April are likely to have a material long-term effect on demand for GAC products, given the increasing focus on efforts to remove PFAS or forever chemicals from our nation's water supplies.

To reiterate, we believe that if you assume all existing water suppliers must reduce their PFAS contamination from 70 parts per trillion to just four parts per trillion, the limitations outlined in the new regulations, this will require each user to consume between 3 to 5 times more granular activated carbon. Taking this further, we believe this leads to a supply gap of approximately 370 million pounds by 2030, or put another way, a potential supply gap greater than the entire North American GAC market today.

And it is not just our forecast that imply this level of supply shortfall and market tightness. A recent research report published by Goldman Sachs included several notable figures that I'll highlight today.

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First, according to the report of the roughly 153,000 public water systems in the US as of 2023, approximately 35% will require PFAS treatment facilities over the next several five to six years, up from 10% today.

Second, they estimate that the US drinking water PFAS treatment market is estimated to reach $2 billion per year by 2030, which is roughly 10 times larger than the market size in 2023.

Third, the report states that given granular activated carbon's advantages versus traditional products and solutions, GAC's market penetration rate for PFAS treatment could reach approximately 80% by 2030.

And fourth, the replacement cycle for PFAS removal equipment is expected to increase by two-folds for groundwater and four-fold for surface water versus historical usage levels.

Together, we believe this evidence is further independent support for a market whose fundamentals will continue to support our business and its growth strategy over the near and long term.

I remain a firm believer that where economic opportunities of this size arise, capital will flow, and we fully anticipate that incremental supply will fill some of this gap. But crucially, we have a critical and strategic first mover advantage. We believe it will take at least two to three years for new supply to come online given permitting, financing, and construction timelines.

Further, we believe that the cost to build greenfield sites today is between $5 to $7 per pound of production, dramatically impacting the economics others can realize through their investment dollars. Brownfield sites may be less expensive at between $3 to $5 per pound of production, but this is still indicative of major capital outlay in a market that has been typically slow to react in terms of capacity. Based on these round numbers, we believe it is reasonable to conclude that our plant assets are worth multiples of our market cap.

Let's turn now to a brief discussion of the regulatory environment, particularly in light of the upcoming election cycle. Irrespective of the outcome in November, the level of demand that we had seen for PFAS-facing GAC solutions prior to the latest EPA regulatory changes makes us very confident that demand is fundamentally customer-led rather than regulatory-driven.

While it is clearly not my place to opine on political outcomes, I would note that there were two areas of environmental regulations that the previous Republican administration did support, and one of them was the PFAS Action Plan, a PFAS strategy.

That being said, the municipal water market/PFAS market is not the sole or primary driver of our expansion into granular activated carbon. Our sales team has made great strides to ensure our GAC contract pipeline represents a true portfolio of opportunities and not just PFAS-related customers.

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As we previously announced, our second GAC contract was with a company specializing in the manufacturing of personal and industrial air purification devices. This is an entirely separate subsector reflecting compelling diversification as well as attractive pricing.

Another sector that I want to briefly touch on is the GAC demand relating to renewable or biogas production. Renewable natural gas or RNG is essentially biogas derived from the thermogasification or biodecomposition and digestion of organic matter. The organic matter can come from livestock waste, landfills, water, sludge, food waste, and other organic waste operations. The RNG in turn has to be processed to purity standards before being introduced to the pipeline grid, and this processing includes the removal of sulfur-containing components such as hydrogen sulfide or H2S and silicone-containing impurities.

Specific to sulfur and silicone impurities, granular activated carbon is the leading technology used by biogas producers globally for their removal. Lab-scale testing has continually confirmed the efficacy and tunability of our specialty Arq GACs, achieving up to 150% the removal performance of currently applied GACs and alternative metal oxide-based sorbents. Early testing and collaboration with a large market-leading biocast producer has been very positive.

In a growing market like renewable biogas purification, being able to reliably grow with the market, provide a consistent supply, and ability to support products commercially, supply chain-wise and through technology collaborations can be a key differentiator, all things we are poised and capable of doing.

I reference this market for two reasons. One, because it demonstrates that our growth business is not just tied to the fortunes of PFAS-related regulations, and two, because not only is the RNG market another rapidly growing industry, but it is also one which is dominated by producers who have massive engineering expertise and capital budgets to facilitate this expansion.

To give you some idea of the scale, in the EU today, there are some 1,300 biogas sites already in production, and this figure is estimated to be growing at roughly 20% per year.

In terms of energy production, and to give you an idea of scale, this equates to more than 120 million barrels of oil equivalent per annum. In the US, where the industry was slower to start, the figure is closer to 12 million barrels of oil equivalent per annum, but growing quickly and rapidly catching up. We are focused on multiple industries and end users across a wide swath of the market. This diversity of customers can help eliminate reliance on any one segment or sector.

In turn, our customers' focus is on being able to secure product from a fully integrated supplier of granular activated carbon, who also offers best-in-class performance. Our ability to provide incremental environmental benefits as well makes this a very compelling offering. We remain extremely excited about this space, continue to see strong demand across the board, and anticipate updating the market as we win more contracts over the coming months.

As we mentioned previously, our CapEx guidance portfolio 2024 remains in line with our previously committed guidance of between $60 million and $70 million. We continue to aggressively seek and identify opportunities to reduce our expenditures and have been successful in capturing multiple savings as a result.

I would emphasize that our 2024 capital spending forecast remains unchanged despite the negative impacts associated with the unprecedented rain in the region of our Red River facility. These conditions have contributed to a construction delay of roughly six to seven weeks. Our team is working actively to identify solutions to claw back some of these delays, and as of today, we remain confident in achieving first deliveries in Q1 2025 as previously forecasted.

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Related to capital spend, and as we previously mentioned, we took the decision in April to implement our maintenance program, which we typically execute every two years. The logic for this decision was that we wanted to do it ahead of our expansion into GAC production, so that we could minimize downtime once we are at nameplate capacity in 2025. I believe this will prove to be a prudent decision, and although it drove approximately $1.4 million of costs that we were not able to capitalize during the second quarter, we are highly confident the near and long-term benefits will far outweigh this.

As I noted earlier, we have signed a non-binding term sheet to refinance the company's existing term loan that would materially expand the size of the facility while further enhancing liquidity. We continue to be conservative in our assumptions, and the contemplated facility is sized to fully finance our capital investment and working capital requirements as relates to our ongoing granular activated carbon projects, which we expect to contribute quickly to our cash flow generation.

With that, I will hand over to Stacia to discuss the latest financials in greater detail.

Stacia Hansen

Thanks, Bob. And thanks, everybody, for joining us today. We delivered strong financial results during the second quarter, with revenue growing 24% year-over-year, driven largely by enhanced contracts terms, which include 16% growth on average selling price, our fifth consecutive quarter of double digit year-over-year percentage growth in ASP, as well as positive changes in product mix and a 3% increase in volume.

Our gross margin in the quarter was approximately 32%, up more than 700 basis points versus the 25% margins reported in prior-year period. As Bob mentioned, these results were achieved despite the inclusion of approximately $1.4 million of costs associated with our proactive acceleration of certain maintenance cost, without which our gross margin would have been even better.

We generated positive adjusted EBITDA of approximately $450,000 compared to an adjusted EBITDA loss of $3 million in the prior-year period.

Net loss was $2 million, a significant improvement versus net loss of $5.9 million in Q2 of 2023.

As I mentioned earlier, average selling price for the quarter improved 16% year-over-year. We continued to eliminate negative margin contracts as we focused on profitability over volume and, at the end of the second quarter, have reduced loss making contracts to roughly 2% of volumes versus roughly 24% in 2022 and approximately 13% in 2023. Subsequent to quarter end, we have amended the sole remaining loss making contract which we expect to be a net contributor in 2025.

Selling, general and administrative expenses totaled $7 million, reflecting a reduction of approximately $1 million versus the prior-year period, driven by a reduction in payroll and benefits expenses as well as legal and professional fees.

Our research and development costs for the second quarter totaled approximately $900,000. This is compared to approximately $800,000 in the prior-year period. Year-over-year growth in R&D was primarily driven by conducting further product qualification testing with potential lead GAC adopters.

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Overall, and on an annualized basis, our performance demonstrates our ability to operate our PAC business in a way that contributes positively to our economic position by further enabling us to pursue and execute on growth and high margin opportunities within our expanded GAC business.

As Bob mentioned, we fully anticipate that our PAC business will be cash generative in 2024. And with it, we will have much more secure foundational business on which we can add more rewarding GAC opportunities.

Turning to the balance sheet, we ended the second quarter with cash of $28.5 million. The change versus last year and quarter driven by our ongoing strategic investment and expansion at Corbin and Red River. This is partially offset by the $15 million pipe investment we made – by an institutional investor in May.

Today, we are reiterating our 2024 CapEx forecast of $60 million to $70 million, of which we continue to expect Red River phase one will account for $55 million to $60 million. We continue to expect to fund our CapEx needs via our existing cash, cash generation, ongoing cost reduction initiatives, potential prepayments on GAC contracts and, importantly, in anticipated credit refinancing.

As Bob noted, we continue to have positive discussions with potential lenders on refinancing of the company's existing term loans that when finalized would provide an increased facility that we believe would be sufficient to cover the expected capital requirements through this year and beyond. We expect to complete this refinancing later in the third quarter.

With that, I will turn things back to Bob.

Robert Rasmus

Thanks, Stacia. Overall, this has been another steady quarter of progress. I would like to leave you all with what I believe are the four key takeaways today.

First, I am confident that we have secured the long term stability of our foundational PAC business, such that it will now be self-sustaining and continue to grow. We continue to believe that this business will be cash flow positive for the full year 2024 and beyond.

We continue to build momentum throughout the second quarter, providing strong tailwinds as we head into the second half of the year, which represents our seasonally strong period.

Second, we continue to make outstanding progress on contracting granular activated carbon volumes at attractive pricing, well ahead of our first production. This provides third party validation of our shift towards granular activated carbon, while also demonstrating the quality of our offering.

We continue to believe our GAC capacity will be fully contracted prior to initial production and are confident that there is more encouraging news to come in the weeks and months ahead.

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Third, Corbin commissioning has been successful and we are now in a position to stockpile feedstock for use at Red River as required. I am very pleased with the way our new team has been able to focus on cost saving initiatives to keep this project on track for first deliveries in Q1 2025.

And fourth, our capital position remains strong and, upon completion of our refinancing, we will have further enhanced our capital structure. Over the coming months, we will continue to update the market as appropriate and as a team we remain very excited by the busy, but transformational period that lies ahead.

With that, I will turn the call back over to our operator to move us to Q&A.

Question-and-Answer Session

Operator

[Operator Instructions]. Our first question comes from the line of Gerry Sweeney with Roth MKM.

Gerry Sweeney

I've got a few different questions all over the place, but just going to start with Red River, the delay. You're targeting $60 million to $70 million, I think, in CapEx. Have you looked at maybe spending a little bit more to get the project back on track? There's obviously puts and takes to that. Just curious to your view. Or is it short enough a delay that upping CapEx just doesn't make sense?

Robert Rasmus

A couple comments on your question, Gerry. One, the CapEx project actually is on target. We had hoped – I'm a conservative guy and always prefer to under promise and over deliver. We had hoped and had built in some delays, such that we would be able to actually begin first deliveries in the fourth quarter. Given the seven weeks delay due to the biblical rains, that is unfortunately not going to happen. However, we still are on target for commissioning the facility, beginning that in the fourth quarter, and still on target for first deliveries in the first quarter of 2025.

And based on our model and our numbers and based on how we originally made the financial investment decision, we don't think it's a prudent use of capital to increase that expenditure and to bring it back to our hoped for timeline as opposed to our planned timeline.

Gerry Sweeney

Now, just for the sake of clarity, I sort of anticipated sales, we'll say early Q1. There was a delay. I was thinking later in Q1, but it sounds as though you were being conservative. So it's fair to say that maybe some product sales at least in the first half of Q1, not late in Q1.

Robert Rasmus

I think, again, it's what's first half. Is that February 14th or below or is the later? But I think rather than splitting hairs as it relates to days, as I say, we're entirely confident that we will have completed the commissioning in the first quarter and begun first deliveries in the first quarter. Certainly, by the end of the first quarter, we'll be able to realize the full impact of the expanded capacity and production.

Gerry Sweeney

Corbin, I think you touched on it a little bit at the end. It sounds like it's fully commissioned. You're stockpiling. But just want to get a little bit more depth and clarity on that. Is that facility you're comfortable with the commercialization process and any items that we should be paying attention to there?

Robert Rasmus

No, we're very pleased with the way Corbin has worked out. One, just to reiterate something we always mentioned that the unique quality of our feedstock using bituminous coal waste and using that waste as the ability to remediate other waste gives us two bites at the environmental apple. So then you add that to the operational capability. It's fully commissioned. We are very pleased with that. We're ahead of time. We're under budget in terms of Corbin. So we're very pleased with that aspect of it.

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We have done, if you will, the full commissioning process. We are just waiting to turn that back on to begin stockpiling feedstock in anticipation of being able to supply commercial quantities to Red River once we begin production of our GAC there.

Gerry Sweeney

You did mention the uniqueness of the bituminous product out of Corbin. And you're seeing, I think, some very good interest, not just in municipal water, but air filtration and biogas. We've spoken in the past, Arq's GAC is, for lack of a better term, different in size and conformity of size and shape. Is that difference driving an advantage in the air filtration and biogas markets or even the municipal water market by chance?

Robert Rasmus

I think a couple things there. One, just the overall market fundamentals are very compelling in all aspects of the market, whether it's renewable natural gas, whether it's water filtration, whether it's PFAS remediation, whether it is air purification, soil or water remediation. It's very compelling market dynamics. But then you layer on top of that our very unique product offering. And as you have heard me say previously, that activated carbon is a technical sale. It's not something where our salesman just shows up and says to a customer or a potential customer, we can have a truckload of granular activated carbon here next week, next month, when do you want it? You have to undergo and meet and pass very stringent product qualification and testing.

As a result, we began this in the second half of last year, as we talked about previously. We identified over 100 potential lead adopters across a wide variety of industries, biogas, municipal water, remediating runway foam, remediating deicing liquids, air filtration, et cetera. And in every instance, where we engage with those 100 lead adopters, 100 plus actually, we either moved from product testing to actually committed contract, product testing to contract negotiations which we're engaged in now or product testing to the next level of testing. And I think that's a testament to a couple factors besides the efficacy and hard work of our R&D team and our sales force, but it also relates to the quality of our product because of the unique quality of our feedstock. Being very high quality bituminous metallurgical coal, we believe, and the testing is showing, that we have a performance advantage relative to the competition and what other people have been using in the past.

You combine that with the lower CO2 footprint from our process versus mining virgin coal as much as a 40% reduction in reduced CO2 exposure as well as adding into that that being the only domestic fully vertically integrated supply chain we qualify for the Build America Buy America, which is important at many federal, state and local contract levels. All of those factors combined to make our product a very attractive offering.

Gerry Sweeney

One or two short questions. I know you're not going to tell me pricing per pound, but I was wondering.

Robert Rasmus

You're right.

Gerry Sweeney

If you could maybe, we have municipal water, we have air, we have RNG, what's the more the higher ASP in those markets? The sort of rank of pricing.

Robert Rasmus

Pricing varies across the various market segments. I'll reiterate what I've said in the past. The market pricing for granular activated carbon as a whole is a multiple of our PAC pricing.

Does it cost more to produce granular activated carbon versus powdered activated carbon? Yes. Does it cost a multiple to produce granular activated carbon versus powdered activated carbon? Absolutely not.

The important thing in terms of the pricing and the actual contracts we've signed across three different industries as well as the pricing discussions we are having in our current contract negotiations, they provide further evidence and further validity that this is a very compelling economic investment with a three year or less investment payback for us.

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Gerry Sweeney

Last final question. Congrats knocking out the negative contracts. Just curious, as you look at the PAC market and just moving forward, curious if there's actually some opportunity to continue to drive some pricing and some better contracts, especially maybe contracts that you reworked a couple years ago. Any thoughts on that front?

Robert Rasmus

No, we're absolutely not done. As we mentioned, this is the fifth consecutive quarter of double digit average selling price increase. Some of that is the low hanging fruit that we've been able to harvest, but there's been no magical elixir in terms of doing what we've been doing and being able to continue to do that. It's basic blocking and tackling. It's concentrating on profitability over volume. It's having customers and selling the value of our vertically integrated domestic supply chain and the certainty and availability of supply and the advantages that entails for our customers. It's also not just transforming our existing power generation business, but it's also transitioning into adjacent markets like waste to energy, like the municipal water, both of which carry a higher average selling price, as well as an average – higher average margin as a result.

As an aside, there also is a small component of our extremely high quality PAC product being able to use for PFAS remediation. Now, we've talked about that the EPA regulations reducing the amount of permissible PFAS and water going from 70 parts per trillion to 4 parts per trillion. You need granular activated carbon to be able to do that. But in instances where municipal water authorities are currently at 10 parts per trillion or less, they can use a really high quality or highest quality PAC product to get them in compliance with the new EPA regulations.

Now, that is capable only from 10 parts per trillion down to 4. It doesn't get you from 30 to 4, doesn't get you from 70 to 4, doesn't get you from 100 parts per trillion to 4. But that's another avenue where we think we can continue to expand margins and average selling price on our foundational PAC business.

Operator

Our next question comes from the line of Graham Mattison with Water Tower Research.

Graham Mattison

Just to follow up on Gerry's last question, obviously, huge improvements on the PAC side with the pricing. And it sounds like there's definitely more room to run on that side for improving margins there. How much opportunity is there still left with in terms of operational improvements to help the margin there?

Robert Rasmus

No, there's definitely improvement there. As we mentioned, we had a 700 basis point improvement in our gross margin this quarter. If we had not had the extraneous $1.4 million to bring forward our biennial plant maintenance, that increase would have been more than double to give you an indication. And we think we still have more that we can wring out there.

And again, like I mentioned, there's no magical elixir. Every penny counts. I was just recently at a plant with the chief operating officer to speak about the need to make sure everyone is paying attention, that details matter. And before the meeting, I threw some pennies on the ground beforehand to see who picked those up. And what I was trying to emphasize is that every penny counts. Every penny we save in terms of operating costs has almost a $1 million impact directly to our bottom line. So would people stop to pick up a penny? I hope so because it's the equivalent of picking up a million dollars. So we're continuing to emphasize and reinforce that everything matters, everything counts.

And it's not just on the operating side, too. It's also on the SG&A side. We're pleased we were able to bring our SG&A down this quarter by over a million dollars. So it's looking at all aspects of the business. Every penny, nickel, and dime counts.

Graham Mattison

Question on the new GAC customers. Where are they coming from? Are they companies that are new to looking to secure supply or are they moving from another supplier to you?

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Robert Rasmus

It's really a combination of both. For some people, they're attracted to the quality of our product. They're attracted to us. They've been beating a dead horse on our vertically integrated supply chain. The certainty of supply, not having to rely on imports or others. So I think that's one aspect of it.

The other is it's both existing users of granular activated carbon and new who are looking for granular activated carbon supply because the market is so woefully under supplied and demand is so great. So we're seeing demand in signing contracts and interest in negotiating contracts from both existing users who like the quality of our product, existing users who need access to additional product, and new potential users who need access to the product.

Graham Mattison

In terms of as the market grows, what are your options for increasing capacity?

Robert Rasmus

As we've talked about, this is the first 25 million pound expansion. It's really a series of modular expansions. We've always assumed and run our numbers on 25 million pounds. We do have some expectation and belief that we will be able to generate additional production capability over and above that 25 million pounds. Could it be 10%, 20%, 30%? Time will tell. But for now, we want to be conservative in terms of what we've modeled and what we have discussed with the marketplace. So, that's one area where we could increase capacity.

Two, as it relates to phase two, we expect that the market fundamentals will remain extremely strong. And when you look at the advantages we have, not only the product advantages we have that we've mentioned in terms of Gerry's question, but also we have first mover advantages. As I mentioned, we could expand 4 more times beyond this to a total of 125 million pounds of granular activated carbon capability.

We are fully permitted, not just on the initial 25 million pounds, but all 125 million pounds. That gives us a significant advantage relative to somebody else who would be greenfield or brownfield. We think that gives us a minimum one year advantage and potentially as much as a two year advantage.

The other aspect for us there in terms of bringing on capacity is that we can do it for $3 a pound or less versus we think a minimum of $5 to $7 a pound for greenfield capacity as it relates to that. And the other advantage of phase two is that we've spent a lot of money still with a three year or less payback on this first line of 25 million pounds, but some of the funds that we've already spent will [indiscernible] the benefit of phase two, so it will be an even more attractive return. So we have plenty of options both in terms of being able to produce more than 25 million pounds on this initial capacity as well as being able to rapidly go and expand into phase two and phase three and phase four or phase five if need be.

Robert Rasmus

Definitely, I think on the permitting side it's probably longer than two year head start on that front. One last question on the PAC pricing. What's been driving the improvement in margin as you go forward? Is it customers seeing the demand and market price going up, better negotiating or discussions with your customers or is it just a mix of the new customers that you're bringing in?

Robert Rasmus

Our head of sales would definitely say better negotiating on their part with our customers as it relates to that. But I think that is an element which they deserve kudos for.

But as I mentioned with Gerry, it's also expanding into adjacent markets as well. It's in the water market, it's in the waste to energy, it's in the remediation markets, all of which carry a higher average selling price and, as consequence, much higher margins. So all of those factors, prioritizing profitability over volume as well as adjacent market being able to tap those is what has enabled the price increases and the margin expansion.

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Operator

Thank you. Ladies and gentlemen, that concludes our question-and-answer session. I'll turn the floor back to Mr. Rasmus for any final comments.

Robert Rasmus

Thank you, Melissa. And thank you to everyone for joining us today. We continue to make exciting and undeniable progress on our ongoing transformation to an environmental technology company. We are improving the performance and value of our foundational PAC business and executing steadily on our GAC growth strategy.

Having the right relationships, the right team and tools is an essential component of success. I am entirely confident that at Arq, our tools, our team, our platform and our opportunity are unique and will continue to contribute to our ongoing future success.

We are confident that the investments we are making in GAC and our ongoing execution will drive very attractive returns in shareholder value over both the near and long term. I look forward to our next quarterly call. Thank you everyone.

Operator

Thank you. This concludes today's conference call. You may disconnect your lines at this time. Thank you for your participation.

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