Ampco-Pittsburgh Corporation

Fourth Quarter 2017 Results Conference Call

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CORPORATE PARTICIPANTS

John Stanik, *Chief Executive Officer*

Michael McAuley, *Senior Vice President, Chief Financial Officer and Treasurer*

Melanie Sprowson, *Director, Investor Relations*

PRESENTATION

Operator
Good morning and welcome to the Ampco-Pittsburgh Fourth Quarter 2017 Results Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then 1 on your telephone keypad. To withdraw your question, please press star, then 2. Please note that today's event is being recorded.

I would now like to turn the conference over to Melanie Sprowson, Director of Investor Relations. Please go ahead.

Melanie Sprowson
Thank you, Andrea, and good morning to everyone joining us on today's fourth quarter conference call. I'm joined by John Stanik, our Chief Executive Officer, and Mike McAuley, Vice President, Chief Financial Officer, and Treasurer.

Before we begin, I would like to remind everyone that participants on this call may make statements or comments that are forward-looking and may include financial projections or other statements of the corporation's plans, objectives, expectations, or intentions. These matters involve certain risks and uncertainties, many of which are outside of the corporation's control. The corporation's actual results may differ significantly from those projected or suggested in any forward-looking statement due a variety of factors, including those discussed in the corporation's most recently filed Form 10-K and subsequent filings with the Securities and Exchange Commission. We do not undertake any obligation to update or otherwise release publicly any revision to our forward-looking statements.

A replay of this call will be posted on our website later today and remain available for two weeks following the conclusion of the call. To access the earnings release or the webcast replay, please consult the Investor section of our website at ampcopgh.com.

Now let me turn this call over to Mike, who will provide an overview of the company's financial performance for the fourth quarter.

Michael McAuley
Thank you, Melanie. Good morning, everyone, and thank you for joining our call. Our earnings release for the fourth quarter and full fiscal year 2017 was issued this morning, and I hope you've all had a chance to read it. I will give a financial review for the quarter by taking you first through our consolidated P&L. Then I'll provide more color at the segment level and then review some balance sheet and cash flow activity.

Ampco's net sales for the fourth quarter of 2017 were $114.4 million. This compares to net sales for the fourth quarter of 2016 of $92.1 million. Net sales in the Forged and Cast Engineered Products segment grew nearly 30 percent compared to prior year, driven by higher sales of forged engineered products for the oil and gas industry, the full period effect of the November 2016 ASW Steel acquisition, and higher sales of mill rolls. Net sales for the Air and Liquid Processing segment for the fourth quarter of 2017 rose 5 percent from the prior year quarter. I'll comment more on the business segment results in just a moment.

Gross profit as a percentage of net sales was 18.1 percent for the fourth quarter of 2017 versus 12.4 percent for the fourth quarter of 2016. The increase primarily reflects higher Q4 2017 sales volumes and selling prices, plus a number of non-recurring items last year which diluted the Q4 2016 gross profit margin, including some inventory adjustments related to physical inventory losses, reserves against certain inventory for two customers who filed bankruptcy, and an unfavorable LIFO cost impact. Negatives affecting the fourth quarter gross margin for 2017, include higher raw material and operating costs, including the impact of idling one of our foundries.

Selling and administrative expenses were $16.9 million, or 14.7 percent of net sales, for the fourth quarter of 2017 compared to $14.4 million, or 15.7 percent of net sales, for the fourth quarter of 2016. The dollar increase is primarily related to higher commission charges associated with the higher volume of shipments, higher corporate expenses associated with the company's increased scale, higher fringe benefits, and professional fees. This was offset by a non-recurring reserve in Q4 2016 of $1.5 million against pre-petition accounts receivables from our customer who filed for Chapter 11 bankruptcy protection last year.

Depreciation and amortization expense of $5.4 million for the fourth quarter of 2017 was approximately flat with the prior year. The prior year included an impairment charge of $26.7 million, primarily for the write-off of goodwill in the Forged and Cast Engineered Products reporting unit and a net asbestos charge of $4.6 million, both of which we described at length on last year's call and in our 2016 10-K disclosures.

Loss from operations for the fourth quarter of 2017 was $1.8 million. This compares to a loss from operations in the prior year of $39.8 million, which is inclusive of the prior year charges for impairment and asbestos litigation as well as the customer Chapter 11 receivable I just mentioned. I'll expand on operating income changes a bit further for you in my segment-level discussion momentarily.

Other expense net for the fourth quarter of 2017 declined $1.1 million versus prior year, primarily due to a small foreign exchange gain in the current year versus FX losses in the prior year quarter.

The income tax provision for the current year includes the effect of the new Tax Cuts and Jobs Act, which, among other things, lowered the U.S. corporate statutory income tax rate from 35 percent to 21 percent, implemented a modified territorial tax system, and imposed a one-time tax on deemed repatriated earnings of foreign subsidiaries. The tax reform negatively impacted our income tax provision by approximately $1.6 million in the quarter, primarily related to the one-time repatriation transition tax, offset by income tax benefits resulting from 100 percent bonus depreciation.

There was no cash outlay due to the tax reform; however, it reduced our net operating loss carryback refund opportunity. Additionally, there was no significant impact from remeasuring our U.S. deferred income tax assets and liabilities at the new enacted statutory income tax rate, since these net deferred income tax assets are fully valued. We will continue to analyze the tax reform and refine our provisional amounts, which could potentially impact the measurement of our tax balances in subsequent quarters.

As a result, the corporation incurred a net loss of $3.2 million, or 26 cents per share, for the fourth quarter of 2017 compared to a net loss of $43.1 million, or $3.51 per common share, for the fourth quarter of 2016.

Now, here's some detail on our operating segment results. Net sales for the Forged and Cast Engineered Products segment for the fourth quarter 2017 increased approximately 30 percent compared to prior year. This growth reflects a significantly higher volume of sales of frac blocks due to significantly higher demand in the oil and gas industry. The full period effect of the November 2016 acquisition of ASW Steel and higher sales volume of mill rolls, primarily cast roll volumes for hot strip mills, and also higher pricing.

The segment recorded a small operating income for the quarter, which is a significant improvement over prior year on an underlying operational basis, which is evident if you adjust for the non-recurring prior year charges for goodwill impairment and the customer Chapter 11 receivable reserve recorded in Q4 '16. The main drivers for the improvement were the higher sales volume and higher pricing, offset in part by higher operating and raw material costs and an unfavorable absorption effect from the idling of the cast roll foundry.

Net sales for the Air and Liquid Processing segment increased 5 percent for the fourth quarter of 2017 versus prior year, as higher shipment volumes of custom air handlers and heat exchange coils more than offset lower shipment volumes of centrifugal pumps. Given the $4.6 million asbestos charge recorded last year, Air and Liquids operating income rose significantly for the quarter compared to prior year but grew also on an underlying basis from the segment's higher shipment volumes this year.

Backlog at December 31, 2017, approximated $326 million, a 40 percent increase from the $234 million in backlog at December 31, 2016. This increase is primarily from higher order intake in the Forged and Cast Engineered Products segment, particularly in frac blocks and both forged and cast mill rolls, as well as higher order intake in Air and Liquid processing, primarily of centrifugal pumps for U.S. Navy shipbuilders.

Now, to review changes in the working capital accounts and some other cash-related items. Accounts receivable at December 31, 2017 increased $14.4 million from December 31, 2016, primarily from higher sales. Inventories at December 31, 2017 increased to $24 million from December 31, 2016. The inventory growth is primarily due to increased production levels in the Forged and Cast Engineered Products segment on higher order booking levels for frac blocks and roll demand.

Accounts payable at December 31, 2017, increased approximately $10.4 million from the balance as of December 31, 2016, reflecting higher raw material and operating expenditures associated with the higher production activity.

Cash and cash equivalents of $20.7 million at December 31, 2017 declined $17.9 million compared to the December 31, 2016 balance of $38.6 million. Some key uses of cash for the year included trade working capital growth to support sales and production growth, which I just mentioned, and capital expenditures of $14.6 million for the year.

Drawings on the Ampco revolving credit facility are $20.3 million at December 31, 2017, reflecting the refinancing of higher-interest debt assumed in the ASW Steel acquisition of approximately $7.7 million, inclusive of early repayment fees, and the balance to fund working capital growth. In addition to its cash balance, the corporation also has remaining availability on the revolver of approximately $56 million at December 31, 2017.

I will now turn the call over to John Stanik for his remarks. John?

John Stanik
Thank you, Mike. Good morning, everyone. While I'm disappointed that we aren't reporting an operating profit for the fourth quarter, I am pleased to report that major progress in many areas continues to improve — or to occur. Excluding non-recurring, non-cash adjustments that arose in December, operating profit was realized for two of the three months in the quarter. The exception was the month of November, during which we experienced equipment failures in three of our plants. As a result of the associated downtime, revenue was pushed out of the quarter, maintenance spending was above expectation, and fixed cost absorption was reduced.

November was the third month in 2017 during which we experienced extraordinary equipment failures. The November problems were resolved, and our operations have been running smoothly for the last three months; however, I'm not satisfied that we have a sustainable corporate-wide maintenance process and capability in place. Therefore, we are actively looking to upgrade our proactive methods and procedures and will add new global maintenance leadership.

The maintenance issues were the only negative of the quarter. We continue to book new business in both our roll business and in our open-die forged business. In fact, our backlog of business for 2018 on December 31, 2017, as Mike just said, is approximately 40 percent higher than it was December 31 of 2016. This means that our markets continue to strengthen in both of these areas. Additionally, and very importantly, we achieved new production and shipment records for rolls and frac blocks in October and December.

You may recall during our last call, we reported a global shortage of electrodes and refractories. The lack of availability has resulted in significant cost increases to procure them. Consequently, on November 3, 2017, we announced that we were going to impose pricing surcharges for both electrodes and refractories beginning January 1, 2018. As many of our customers have imposed similar surcharges and price increases to offset these costs for themselves, most have accepted our surcharge.

Raw material costs continue to be at a higher level than they were in 2016. In fact, the total 2017 year-over-year purchase cost increase was in the range of $4 million globally, equaling more than 40 percent of our whole-year operating loss. Our salesforce has been working very hard since 2017 to institute pricing surcharges for raw materials on customers who, at the time, did not have them in place. Now, approximately two-thirds of our customers have contractual surcharge coverage; however, this is still not our preferred level, and we will continue our efforts to negotiate them into new contracts. I am happy to say that our contractual product pricing for 2018 is considerably higher than in 2017. While the November manufacturing difficulties pushed some 2017 product to be produced and shipped into January of 2018, 2018 contractual pricing is now in effect.

Due to the rising costs of our raw materials, labor, and benefits and the fact that not all of our customer contracts include raw material surcharges, we expect to announce price increases in the very near future, prior to the 2019 customer contract negotiating period, which will begin this May. As promised, the first roll product of the new *TwinAlloy*™ product family was launched in December. We continue to be very excited about this series as these products are expected to improve the cost effectiveness of our customers' rolling mills. Testing in actual service supports our claim. Assuming the recently announced tariffs have the impact that is hoped for, which is increasing the utilization of capacity of our customers in the U.S., cost effectiveness improvements will become critically important to them, and the higher prices we will charge for the *TwinAlloy* rolls should be easily justified.

The first product in this series, VICTURA™, is applied to the finishing ends of hot rolling mills. Future new product launches will be aimed specifically at other sections of a rolling mill. The next *TwinAlloy* new product launch is tentatively scheduled for the second half of this year. We are a world-leading roll technology company, and I strongly believe that such a company should be responsible for regularly improving its product line capability. The fact that we were able to fund and launch this significant breakthrough in less than two years is a testament to our R&D capability.

Another important accomplishment in the fourth quarter is the progress we made in repurposing the Pennsylvania cast roll plant that was partially idled beginning in April of 2017. It now plays an important role in the manufacture of overflow rolls and open-die forged products, including frac blocks. We relocated and installed equipment in order to achieve this goal. As a result, the plant was an important contributor in achieving our production records in October and December. The overall future of that plant in the short term will continue to be based on this strategy; however, the steel and aluminum tariffs announced last week could have an impact on our plans should U.S. roll demand increase further.

Let's talk a little bit about the global tariffs. As you know, the newly announced tariffs of 25 percent and 10 percent, respectively, for steel and aluminum imports, will be applied very soon. Being a global company, the tariff represents good news for our U.S.-based business and could have very little impact on our European and Asian manufacturing as they are mostly region-centric; however, some scheduling adjustment may be necessary. Currently, our European plants provide most of the cast rolls that we ship to U.S. customers. With the tariff in place and customer rolling mills expected to operate at higher capacity utilization, greater roll consumption and more spares may be needed at our customers' sites.

The impact of this could be increased sales potential for hot mills and cold mill rolls. The recent weakening of the U.S. dollar, along with higher rolling mill utilization rates, could create more favorable circumstances to restart the down portion of this partially idled Pennsylvania plant if certain cost inefficiencies can be corrected. Since the tariffs exclude Canada, at least initially, they have no negative impact on our Canadian subsidiary, ASW Steel. We will follow all announcements closely regarding potential future changes to the tariff that may threaten the Canadian exception and prepare proactively.

I want to briefly mention the 2017 revenue growth of our equipment business. From an operating standpoint, revenue grew by more than 4 percent. That may not sound like a lot to you, but consider that Aerofin's major customer base for the coal-fired power market still has not recovered from its decline in 2015 and 2016. That used to be the number one vertical for that business. Further, during 2017, an important market for Buffalo Pumps, turbine power generation significantly contracted. This resulted in a few million dollar reduction in sales compared to our expectations. Thus, our team managed to grow revenue even when faced with these substantial headwinds. The faithful execution of their strategic plan initiatives allowed this to happen while maintaining their operating income contribution to the corporation.

There were a couple of developments late in the fourth quarter and in January, about which we have received questions from a few shareholders. One was an S-3 shelf registration statement filing made by the company, and the other was a 10b5-1 trading plan adopted by the Louis Berkman Investment Company, a significant shareholder of Ampco. I'd like to clarify both of these matters to hopefully eliminate any confusion.

The filing of the shelf registration statement was pursuant to a contractual obligation we entered into at the time of the Åkers acquisition which was completed in March of 2016. In the acquisition, we issued unregistered shares of Ampco stock to the seller and agreed to register the shares at a later date, which we now have accomplished. While the registration statement is effective, we believe none of the shares registered have been sold by Altor to date. Altor was the seller of the business, by the way.

The second item involved sales of Ampco stock by one of our significant shareholders, the Louis Berkman Investment Company, pursuant to a 10b5-1 plan, a trading plan for which insiders of a publicly traded company can sell a predetermined amount of shares at a predetermined time, regardless of whether there is an open window for insiders. This plan was adopted by the Lewis Berkman Company to allow members of the Berkman family to satisfy liquidity and diversification objectives.

I have a brief update on the identification of my successor. As I've said previously, the Board of Directors has created a CEO Search Committee, and the committee has started its search. I don't have any definitive information beyond that to provide to you at this time. I continue in my capacity with all the focus and determination that I have had since my first day as CEO of Ampco-Pittsburgh in January 2015 and will continue to do so until there is a smooth transition to a new CEO. I am involved in the process, and I am both pleased and convinced that the committee is doing their very best to identify the appropriate candidate. I do not have any projection of a date for an announcement at this time.

I'll end my comments with a look ahead. I have high expectations for 2018 in general, considering the vast amount of progress that we made in 2017. The surcharge coverage we will get in place, the 2018 price increases already embodied in contracts, and ongoing improvements in our operations capabilities will all help, and we will continue to improve beyond that. We are very focused on reducing manufacturing inefficiencies and reliability problems.

I expect revenue increases, barring any currently unforeseen negative market occurrence, and gross margin should continue to increase. That has already been shown in January. As Mike reported, 2017 revenue grew by 30 percent over 2016. For a company that's had its revenue decline four of the five years consecutively due to market conditions, this is an exciting development. Yes, a majority of this growth resulted from whole-year contributions from our two major acquisitions made in 2016, but our growth goes beyond that, and we will demonstrate this again in 2018. Companies that are able to grow and have initiatives in place to improve cost efficiencies and the market capability to increase prices to offset inflationary cost increases, have potential. Ampco-Pittsburgh Corporation now has that potential. As evidenced, despite the downtime that occurred in 2017 in our manufacturing plants and the raw material cost increases, our gross margin in that year grew 600 bps. Other than ERP software implementation at some of our acquired facilities, the integration of the Åkers Group and ASW Steel was completed. We launched a new product. The lag time embedded within our surcharge models will expire, and we'll begin to capture surcharge protection for 2017 raw material cost increases.

And, finally, our price increases will have a cumulative effect on our gross margins. I am very pleased with where this company is right now. Its future prospect is to continue to grow and with increasing margins.

Thank you. We will now take your questions.

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. To ask a question, you may press star, then 1 on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2. Please limit yourself to one question and one follow-up. If you have further questions, you may re-enter the question queue. At this time, we will pause momentarily to assemble the roster.

And our first question comes from Michael Gaugler of Janney. Please go ahead.

Michael Gaugler
Good morning, everyone.

John Stanik
Morning, Michael.

Michael McAuley
Good morning, Mike.

Michael Gaugler
I've got three questions, John.

John Stanik
Okay.

Michael Gaugler
I'll start with the easy one. I'm wondering if you can give us just a brief overview of what you're seeing in the frac blocks. Is the market demand accelerating, has it flattened out?

John Stanik
Well, if you read the reports that are published every week, it seems that the United States' well expansion is continuing, at least by small numbers, and the Canadian number of wells seems to have stabilized. There is business out there, and I would say that it's continuing to grow. We continue to get more pressure to supply blocks to additional customers. That's difficult for us to do at this point, although the production records that we talked about in December and October certainly help give us confidence that we can sell more than we did at the end of the year. So I think the short answer is that there's at least a stable level, but probably it's growing a small amount.

Michael Gaugler
Okay. Then on to a stickier question, and I don't know if you can answer this or not, but along the same lines. With the NAFTA renegotiation pushing forward, if that goes poorly and you decided to move ASW operations into the U.S., any idea of what kind of cost that could generate on your side to do something like that?

John Stanik
Well, I hate to say it, Mike, but it would be sizable. The ladle metallurgy equipment that ASW has can be moved, there's no doubt about that. You can't move experience, and this is equipment that is embedded in the ground with extensive foundations and concrete, et cetera; power requirements are very expensive, so it's important for us to continue to get an exception. And, as

I mentioned in my comments, we are looking into proactively what type of a case we can put together, regardless of how the NAFTA investigations go. Being a U.S. company and ASW selling exclusively to a U.S. company, hopefully there will be a way that we can accomplish that objective.

Michael Gaugler
Okay. And then, finally, I know you were looking for a level of profitability for last year, and certainly the tax reform and job — the tax cut and job reform act didn't help that out. Do you think it's a first-half 2018 event or a second-half 2018 event?

John Stanik
I do think it's a first-half, Mike. If we were to cook all this stuff down, basically, we're not getting enough price for what we're doing. We're not getting enough value for our products. It's been a long painful process to get that price in place. The roadblock that we encountered last year with the sizable raw material cost increase of $4.2 million, whatever the exact number was, the fact that we idled a plant that cost us roughly another $8 million, you take those two elements out, and we have a pretty decent year, maybe a 50-cent year, and I'm really generalizing here when I make that comment. So as these surcharge time lags expire, as we get the price increase that has been negotiated months ago that began effectively on January 1 of 2018, as we get more price increases for blocks because of the growing market case in that situation, we finally should be getting to numbers that our products merit.

And, yes, we have some other problems. We've got a pretty serious maintenance issue that we've got to resolve, but all of these things should come together. There's been so much improvement in all the other areas of running the corporation, it's basically this one last agreement. Now, things always happen and go bump in the night, that type of thing, but the stars are aligning at this point.

Michael Gaugler
Good to hear. That's all I've got, John. Thank you.

John Stanik
Thank you.

Operator
Our next question comes from John Walthausen of Walthausen & Co. Please go ahead.

John Walthausen
Okay. I'll try to limit myself to two questions and move it in the right direction — both about the fourth quarter. On the simpler one, when I look at your notes about ASW, you ran $47 million in revenues for the year, but a bit less than $11 million. Am I looking at that the right way to say that things slowed down there, and, if so, could you explain?

And then the second — well, I'll just do that question.

John Stanik
No, not at all. I think it's actually the opposite. I think that ASW did better as the year progressed. Now, we have encountered a loss of a major customer in our market for ASW who literally closed their factory. That's going to have some impact in the first quarter as we try and replace that hole that was created, but in terms of 2017, as the year progressed, ASW continued to do better, and we're quite confident that, given a few months, we'll be able to fill the hole that was created in January when the one customer I mentioned shut down. Mike, do you have any —

Michael McAuley
Yeah, John, I'd just say, to add to what John just said, that ASW, we acquired the business at the very beginning of November of last year, so part of what I was describing in my remarks was just the full quarter or full period effect of ASW being one piece. But ASW sales have grown significantly from the timeframe when we acquired them. And another important key factor is that in addition to its trade sales of steel to customers, it's a very valuable contributor on an intercompany basis to providing a significant load into Union Electric Steel for the production of our forged engineered products, primarily frac blocks and some other products. So there's a heavy internal sales demand on that business, and it's a very important part of the supply chain we've built for the oil and gas end market.

John Walthausen
Good, that's very helpful. I was wondering whether it wasn't just external sales that you were quoting there, and that's good to hear.

The second question is when I look at the fourth quarter versus the third quarter, you gained sales, I think, of a bit more than $10 million, but only if I take out some of the extraordinary things, only about a million dollars more operating income, which would strike me that for your businesses, the incremental margin should be more like a 30 percent type thing. So I'm guessing part of that is the November issues that you talked about and some is the pricing, the raw material versus pricing squeeze, but can you break down what the relative effects of those two things were in that lack of margin improvement?

Michael McAuley
Yeah, John. Yeah, on a sequential basis, Q4 versus Q3, first, the incremental margins aren't quite at that level that you mentioned, number one. Number two, you're right, the operating problems that we had, especially those John indicated in his remarks that were especially evident in November, caused some under-absorption, much more so than in the prior quarter, and that was a key factor. Raw materials just crept a bit in Q4 versus Q3, but most of the rise in the raw material effect for the full year had occurred around, and peaked out, in Q3. There was a slight creep in Q4, so that was a part of it but a lesser part of it.

John Stanik
But if you think about it, if the cost increase is $4 million, so let's assume that the run rate's around a million, and then the added expenses with the maintenance repairs, as I said in my comments, we had made an operating profit for two of the three months, with November being basically the sole negative factor that produced the $1.8 million operating loss.

John Walthausen
Thank you.

Operator
Again, if you have a question, please press star, then 1.

Our next question comes from Justin Bergner of Gabelli & Company. Please go ahead.

Justin Bergner
Oh, thanks, John. Thanks, Michael. The first question would relate to just if you could review again the timing of the price negotiations, what price increases are taking effect from prior

negotiations? What would be the next round of price increases to take effect for future negotiations? Just the timing of that event would be helpful.

John Stanik
Yeah, typically, the contract negotiation period for the following year begins in April and ends sometime in August or early September. We're experiencing customers wanting to negotiate for periods longer than one year, which I take as a sign that the market is stronger, and they are trying to fix their costs for beyond one year. That's something that we're being very careful about in this year. There is a portion, however, Justin, of our revenue that is not done in the way I just described, and it's more on a spot contract type of basis, where it's not for a period of a year or more. I would say that's a relatively small portion, maybe 20 to 30 percent at most, but certainly the big guys that we deal with, with maybe one or two exceptions, all fall within that three or four month period. So when I say that we're going to be announcing a price increase, we should be announcing that probably by a press release, sometime in the next month or two.

Justin Bergner
Okay, great. That's helpful. And then the price increases from last year's negotiation took effect roughly around January 1st?

John Stanik
Correct.

Justin Bergner
So you —

John Stanik
Yes.

Justin Bergner
Okay, so the pricing book for this year is pretty much set except for that 20 to 30 percent.

John Stanik
Yeah, except the frac block business is roughly a three- or a four-month cycle, so we'll continue to price those — in fact, that's exclusively the case, so it's unlike the roll business. We have opportunities to make adjustments much more frequently there.

Justin Bergner
Okay. Switching to the raw materials, the $4 million year-on-year increase in raw material prices, how does that relate to the one-third, does that include or exclude costs that are recovered by the surcharge mechanism?

John Stanik
It's a gross number, but if you remember from prior calls, we have a time lag of at least six months in our models, so in the third quarter during my call, I had mentioned — I think I did — that I mentioned that we were still paying customer credits in 2017 through the month of October for raw material cost decreases that occurred in 2015 to '16. So we were actually — how do I say this — actually doubling the negative impact. That's over now, and since November, we have flipped, and we are beginning to receive positive contributions related to the surcharge coverage. The fact that we only have two-thirds of our customers now, and that's been a progressing thing — it was less than that prior to the end of the year — considering that we only have two-thirds of those customers, that's still not a good situation for us, and our salesforce is trying very hard to

increase that number somewhere, hopefully, into the 80s, but to answer your question, I think it's in positive territory and should stay there and should increase for the next few months.

Justin Bergner
Okay, that's helpful backdrop. Just, finally, on the tariff issue, you presented a relatively sanguine case for the effect of U.S. tariffs on your European and Asian roll business. If you could just elaborate on that a bit more, and what's the bare case for the effective tariffs on your international business?

John Stanik
Well, there's really only one negative, potentially. Forget Canada for a moment. I think that's going to be safe for a while, and none of us know how long, but going back to the fact that a lot of our hot mill rolls are produced — the metal for those are produced in Europe, that is the negative. So how can this company respond competitively to eliminate the tariff or in some way improve its financial performance? And the obvious answer may be the Pennsylvania plant that's idled, which we could reactivate, restart, and take a bunch of new business. It would have somewhat of a negative impact on one of the plants in Europe, but it would certainly help the financial situation that we had in 2017 with respect to that plant.

The problem that we have there is this really damaging union contract that's been in place since we bought the facility, and the reluctance of the rank and file to adjust, so it becomes a question of economics, what is the best operating scenario for the company, where can we make the most money? Is that with the Pennsylvania plant restarting its melting facility and producing the rolls, or is it with the European facility continuing to make the metal, us paying the tariff and generating operating income?

Justin Bergner
Got it. And then are you worried about decreased demand for forged and cast rolls for the international customers if the production of steel in those international markets is affected by U.S. tariffs?

John Stanik
Well, roughly one-third of the rolls that are consumed in the United States come from Europe, excluding us, they're coming from two or three countries over there. So the tariff will make it more difficult for them to be competitive, and that should be a positive for us.

I was just passed a note, Justin, that we're not certain that the tariffs will apply to finished parts, so the rule being new is still subject to interpretation, and we don't have a final judgment yet, but if what I just said is accurate, then the answer I provided on our European competitors would also not apply, and the competitive situation would be pretty similar to what it is today.

Justin Bergner
Got it. So that's very helpful. So basically you think you have a more U.S.-centric footprint than the bulk of your competitive set as it relates to U.S. demand?

John Stanik
Absolutely. We believe that we have the greatest capacity to supply in this country than our competitors.

Justin Bergner
Okay, thanks for taking all my questions.

John Stanik
You’re welcome.

Operator
Our next question is a follow-up from John Walthausen of Walthausen & Co. Please go ahead.

John Walthausen
Hi, yes, thank you. I wanted to switch over to the new model of rolls that you introduced, and I was wondering how many rolling mills are those actually operating in now and what the expectations for the mill operators are of those rolls.

John Stanik
Well, typically, most customers will go through a trial period before they commit such an important high-cost operation to something new, but we have more than a dozen mills running on those rolls already, and they’ve only been commercialized a short period of time ago. So that tells me that there’s a great interest in our claims and proving that those claims are correct, which we’re, of course, convinced they are.

John Walthausen
And those claims are basically longer lasting primarily, or is it also getting a more precise thickness?

John Stanik
Well, I think they’re one in the same. Longevity without surface marks on the steel product is what the key is, but I think there are also advantages to taking the roll out of service for refinishing less frequently, so not only is the roll lasting longer overall, but it’s lasting longer from refinishing to refinishing, if you understand what I’m trying to say.

John Walthausen
Yeah. No, no, exactly. I understand precisely, yes. I grew up in [Unintelligible] after all, so —

John Stanik
Oh, okay.

John Walthausen
How long will it take before we know whether those dozen mills that are running are getting the results that have been promised?

John Stanik
Well, first of all, we have a bunch of data from the trials that have been ongoing for, I want to say, more than a year, but it would probably — I can’t really give you a good answer, John. It would probably be different from customer to customer. This is the finishing end. It would depend on what the specific customer’s experience was with the rolls they used previously in terms of the time between refinishing the roll. And I don't really know off the top of my head what the longest service of those 15 or so mills is.

John Walthausen
Okay, that’s helpful. And then in making these rolls, is it complicated enough so that it will take us a while to get full efficiency in producing those so that we can get our costs down to where we want to, or is that a correct assumption, and can you put some timeframe around that?

John Stanik
No, I think we're pretty adept at making those rolls now, unless you're just talking about the general issue that we're having with maintenance. Is that what are you —

John Walthausen
No, no. Not specifically, just the learning curve in making the product.

John Stanik
I think the learning curve is behind us.

John Walthausen
Good. Well, that answers my question. Thanks.

Operator
Our next question comes from Timothy Chatard of Quantum Capital Management. Please go ahead.

Timothy Chatard
Hi, I think in prior calls there was some discussion about the effort to develop some new product within the forged segment outside of the frac block area, and I'm just trying to see if there's any update there with anything.

John Stanik
Well, there's two areas there. One is the ongoing R&D efforts, which are twin alloy efforts for forged rolls. That's one area. And those are in the backseat, so to speak, when compared to hot mill cast rolls. The second is the diversification into the open-die forged product area, and the only thing I can really say right now is that we continue to put more product into different industries. These are generally small numbers, so we're talking probably somewhere in the area for '17 of less than $10 million of sales, excluding blocks of course. And we expect that number to grow. We have some prospects that we may be close to announcing here within the next couple of weeks, but it's a process, and it does take some time, and every quarter I will continue to update that situation. If we have any breakthrough orders, you'll see press releases on those that will publicize us getting into new markets, et cetera.

Timothy Chatard
Can I ask one question on a big picture level? Looking at the business broadly, going back to the prior cycle, prior to the financial crisis, so the last time we had strong steel markets, the business was operating high 20s, low 30s gross margins. Obviously the business hasn't approached those levels in recent years, but I'm wondering, especially with the new product introduction, the VICTURA, and other follow-on products that might come from that that I think have been implied to be better gross margins than the existing portfolio, is there a reason structurally why this business is a 20 percent gross margin business today at its peak as opposed to high 20s to low 30s? Can it approach those levels that you had in the past, or is there any reason to change those ranges?

John Stanik
Not today, to answer your last comment. I think that this business and our competitors are all struggling with a multiple-year — six or seven year decline in consumption of rolls, the fact that our customer base was in financial distress during that period of time, and we were compelled to lower prices and lower prices and lower prices some more. So we're trying to heal and recover

that margin, that price. I think that the company has, and I'd venture to say all of our competitors also, have done a great job with getting blood out of the stone from a cost standpoint, but those types of methods eventually run out.

So it's going to take a little bit of time. When you release a product like VICTURA, we expect our margins to be beginning of cycle, if you know what I mean, from a new product standpoint, so we would expect to be earning margins higher than the ones you mentioned going back to the first decade in the century, the higher than 30 percent. That's my aspirations for the new product, and to roll out three of those in the next 18 months and, hopefully behind that, a forged roll, I think gives us a really strong potential for the future.

Timothy Chatard
Thank you.

CONCLUSION

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to John Stanik for any closing remarks.

John Stanik
Yeah, thank you. I have just a few. I won't repeat the comments that I provided during my presentation, of course, other than to say Ampco-Pittsburgh Corporation is growing. Our bench is deepening, our strategic plan is working, our margins are increasing, and it's an exciting time for the employees and the corporation. I continue to feel very good about what we've accomplished in the past three years, and I look forward to this company continuing to realize its full potential with respect to sustaining growth and profitability. I thank everyone for your time and wish you a great remainder of your day. Goodbye.

Operator
This conference has now concluded. Thank you for attending today's presentation. You may now disconnect.