WEBCO INDUSTRIES INC
Form 10-K
October 29, 2004

Table of Contents

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended July 31, 2004

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from __________to__________

Commission File No. 0-23242

WEBCO INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

Oklahoma	73-1097133
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

9101 West 21st Street
Sand Springs, Oklahoma 74063
(Address of principal executive offices, including zip code)

Registrant s telephone number, including area code (918) 241-1000
SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT: None
SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:

Common Stock, par value $.01
(Title of class)

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). [ ] Yes [X] No

As of October 1, 2004, the aggregate market value of the voting stock held by non-affiliates of the registrant was $13,700,000.

On October 1, 2004, the number of shares outstanding of the registrant s common stock, $.01 par value, was 7,081,723 shares.

DOCUMENTS INCORPORATED BY REFERENCE: None

1

WEBCO INDUSTRIES, INC. AND SUBSIDIARIES

TABLE OF CONTENTS

2

Table of Contents

WEBCO INDUSTRIES, INC. AND SUBSIDIARY
FORM 10-K

PART I

ITEM 1. BUSINESS

General

Webco Industries, Inc., an Oklahoma corporation, was founded in 1969 by F. William Weber, Chairman of the Board and Chief Executive Officer. Webco is a manufacturer and value-added distributor of high-quality carbon steel, stainless steel and other metal tubular products designed to industry and customer specifications. Webco s tubing products consist primarily of pressure tubing and specialty tubing for use in durable and capital goods including heat exchangers, boilers, autos and trucks, and home appliances. The Company has three production facilities in Oklahoma and Pennsylvania and five distribution facilities in Oklahoma, Texas, Illinois and Michigan, serving more than 1,000 customers throughout North America.

The Company s philosophy is to pursue growth and profitability through the identification of niche markets for tubular products where the Company can use its leading-edge manufacturing and information technology to provide a high level of value-added engineering and customer service in an effort to become the market leader.

Unless the context otherwise requires, the information contained in this report, and the terms Webco and the Company when used in this report, include Webco Industries, Inc. and its subsidiaries, Webco Tube, Inc. and Phillips & Johnston, Inc. (P&J), on a consolidated basis.

Recent Events

On June 1, 2004, Webco announced that a Special Committee of its Board of Directors, comprised of three independent directors, had been formed to evaluate a proposed reverse stock split of the Company s common stock that would result in Webco having fewer than 300 common stockholders of record and thereby permit Webco to deregister its common stock under the Securities Exchange Act of 1934 (the 1934 Act). This announcement was made after months of evaluating alternatives by the full board of directors, including the input from legal and financial advisors, of the benefits and detriments to the Company and its stockholders of remaining a public reporting company, which lead to the choice of going private.

On June 25, 2004, the Company announced that the Special Committee and the full Board of Directors had unanimously approved an amendment to the Company s Certificate of Incorporation which, if approved by the Company s stockholders, would allow the Board of Directors in its discretion to select one of five alternative reverse/forward common stock splits. If the reverse/forward split is effected, Webco would likely have fewer than 300 shareholders of record. If that is the case, Webco would deregister its common stock under the 1934 Act and its stock would cease to be quoted on the American Stock Exchange.

The proposed amendment to the Company s Certificate of Incorporation for the reverse/forward common stock split will be submitted to the stockholders of the Company for their approval at a Special Meeting to be held on a date yet to be determined. A Notice of the Special Meeting and a related Proxy Statement that describes, among other things, the reasons for and the effect of the reverse/forward stock split, will be sent to Webco common stockholders of record entitled to vote at the Special Meeting. The Board of Directors has not yet determined the record date.

3

Table of Contents

Industry Overview

Over the past several years, the steel industry in the U.S. has been characterized by changing customer demand, foreign competition, domestic manufacturing overcapacity, and government influence on raw material and finished good import prices. During the last twelve months, a significant demand for steel in China as well as disruptions in the supply of steel making inputs has caused a lack of domestic availability for certain types of steel, primarily carbon steel. The declining value of the U.S. dollar to foreign currencies has contributed to this market condition, primarily by reducing foreign imports and increasing domestic exports. A lack of availability and high-cost of steel-making inputs such as coke, scrap metal and energy has created an environment where steel sheet coil, primarily carbon, is dramatically increasing in cost. Over the past several quarters, carbon steel coil producers have raised their prices and placed surcharges on their products that have greatly increased the replacement cost of carbon steel. The lack of availability of steel and the related mitigation of the excess manufacturing capacity in the tubing industry has also created an enhanced pricing environment for steel tubular products as customers are not able to source products at more competitive prices from alternative suppliers.

In dealing with the current environment, management has passed along to customers as many raw material price increases as possible, including surcharges. The Company has agreed-upon pricing with some customers on certain products and as the Company s supplier arrangements for these products are modified for surcharges or base price increases, management attempts to pass on price increases to the extent possible. The increased sales prices for the Company s products, which are reflected in the Company s financial statements for the last two quarters of fiscal 2004, were matched against lower average-cost carbon steel coil inventories resulting in a significant gross profit increase in the third and fourth quarters of fiscal 2004. The Company does not believe that the earnings attributable to selling from lower average cost inventories is sustainable, since the average cost of inventories will increase as inventory is replenished with steel purchased at the current replacement cost. An increase in the availability of steel could act to decrease selling prices and depress margins since the Company would have high-cost inventory.

Over the years, Webco has forged solid and loyal relationships with its steel suppliers. These relationships have, in most circumstances, secured the availability of carbon and stainless steel in sufficient quantities to satisfy customer requirements during this recent period of reduced supply. There can be no assurances, however, that the Company s carbon and stainless steel requirements will continue to be met, which, if not met, would negatively impact sales and income from operations and cash flows.

Tubing producers occupy a manufacturing niche between the primary steel producers and customers who utilize precision tubing in the manufacture of products primarily for the durable and capital goods industries. As contrasted with commodity pipe producers, tube mills manufacture products which are engineered and tailored for more specialized and critical end-use applications such as automotive components and petrochemical applications.

The tubing industry was once dominated by the major integrated steel producers. Over time, these integrated producers lost their competitive advantage due to higher cost structures and lagging technology and have largely withdrawn from this segment. During the late 1990 s, many tubing manufacturers added significant capacity. While the industry has experienced some consolidation over the last several years as less efficient producers were rationalized, the industry continues to be subject to significant competition and pricing pressure in the absence of a shortage of steel coils in the market. The tubing industry is highly fragmented and is comprised of independent producers that occupy relatively focused market niches.

While the Company does not expect the current favorable pricing environment to continue indefinitely, the tubing industry has been affected by several trends that are expected to continue for the foreseeable future. First, customers increasing emphasis on just-in-time inventory methods has required tubing producers to increase operating efficiencies to accommodate more frequent, smaller sized orders, and has placed greater

Table of Contents

emphasis on technology advances, inventory management and cost controls. Second, customers desires to cut operating costs through the outsourcing of specific processing functions, such as tube manufacturing, has created the opportunity for third-party tubing producers to replace production from captive mills.

TUBING MANUFACTURING PROCESSES

Manufactured Products

Electric Resistance Carbon Steel Weld Process: The Company maintains inventories of carbon steel sheet coils weighing approximately 15 to 25 tons from which it manufactures tubing using electric resistance welding. All customer orders for manufactured products are entered into a computerized order entry system, and the appropriate steel coil is selected from inventory and scheduled for processing in accordance with the customer s delivery date and product specifications. The Company attempts to maximize efficiency by combining orders to optimize mill production and by ordering the size changes in a manner that reduces the amount of setup time necessary to move from one order to the next.

The manufacturing cycle begins with the slitting of wide steel sheet coils into narrower bands. As the steel coil is unwound during the manufacturing process it is in the form of a continuous sheet, typically 48 to 60 inches wide and between .049 and .500 inches thick. The outside diameter of the tube to be produced determines the width of the slit band. Steel coils up to .180 and .250 inches thick are slit to pre-designated widths at the Sand Springs and Oil City facilities, respectively, using Company equipment. Steel coils over those limits are slit by outside vendors. Conversion from slit band to tubes is accomplished by (i) continuously roll forming into the desired tubular diameter; (ii) continuously welding the edges; and (iii) cutting to approximate finished length or multiples thereof. After the tube has been welded, and depending upon product specifications, it may be moved to additional processing stations such as annealing (heat treatment through an atmospherically controlled roller hearth furnace), rotary straightening, and finishing (i.e., cut-to-length, non-destructive test, stencil, oil coat and package). The Company also utilizes outside vendors for certain value-added processing. The Company has stringent quality control standards in place at each stage of the manufacturing process.

This process produces welded tubing and cold draw hollows (the raw material for the cold drawing process, which does not go through the finishing process). Hollows are primarily used for specific cold draw orders; however, smaller amounts are produced for inventory.

Carbon Steel Cold Drawing Process: The Company uses manufactured cold draw hollows and seamless tube hollows purchased from outside vendors as the raw material for the cold drawing process, which produces various tubing products. Most of the welded hollows are manufactured by the Company s own weld mills, while seamless hollows are all purchased from other manufacturers. The Company currently offers precision, made-to-order cold drawn products from approximately .05 inch to .50 inch in wall thickness and from .50 inch to 5.0 inch in outside diameter for various tubing applications. Cold drawing permits greater flexibility and precision (as compared to the welding process) in meeting customer specifications of tube diameters, wall thickness and other characteristics.

Cold drawing orders are entered into a computerized order entry system. Tube hollows are selected to optimize yields and efficiency and to meet the customer s specifications and required delivery schedule. After the proper material has been selected for each specific order, it is cut to the desired length. The tube is then (i) pickled and lubricated, (ii) pointed to taper the tube end, and (iii) cold drawn through a die and over a mandrel (cold reduction of outside diameter, inside diameter and elongation of tube). After the cold drawn tube has been manufactured to finished size, it is moved to additional processing stations such as annealing, straightening and finishing. The Company also utilizes outside vendors for certain value-added processing.

5

Table of Contents

Welded Stainless Tube Process: The manufacturing cycle for the stainless steel and high alloy weld mill operations begins with customer orders being entered into the computerized order entry system. After receipt of steel coils slit to a pre-designated width by the vendor, slit coils are selected and fed into the stainless weld mills to be formed into a tubular shape and welded by an automated gas or laser welding process. Tubes are then annealed, cooled, straightened, stenciled, non-destructively tested, cut to length and packaged for shipment. For some special customer requirements, the tubing is coiled to lengths up to 40,000 feet. Much of the processing is performed in a continuous operation. The Company also utilizes outside vendors for certain value-added processing. Stainless processing produces welded tubing for a variety of applications and small diameter stainless pipe. The majority of stainless products are made-to-order.

Tubing Facilities

The Company has three manufacturing facilities for producing carbon or stainless steel tubing products. The largest facility is located in Sand Springs, Oklahoma, which produces a wide range of carbon steel tubing products. This facility has been in operation since the Company began in 1969. The Company also has a facility in Oil City, Pennsylvania, which produces carbon steel tubing products. The third facility in Mannford, Oklahoma, produces stainless steel and high alloy tubing products.

The following table sets forth the processing and other techniques performed at Webco s facilities:

	Manufacturing			Distribution				
	Sand Springs, OK	Oil City, PA	Mannford, OK	Sand Springs, OK	Nederland, TX	Lyndon, IL	Grand Rapids, MI	Glen Ellyn, IL
Cold Drawing	X	X						
Slitting	X	X						
Welding	X	X	X					
Annealing	X	X	X	X	X			
Straightening	X	X	X					
Cut-to-Length	X	X	X	X	X	X	X	X
Integral Finning				X				
Electronic Non-Destructive Testing:								
Eddy Current	X	X	X					
Ultra-Sonic	X	X	X					
Hydro-Static Testing	X		X	X				
Stenciling	X	X	X					
Bending			X	X	X		X	
Bar Coding	X	X	X	X	X	X	X	X
Computerized Shop Floor Control	X	X	X	X	X			
Metallurgical Lab	X	X	X					
Spectrometer	X							
Statistical Process Control	X	X	X					

INDUSTRY SEGMENTS

The Company applies the provisions of Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information"(FAS 131). The Company internally evaluates its business by facility; however, because of the similar economic characteristics of the tubing operations, including the nature of products, processes and customers, those operations have been aggregated for segment determination purposes. The Company s continuing operations only include activities related to the manufacturing and distribution of tubular products principally made of carbon, stainless and high alloy steels.

Table of Contents

PRODUCTS

Tubing Products

The Company produces tubing for a wide variety of markets and end-use applications. The Company seeks to identify niche markets and customers that have been serviced by higher cost and lower service competitors. The percentage breakdown of net sales for the Company s main products was as follows for the last three fiscal years:

	2004	2003	2002
Specialty tubing	65%	64%	59%
Pressure tubing and pipe	31	32	38
Freight, scrap and other	4	4	3
Total	100%	100%	100%

Following is a detailed description of the Company s tubing products by the major end-use markets:

Specialty Tubing: Specialty tubing consists of tubular goods made of carbon and stainless steel, copper, brass, aluminum and surgical steel. Most of the products the Company manufactures from its cold draw processes are for specialty tube applications. Through its manufacturing capabilities and its sourcing partners, the Company provides tubing to a variety of end use applications. These end-uses include, but are not limited to the following durable and capital goods: instruments for the petrochemical industry, hydraulic cylinders, automotive components, appliances, oil & gas applications, heating and ventilation and farm equipment. In many cases, the Company provides just-in-time inventory management for its customers using its combined manufacturing and distribution capabilities and through strategic relationships with distribution customers and partners. The Company is a relatively small producer in the overall specialty tubing market, but continues to pursue niche opportunities for growth.

With enhanced stainless manufacturing technology and investments in Oil City, the Company has targeted the specialty tubing market as a growth area over the next several years. While the Company continues to identify niche growth opportunities with improved product offerings, available manufacturing capacity is limited and would require significant capital investment to increase substantially. This market continues to undergo a major change in which final assembly manufacturers (automotive, appliance, etc.) outsource component parts and emphasize just-in-time inventory management to reduce production costs. Webco believes that this market, which is largely comprised of original equipment manufacturers (OEMs), provides an opportunity for the Company to gain market share by utilizing its technological capabilities to offer superior quality, on-time delivery, customer service, and customized products at competitive prices.

Pressure Tubing and Pipe: The Company is a full service manufacturer and value-added distributor of pressure tubing and pipe, which includes tubing utilized in heat exchanger, boiler and piping applications. The Company supplies a variety of pressure tubing and pipe products to the refining, petrochemical, chemical, pulp and paper, pharmaceutical, gas transmission and electric power industries. These industries are serviced by the Company s three manufacturing and two distribution facilities in Oklahoma, Pennsylvania, and Texas. Through its manufacturing facilities and sourcing partners, the Company offers carbon steel, alloy steel, stainless steel, copper, brass, nickel alloy and various other tubular products to these industries. Such products may be welded or seamless and may be cut, bent and/or finned to customer specifications at the distribution warehouses. The Company believes that its combination of manufacturing and distribution capabilities for carbon steel, alloy steel and stainless steel provides a strategic advantage over its competitors.

Table of Contents

The pressure tubing and pipe industry has been impacted by the world-wide demand for steel and the related lack of availability of carbon steel in particular. This has caused a dramatic increase in the price of domestic carbon steel coils in the last twelve months, the raw material for the Company s carbon steel tubes. Other types of steel have been similarly affected, although not to the extent of carbon. The raw material environment has caused pressure tubing margins to increase as current selling prices are based on the replacement cost of steel matched against lower average cost inventories. During this period, the Company has continued to develop and expand its distribution capabilities and expects to relocate from its 58,000 square foot Nederland, Texas, facilities in November 2004 to a leased 125,000 square foot, value-added pressure tube distribution facility in Orange, Texas. The Company is also working to expand its product offerings to the pressure tubing markets, not only in welding of carbon and stainless pressure tubing, but in pressure tubing acquired from outside sourcing partners. The Company believes that these development activities have positioned it to take advantage of growth opportunities that might be caused by our customers compliance with Federal regulations regarding refinery emissions and a possible resurgence of power plant construction should such events occur.

Quarterly Effects and Seasonality

Order rates generally tend to be lower during mid-summer and December as many of the Company s customers schedule plant shutdowns for plant maintenance. In addition, the Company experiences some seasonality in stainless products during its third fiscal quarter, which may result in reduced net sales and income for those periods.

Backlog

The Company s firm backlog of orders at July 31, 2004 and 2003 were approximately $53 million and $34.5 million, respectively. Orders, including a portion of the orders considered firm, are generally cancelable by the customer until work has commenced and the Company has committed resources; thereafter, orders are generally cancelable by the customer only upon payment of a cancellation penalty, which may include costs for raw materials, tooling, engineering, etc. The Company s backlog is not necessarily indicative of the expected level of future revenues and can be affected by product mix, since the different markets served by the Company have differing lead times and order flow processes.

Competition

Tubing manufacturing and distribution is a highly competitive market. Foreign imports and the ability of tubing customers to move facilities to foreign countries can decrease demand for domestically manufactured tubing. Companies compete on the basis of price, quality, service and ability to deliver orders on a timely basis. Public data concerning the size of the markets in which the Company participates is not readily available since almost all of the large competitors are privately held or do not provide detailed segment disclosures of their tubing activities. The Company believes that it is a domestic leader in the manufacture and distribution of pressure tubing and certain stainless steel and high alloy tubing products. The Company believes that its manufacturing and distribution capabilities provide a strategic advantage over its competitors. Although the Company has a small share of the overall specialty tubing market, management believes that it is well positioned to increase its market share over the next several years by continuing to focus on niche applications.

The Company s major competitors include Associated Tube of Canada, Copperweld, Dofasco, Lone Star Technologies, Metalmatic, Plymouth Tube, PTCAlliance, Rath/Gibson Tube and Tubes, Inc. for specialty and pressure tubing products. Some of these competitors are larger and have access to greater financial resources than the Company. Most of these competitors are unionized. Most of these competitors are privately held corporations and are not required to disseminate information to the public about financial results.

While competition is always present, the current lack of availability of steel in the domestic marketplace has largely mitigated excess industry capacity and made it a difficult environment for tubing manufacturers to

Table of Contents

add new customers with competitively priced products. Until steel availability improves, enhanced selling prices are expected to continue and producers with the ability to obtain steel will have a competitive advantage.

The Company believes that its non-union status, geographic balance, focused niche strategy, product quality, information technology, customer service and continued emphasis on technological innovations position it to compete effectively within each of its niche markets.

Quality Control

The supply of quality products and service is critical to the Company s success. To help foster continuous improvements in quality and service, the Company adheres to a total quality management system based upon ISO 9000 quality system standards. In support of the total quality management system, the Company has created an environment that emphasizes and utilizes teamwork to support continuous improvement of quality and service. The following table summarizes the Company s quality certifications for each of its facilities:

Location	Certification	Year Achieved
Sand Springs, Oklahoma manufacturing facility	ISO 9002	1994
	QS 9000: 3rd ed.	1998
Oil City, Pennsylvania manufacturing facility	ISO 9002	1994
	QS 9000: 3rd ed.	1998
Mannford, Oklahoma manufacturing facility	ISO 9001:2000	2003
Phillips & Johnston facilities	ISO 9001:2000	2003

Fundamental to the Company s quality system is the control of the product and process, from raw material procurement to the ultimate delivery of finished goods to the Company s customers. On a test basis, physical and chemical analyses are performed on raw materials to verify that their mechanical and dimensional properties, cleanliness, and surface characteristics meet Company and industry requirements. The Company has also developed stringent process controls including Statistical Process Control, non-destructive testing methods, and standardized operating and inspection procedures to provide assurance of quality and to ensure that the customer s requirements are met throughout the manufacturing process.

Suppliers

The Company purchases steel sheet coil from a number of primary steel producers including, but not limited to, Nucor, Wheeling-Pittsburgh Steel Corp., ISG, Duferco, Steel Technologies and Gallatin Steel for carbon steel, and Allegheny, North American Stainless and Outokumpu for stainless steel. Webco monitors and purchases some raw material from foreign sources as economic conditions dictate. However, the greatest percentage of Company purchases is from domestically located plants and suppliers. The Company orders steel to specified physical characteristics and chemistry. By purchasing in large quantities at consistent predetermined intervals, Webco is able to obtain quality raw materials at competitive prices. All increments of the cost of purchasing and landing steel are continuously monitored, reviewed and acted upon. Interruptions in supply from its main suppliers could impact the landed cost of new purchases and/or cause production and delivery delays.

The Company also purchases finished welded and seamless tubing made from carbon and stainless steel, copper, brass, aluminum and surgical steel from foreign and domestic sources as economic conditions and customer demand dictate. The Company orders the tubing to specified physical characteristics and chemistry based on industry and customer specifications. Webco believes that it is not dependent on any one of its suppliers for finished goods, however, interruptions in supply could impact customer deliveries and the cost of new purchases.

Webco understands that the Company s supplier base for materials is critical to meeting its customers needs. Constant effort is directed towards developing long-term supplier partners who can provide acceptable quality, competitive prices and dependable delivery.

Marketing and Customer Service

The Company s sales and marketing efforts for its products are directed by the Senior Vice President of Tubing Operations, the President of P&J, and Webco s product sales managers. These efforts are supported by its distribution organization, internal and external sales staff and technical services group. The Company also emphasizes the use of its technical and engineering support staff in its product development and marketing efforts. The Company s technical services, operating, engineering, quality, sales, product planning and purchasing staffs work closely with customers and suppliers to develop products that meet specific customer needs. Variables in the product development process include the steel s microstructure, chemistry, mechanical properties, surface finish, machinability, and product consistency. The Company believes this process is essential to its sales effort and provides the Company with a competitive advantage.

Customers and Distribution

The Company manufactures and distributes tubular products for sale to a diverse group of more than 1,000 customers. No single customer represents in excess of 6% of the Company s net sales. The Company s ten largest customers represent approximately 24% of net sales. The majority of the Company s sales are made directly to industrial customers, including manufacturers of heat exchangers, HVAC equipment, appliances, automotive components, power generation equipment, waste heat recovery systems, industrial and commercial boilers, and other durable goods.

While the Company ships product throughout North America, many of its markets and customers are located within a 500-mile radius of its manufacturing and distribution locations. As it concerns these markets and customers, this geographic advantage places the Company in a more cost competitive position relative to many of its competitors. The Company transports product for local delivery via Company-owned or leased vehicles. Longer distance deliveries are generally made via independent trucking firms.

The Company offers its finished product for shipment directly from its three manufacturing locations. In addition, the Company also inventories finished goods and functions as its own value-added distributor for some of its markets. Such markets and customers are served on a just-in-time basis from the Company s distribution locations in Oklahoma, Texas, Illinois and Michigan. Finished goods inventories for distribution generally are suitable for sale to many customers and generally are not unique to a specific customer s needs.

The Company believes that its long-term relationships with many of its customers are a significant factor in its business and that pricing, quality, service and the ability to deliver orders on a timely basis are the most critical factors in maintaining these relationships. Company executive officers actively participate in the Company s marketing efforts and have developed strong business relationships with senior management of many of the Company s principal customers.

Government Regulation

The Company s manufacturing and distribution facilities are subject to many federal, state, and local requirements relating to the protection of the environment. The Company continually examines ways to reduce emissions and waste and reduce costs related to environmental compliance. The Company has an in-house environmental team leading the Company s environmental program. The Company s Sand Springs manufacturing facility is ISO 14001 certified for its environmental processes and procedures. Management s philosophy is to implement environmental controls that meet or exceed current and foreseeable legal

10

Table of Contents

requirements. Management believes the Company is in material compliance with all environmental laws, does not anticipate any material expenditure to meet environmental requirements, and generally believes that its processes and products do not present any unusual environmental concerns.

The Company s operations are also governed by laws and regulations relating to workplace safety and worker health, principally the Occupational Safety and Health Act and regulations there under which, among other requirements, establish lifting, noise and dust standards. Management believes it is in material compliance with these laws and regulations and does not believe that future compliance with such laws and regulations will have a material adverse effect on its results of operations or financial condition.

The Company is subject to the regulatory and reporting requirements of the Sarbanes-Oxley Act of 2002. Management believes it is in material compliance with the provisions of this Act at this time. Management does anticipate, however, that current and future compliance with such provisions, including the Section 404 certification of internal controls by management and attestation by the Company s independent auditors, will result in significant increases in consulting, audit and legal fees and overhead expenses related to software, hiring new personnel and administrative time. The total cost of the Company s compliance with the requirements of the Sarbanes-Oxley Act is uncertain, although the most costly provisions will be related to the Company s first Section 404 compliance year ending July 31, 2005. However, management believes such compliance costs could exceed $735,000 during the twelve months leading up to July 31, 2005 and could exceed $570,000 for each succeeding year thereafter. These costs are in addition to the approximately $330,000 in costs historically incurred being a public company. Such compliance cost estimates are incremental to current general and administrative expenses and do not include the opportunity costs associated with the time and effort of current employees and management, which is expected to be significant. These estimates are consistent with a survey conducted by Financial Executives International (FEI) in January 2004. A recent update to that survey by FEI found that actual costs are running 40% above the amounts estimated in January by surveyed companies.

Employees

As of September 30, 2004, the Company employed approximately 860 people. None of the Company s employees are covered by collective bargaining agreements. The Company has never experienced a significant work stoppage and considers its employee relations to be good.

Key-Man Insurance

At July 31, 2004, the Company does not have any outstanding key-man life insurance policies on any of its executives or directors.

FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report, including statements preceded by, or predicated upon the words anticipates , appears , believes , expects , hopeful , plans , should , would or similar words constitute forw statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of the Company, or industry results, to differ materially from any future results, performance or achievements expressed or implied herein. Such risks, uncertainties and factors include, among others:

General Economic and Business Conditions

Many of the Company s products are sold to industries that experience significant fluctuations in demand based on economic conditions or other matters beyond their control. No assurance can be given that the Company will be able to increase or maintain its level of sales in periods of economic stagnation or downturn, government regulation, war, terrorist attack or other potential disruptions. Furthermore, no assurance can be given that the Company will not incur significant losses on accounts receivable or inventory as a result of unanticipated events or an economic downturn.

Competition from Imports

The volume and pricing of imported tubular products significantly impacts the domestic tubular products market. The relative strength of the U.S. Dollar to foreign currencies, lower labor costs in other countries and volume motives of some foreign importers could create circumstances where domestic product pricing at competitive levels is marginally profitable or even unprofitable. The Company believes that import levels and import pricing are affected by, among other things, the strength of the U.S. Dollar, overall world-wide demand for tubular products and raw materials, global economic conditions, the trade practices of and government subsidies to foreign producers, lower labor costs in other countries and the weakness or absence of governmentally imposed trade restrictions or tariffs in the United States. Given the uncertainty in the U.S. economy and certain economies of Asia, South America and Eastern Europe, competition from foreign imports is expected to increase in the future. Decreases in the strength of the U.S. Dollar will need to be sustained for more than a short period of time in order to meaningfully affect the advantages most foreign importers have over domestic manufacturers.

Changes in Manufacturing Technology

Over the past several years, there have been significant advances in the technology relating to the manufacture of carbon and stainless steel tubing. Such advances have impacted the speed at which tubing can be manufactured, the quality of the tubing, and the types and thickness of materials that can be welded into tubes. Staying current with advances in manufacturing technologies is necessary to survive as a competitor with other domestic producers and foreign imports and to be able to meet the increased demand by customers for products having greater technical requirements. Staying current with advances in manufacturing technologies and capabilities requires investment of capital. Manufacturers that do not keep pace with current manufacturing technologies may be unable to compete against more efficiently priced products. Due to the volatility of the domestic steel industry in recent years, there can be no assurances that Company operations, capital availability and economic conditions will continue to allow the Company to maintain current technologies or to meet the demand for products that require improved technologies.

Banking Environment

In the course of managing the United States economy, the Federal Reserve affects policy that impacts the cost and availability of money within the U.S. banking system. These policy decisions, along with the quality of the economy, have a direct impact upon bank credit policies and the cost of funds to the Company. Continued tightening of credit availability or increases in interest rates could negatively impact the Company s ability to refinance its debt upon maturity or to refinance at terms that are equal to or more favorable than the current debt structure. Increases in interest rates could materially impact results of operations and cash flows at current debt levels.

Relocation of Domestic Demand and Capacity

The relative strength of the U.S. Dollar to foreign currencies has caused, in many industries, a flight of manufacturing capacity to countries where there exists an economic advantage over U.S. manufacturers. As a result, certain competitors may have an economic advantage over the Company due to the Company s U.S. domicile. Further, the relative strength of the U.S. Dollar has caused many companies that consume tubular products to relocate to other countries or to pursue the economic advantage of using suppliers located in foreign countries, potentially causing a reduction in domestic demand for products manufactured by the Company.

Raw Material Costs and Availability

The Company s largest component of cost of sales is raw material costs. These costs can vary over time due to changes in steel pricing which are influenced by numerous factors beyond the control of the Company, including general economic conditions, world-wide demand for carbon steel sheet coil and scrap, foreign imports, domestic competition, labor costs, labor and environmental laws, import duties and tariffs and other trade restrictions. Tubing companies in the past twelve months have been forced to pass along price increases to customers in order to sustain their economic viability. There is a relatively small correlation between the short-term factors driving the finished goods pricing of the Company s products and the cost of its raw materials. Unsustainable increases in raw material pricing in some circumstances will affect margins due to the inability to pass such price increases on to customers. There is believed to be a fairly high long-term correlation between the price of raw materials in the tubing industry and the price to the market for finished tubing which the industry has experienced over the past twelve months with sustained raw material price increases. However, reductions in the Company s raw material costs often lag behind pressure on the Company s sales prices or increases in raw material costs may precede increases in the Company s sales prices, if increases are obtainable, thus decreasing the Company s profit margins. Although the Company has long-term relationships with steel coil vendors to hopefully ensure a continued supply of raw material, further price increases could have a significant impact on profitability and operating cash flows if the Company is unable to increase sales prices proportionately. Increasing raw material prices during a period of soft demand for tubular products can have a significant negative impact on margins due to an inability to raise sales prices accordingly. A significant increase in steel availability would likely have the effect of driving down steel costs and could have a similar impact on the selling prices for the Company s products. If such circumstances were to occur, the Company would have higher cost inventory in a decreasing selling price environment, which would have a negative impact on margins and profitability.

High demand for the products of the domestic steel producers, a weakening of the U.S. Dollar or a shut down of a producer that is significant to the market can cause a supply and demand imbalance in the market. In such situations it is possible for suppliers to implement quotas for the allocation of steel to their customers or otherwise affect the Company s ability to procure raw material. Given the current level of domestic supply, there can be no assurances that raw material supplies will not be interrupted. Supplier work stoppages due to labor related issues could also have a significant impact on the available supply and cost of raw materials.

Industry Capacity

The Company and many of its competitors, in both the stainless and carbon steel tubing markets, expanded production capacity over the past decade to the point of over-capacity in many markets, putting downward pressure on pricing. The influx of foreign goods into the U.S. market further pressured prices and margins and forced some in the industry to exit the business. Excess capacity in the domestic tubing industry has been largely mitigated by the lack of availability of carbon steel during the last six months of fiscal 2004, creating an enhanced pricing environment as purchasers of tubing products find it more difficult to source products with alternative vendors that cannot obtain steel coil at cost that will enable them to be price competitive.

Domestic Competition

Tube manufacturing is a highly competitive market in which companies compete on the basis of price, quality, service and ability to deliver orders on a timely basis. The Company has different competitors within each of its markets served, some of which are larger and have greater financial resources than the Company. Sales of some of the Company s products represent a high percentage of the market demand for these products, and could be targeted by competitors.

13

Table of Contents

Loss of Significant Customers and Customer Work Stoppages

The Company sells its tubular products to a diverse group of more than 1,000 customers, the largest of which represents just less than 6% of the Company s 2004 net sales. The loss of any significant customer, or a work stoppage at a significant customer or in an important end-use sector, such as automotive, could have an adverse effect on the Company s operating results. In addition, an increase in strength of the U.S. Dollar, lower labor costs in other countries, foreign government subsidies and volume motives of some foreign importers could create circumstances where customers are lost as a result of their inability to remain competitive causing them to relocate to a foreign country or discontinue operations altogether.

Customer Claims

The Company manufactures tubular products to customer specifications. Company products are used in highly technical applications that require stringent controls over quality and the supply chain. From time to time, customers can, and do, make claims against the Company for quality issues, delivery penalties and repair and replacement costs. There can be no assurances that such claims will not deviate from historical experience and have a material impact on the results of operations and cash flows of the Company.

Technical and Data Processing Capabilities

The Company operates all of its facilities on an integrated computer system, which handles all sales, production, accounting and procurement functions. A failure by the Company s system for an extended period of time, or the Company s failure to find adequate solutions to any technical and data processing issues that may arise, could result in a significant interruption to the Company s operations. The Company expects to increasingly utilize the Internet in its business functions and an interruption in service could result in disruptions to the Company s operations. While employing redundant systems is cost prohibitive, the Company continually evaluates its disaster recovery procedures in an attempt to mitigate such risks and exposures. On an on-going basis, the Company must continue to invest in its information technology capabilities to satisfy increasing customer demands for communication and interfacing requirements. There can be no assurances that the Company will have the capital availability to make all necessary investments.

Insurance costs and availability

The Company maintains property and casualty and liability insurance policies, along with other policies, deemed appropriate for the Company s business environment. The Company s insurance program is evaluated each year by management and an outside insurance broker. Subsequent to September 11, 2001, the Company incurred substantial increases in its insurance premiums, as did most industries, which has forced management to look at coverage options, including, but not limited to, higher deductibles, different coverage levels and new carriers, to try and mitigate the rising premium costs. Management believes its current insurance program is appropriate for its business purpose. There can be no assurances that a significant claim against, or loss by, the Company will not exceed insurance coverage levels, or fall outside coverage limitations, and have a material adverse impact on the Company s operations or financial condition.

Table of Contents

ITEM 2. PROPERTIES

The Company s principal properties presently consist of three manufacturing plants and five value-added distribution facilities. The following sets forth the location, area, and whether the property is owned or leased for all existing facilities:

Location	Area	Owned or Leased
Sand Springs, Oklahoma Manufacturing Facility	281,000 square feet 26 acres	Owned
Sand Springs, Oklahoma Distribution Facility	50,000 square feet 18 acres	Owned
Mannford, Oklahoma Manufacturing Facility	195,000 square feet 13 acres	Owned
Nederland, Texas Distribution Facility	25,500 square feet	Long-term lease with a purchase Option of the greater of 93% of FMV or $475,000
Nederland, Texas Warehouses	32,750 square feet	Month to month leases
Oil City, Pennsylvania Manufacturing Facility	205,000 square feet 8 acres	Owned
Titusville, Pennsylvania Cutting Facility	46,700 square feet	Month to month lease
Titusville, Pennsylvania Warehouse	18,500 square feet	Month to month lease
Sand Springs, Oklahoma Corporate Offices	24,400 square feet	Long-term lease with a Purchase option of $750,000
Sand Springs, Oklahoma Warehouse	13,500 square feet	Long-term lease
Tulsa, Oklahoma Finning Facility	28,000 square feet	Long-term lease
Glen Ellyn, Illinois P&J Corporate Offices And Distribution Facility	12,700 square feet	Long-term lease
Lyndon, Illinois Distribution Facility	33,700 square feet	Long-term lease

Grand Rapids, Michigan Distribution Facility	38,000 square feet	Long-term lease

The Company expects to relocate from its Nederland, Texas distribution and warehouse facilities in November 2004 to a 125,000 square foot facility in Orange, Texas, that is being leased on a long-term basis. The Company considers all of its properties, both owned and leased, together with the related machinery and equipment contained therein, to be well maintained, in good operating condition, and suitable and adequate to carry on the Company s business.

Table of Contents

ITEM 3. LEGAL PROCEEDINGS

The Company is a party to various lawsuits and claims arising in the ordinary course of business. Management, after review and consultation with legal counsel, believes that any liability resulting from these matters would not materially affect the results of operations or the financial position of the Company. The Company maintains liability insurance against risks arising out of the normal course of business.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to Webco security holders during the fourth quarter of fiscal year 2004.

PART II

ITEM 5. MARKET FOR REGISTRANTS COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Price Range of Common Stock

Webco s common stock is traded on the American Stock Exchange (AMEX) under the symbol WEB. At the close of business on October 1, 2004, there were 266 holders of record of Webco s common stock. The quarterly prices of Webco s common stock were as follows:

	High	Low
Fiscal Year 2004:		
Fourth Quarter	$ 5.22	$ 3.60
Third Quarter	5.24	3.54
Second Quarter	4.10	3.10
First Quarter	3.76	2.61
Fiscal Year 2003:		
Fourth Quarter	3.25	2.64
Third Quarter	3.50	2.65
Second Quarter	3.75	2.67
First Quarter	3.80	3.00

Dividend Policy

The Company currently intends to retain earnings to support its growth strategy and reduce debt and does not anticipate paying dividends in the foreseeable future. The Board of Directors may reconsider or revise this policy from time to time based upon conditions then existing, including the Company s results of operations, financial condition, and capital requirements, as well as other factors the Board of Directors may deem relevant. Under the Company s current loan agreement, the Company may not pay dividends without the lending group s consent.

Issuer Purchases of Equity Securities

The Company did not purchase any of its own equity securities during fiscal years 2004, 2003 or 2002 and currently does not have a buyback program in place, which would require authorization by the Board of Directors. See Item 1. Business Recent Events for information with respect to the Company s proposed reverse stock split and related matters.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

The following table presents selected financial information for the Company as of the end of and for each of the five years in the period ended July 31, 2004, which has been derived from the audited Financial Statements of the Company.

The selected financial data should be read in conjunction with the Financial Statements of the Company and notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere in this Form 10-K.

WEBCO INDUSTRIES, INC. AND SUBSIDIARIES
Selected Financial Data
For the Years Ended July 31,
(Dollars in thousands, except per share data)

	2004	2003	2002	2001	2000
Income Statement Data:					
Net sales	$212,527	$175,769	$156,294	$148,279	$142,293
Gross profit	31,380	17,794	18,815	14,932	19,105
Income from operations (2)	14,344	5,468	7,849	2,314	4,822
Income (loss) from continuing operations	7,218	1,918	2,996	(1,494)	536
Loss from discontinued operation (1)			(908)	(108)	(1,561)
Net income (loss)	7,218	1,918	2,088	(1,602)	(1,025)
Net income (loss) per common share basic:					
Continuing operations	1.02	.27	.42	(0.21)	.08
Discontinued operation (1)			(.13)	(0.02)	(0.22)
Net income (loss)	1.02	.27	.29	(0.23)	(0.14)
Net income (loss) per common share diluted:					
Income (loss) from continuing operations	1.01	.27	.42	(0.21)	.08
Loss from discontinued operation (1)			(.13)	(0.02)	(0.22)
Net income (loss)	1.01	.27	.29	(0.23)	(0.14)
Balance Sheet Data:					
Working capital	$ 16,835	$ 11,650	$ 7,218	$ 9,949	$ 12,456
Total assets	145,431	130,527	123,928	128,347	130,123

Long term debt (net of current portion)	8,310	12,100	15,222	25,740	26,306
Stockholders equity	58,456	51,064	49,146	47,046	48,648

(1) The loss from the discontinued operation for all years relates to the operations of QuikWater and the sale of that separate business segment in 2002. See Note 4 to the consolidated financial statements of this Form 10-K.

(2) Fiscal year 2002 includes a $1.58 million litigation award from an equipment vendor.

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Selected Financial Data and the Financial Statements of the Company and notes thereto appearing elsewhere in this Form 10-K.

Executive Overview

The Company benefited from two separate business conditions during fiscal 2004. First, the lack of availability of steel, and the related mitigation of the over-supply condition in the industry, created an enhanced pricing environment for steel tubular products. Second, these enhanced selling prices were matched with lower average-cost inventories. These two conditions are largely responsible for the substantial increases in the Company s sales and income. To a lesser extent, part of the earnings increase was attributable to improved operations and higher demand due to a stronger industrial economy. The Company does not believe that the industry-wide pricing environment is sustainable as steel availability improves. The Company expects the cost of steel will stabilize or decline in the future while the current average cost of inventories is increasing as inventory is replenished with steel purchased at higher costs. The Company does expect to continue to benefit from the improvements in operations.

The Company s philosophy is to pursue growth and profitability through the identification of niche markets for tubular products where the Company can provide a high level of value-added engineering and customer service in order to become the market leader. The Company uses its quality standards, information technology, customer service and manufacturing technology to achieve such market penetration.

Current Industry Conditions

Over the past several years, the steel industry in the U.S. has been characterized by changing customer demand and foreign competition, domestic manufacturing overcapacity, and government influence on raw material and finished good import prices. During the last twelve months, a significant demand for steel in China as well as disruptions in the supply of steel making inputs has caused a lack of domestic availability for certain types of steel, primarily carbon steel. The declining value of the U.S. dollar to foreign currencies has contributed to this market condition. A lack of availability and high-cost of steel-making inputs such as coke, scrap metal and energy has created an environment where steel sheet coil, primarily carbon, is dramatically increasing in cost. Over the past several quarters, carbon steel coil producers have raised their prices and placed surcharges on their products that have greatly increased the replacement cost of carbon steel. The lack of availability of steel and the related mitigation of the excess capacity in the tubing industry has created an enhanced pricing environment for steel tubular products. In dealing with the current environment, management has passed along to customers as many raw material price increases as possible, including surcharges. The Company has agreed-upon pricing with some customers on certain products and as the Company s supplier arrangements for these products are modified for surcharges or base price increases, management attempts to pass on raw material price increases to the extent possible. The increased sales prices for the Company s products, which are reflected in the Company s financial statements for the last two quarters of fiscal 2004, were matched against lower average-cost carbon steel coil inventories, resulting in a significant gross profit increase in the third and fourth quarters of fiscal 2004. The Company does not believe that the earnings attributable to selling from lower average cost inventories is sustainable, since the average cost of inventories will increase as inventory is replenished with steel purchased at the current replacement cost. An increase in the availability of steel could act to decrease selling prices and depress margins since the Company would have high-cost inventory.

Over the years, Webco has forged solid and loyal relationships with its steel suppliers. These relationships have, in most circumstances, secured the availability of carbon and stainless steel in sufficient quantities to satisfy customer requirements during this recent period of reduced supply. There can be no

assurances, however, that the Company s carbon and stainless steel requirements will continue to be met, which, if not met, would negatively impact sales and income from operations and cash flows.

Overview of Financial Results

For Fiscal 2004 ended July 31, 2004, the Company reported net income of $7,218,000, or $1.01 per diluted share. Fiscal 2003 earnings were $1,918,000, or $0.27 per diluted share. Net sales for fiscal 2004 were $212.5 million, a 20.9 percent increase over the $175.8 million for fiscal 2003. Gross profit was 19 percent of net sales for the last six months of fiscal 2004 compared to 9.5 percent in the first six months of fiscal 2004.

The Company s business during the third and fourth quarters of fiscal 2004 was largely impacted by two separate business conditions. First, selling prices for finished product were based on the higher replacement costs of coiled steel and were matched against the Company s lower average-cost inventories. Second, the lack of availability of steel limited the ability of customers to purchase products from the Company s competitors resulting in tubing industry excess capacity being largely mitigated by the lack of availability of carbon steel coils in the domestic marketplace.

The conditions driving the steel industry during the last six months of fiscal 2004 have resulted in substantial increases in sales and income. The Company does not believe these results are sustainable. The level of operating profitability achieved during the third and fourth quarters enabled the Company to afford the higher working capital requirements caused by increasing steel costs, despite borrowing limitations in the Company s revolving line of credit. At such time when steel costs begin to decline, the Company believes it may have the opposite challenge of matching decreasing sales prices with higher average-cost inventories.

Results of Operations

The following table sets forth certain income statement data for each of the three years in the period ended July 31, 2004 (certain amounts may not calculate due to rounding, dollars in millions):

	2004		2003		2002	
	Dollar Amount	% of Net Sales	Dollar Amount	% of Net Sales	Dollar Amount	% of Net Sales
Net sales	$212.5	100.0%	$175.8	100.0%	$156.3	100.0%
Gross profit	31.4	14.8	17.8	10.1	18.8	12.0
Selling, general and administrative expenses	17.0	8.0	12.3	7.0	12.5	8.0
Income from operations (1)	14.3	6.7	5.5	3.1	7.9	5.1

(1) - Fiscal 2002 income from operations was positively impacted by a litigation award of $1,580,000.

Fiscal 2004 Compared with Fiscal 2003

Tubing product sales increased $36.7 million, or 20.9 percent, to $212.5 million in 2004 from $175.8 million in 2003. The increase in net sales is primarily the result of increased sales prices to pass along large price increases and surcharges imposed by steel producers on the supply of carbon steel coils to the market. The lack of availability of steel, which has largely mitigated excess capacity in the industry, has created an enhanced pricing environment for the Company s products. Shipped tonnages improved 9.3 percent over the same period in fiscal 2003, primarily due to the development of certain high alloy and OEM markets and the Company s ability to obtain raw materials, which accounted for approximately 6.2 percent of the increase in sales. Although the tubing industry continues to deal with excess capacity, the limited availability of carbon steel coils has largely mitigated this condition. The overall price per ton for the Company s products increased during the year, which is reflected in the Company s gross profit margin percentages for fiscal 2004.

Gross profit for Tubing products increased to $31.4 million, or 14.8 percent of net sales, in 2004 from $17.8 million, or 10.1 percent of net sales, in 2003. Gross profit margins in fiscal 2004 were positively impacted by increased sales prices, which followed higher raw material pricing, being matched against lower average-cost raw materials. As the Company s average-cost of raw materials increases towards current replacement cost, gross profit margins are expected to decrease, assuming selling prices do not increase proportionately. Excess tubing industry capacity, which still exists, is currently being mitigated by the limited availability of carbon steel coils.

Selling, general and administrative expenses were $17.0 million in fiscal 2004 compared with $12.3 million in fiscal 2003. The fiscal 2003 period includes a pre-tax insurance recovery to the Company of $299,000 from a fire at the Oil City facility in 2001. Without the insurance recovery in the prior year period, S,G&A costs increased $4,411,000 primarily due to a $3,000,000 increase in employee and executive bonus accruals resulting from improved operating performance. Legal expenses and certain financial advisory costs related to the reverse/forward stock split increased expenses by approximately $770,000 while expanded selling activities also increased expenses by approximately $520,000.

Interest expense for fiscal 2004 increased to $2,318,000 from $2,216,000 in fiscal 2003. The slight increase in interest is primarily the result of the increase in the average level of debt under the bank Loan and Security Agreement to $46.0 million for 2004 from $41.7 million for 2003. The average interest rate decreased to 4.1 percent in 2004 from 4.56 percent in 2003. The Company has historically elected for its term debt and a significant portion of its outstanding revolving loan to bear interest at a floating rate based on LIBOR. Borrowing levels under the revolver increased to finance higher inventory and accounts receivable levels due to the increase in raw material prices and sales for the year. A significant increase in interest rates could have a material impact on the Company s results of operations and cash flows. The reader should refer to Part II, Item 7A: Quantitative and Qualitative Disclosures about Market Risk of this Form 10-K for additional information regarding this matter.

The recorded income tax provision is based upon the estimated annual combined effective federal and state income tax rates. The effective income tax rate for fiscal 2004 was 40 percent compared to 41.0 percent in the prior fiscal year.

Fiscal 2003 Compared with Fiscal 2002

Tubing product sales increased $19.5 million, or 12.5 percent, to $175.8 million in 2003 from $156.3 million in 2002. The increase in net sales was primarily the result of improved specialty tubing volumes across all facilities driven by new market opportunities and the development of the Oil City, Pennsylvania, expansion capacity. Shipped tonnages improved 2.8% over fiscal 2002 mostly due to new market opportunities in the specialty tubing markets. Tonnage improvements over the prior year were primarily driven by the specialty OEM market. Although the overall price per ton for the Company s products increased during the year, the change in sales-mix towards lower margin products resulted in a reduction in gross profit margin for the year as seen below. Pricing pressure continued to depress the specialty tubing markets, which was reflected in the Company s gross profit margin percentages for fiscal 2003.

Gross profit for Tubing products decreased to $17.8 million, or 10.1 percent of net sales, in 2003 from $18.8 million, or 12.0 percent of net sales, in 2002. The decrease was primarily a function of the increase in volume in the specialty OEM market, which historically has significant competition and pricing pressure. Excess capacity and over-supply conditions continued to exist among most of the Company s product lines. Although increased production at the Oil City facility helped drive the increase in sales for the year, production problems and related operating inefficiencies depressed margins at that location during the last half of the year. Shutdowns for repair and maintenance projects at the Company s Sand Springs, Oklahoma, facility during the third quarter further reduced gross profit for the year. Margins were also adversely impacted by higher carbon steel raw material prices during fiscal 2003.

20

Selling, general and administrative expenses were $12.3 million in fiscal 2003 compared with $12.5 million in fiscal 2002. The second quarter of fiscal 2003 included an insurance recovery to the Company of $299,000 from a January 2001 fire at the Company s Oil City facility. The Company had a reduction of $489,000 in employee incentive payments and executive bonus accruals in fiscal 2003 as a result of failing to achieve budgeted profitability levels. These decreases were offset by an increase of $259,000 in enterprise resource planning expenses primarily due to a computer hardware migration project and a $311,000 increase in sales and marketing expenses driven by new market opportunities and increased sales volumes.

In January 2002, the Company recorded a litigation award from a previously disclosed lawsuit against an equipment vendor. The total judgment of $1.58 million has been collected, and the Company does not anticipate any further action by either party in the case.

Interest expense for fiscal 2003 decreased to $2,216,000 from $2,998,000 in fiscal 2002. The decrease in interest was primarily the result of the average interest rate decreasing to 4.56 percent in 2003 from 5.96 percent in 2002. The average level of debt under the bank Loan and Security Agreement decreased only slightly to $41.7 million for 2003 from $41.8 million for 2002. The Company has historically elected for its term debt and a significant portion of its outstanding revolver to bear interest at a floating rate based on LIBOR. Borrowing levels remained relatively flat as operating cash flow was used to fund higher inventory levels and capital expenditures during 2003.

The recorded income tax provision was based upon the estimated annual combined effective federal and state income tax rates. The effective income tax rate for fiscal 2003 was 41.0 percent compared to 38.4 percent in the prior fiscal year. The higher effective tax rate resulted from the Company cashing in two key-man, whole-life insurance policies during the second quarter of fiscal 2003 and realizing a taxable gain on the transaction.

On March 31, 2002, the Board of Directors approved a plan of divestiture for the Company s QuikWater Division and on May 10, 2002, the Company sold substantially all of the assets of this segment to a group of independent investors and members of management of QuikWater, which included Ashley Weber, daughter of F. William Weber, Chairman and Chief Executive Officer of the Company. The purchase price for the assets was $100,000 paid in cash at closing, the assumption of approximately $70,000 in liabilities and an additional $300,000 that could be realized based on future earnings of the new entity over a three year period. None of the additional $300,000 has been recorded on the sale due to management s assessment of the contingent nature of the amount. The sale of the QuikWater Division represents a disposal of a business segment under Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (FAS 144). Accordingly, prior period results of the QuikWater segment have been classified as discontinued. A loss of $914,000 was recorded on the disposal of the business segment, net of realized proceeds, which includes $80,000 of related disposal costs. The reader should refer to Part II, Item 8: Note 4 - Discontinued Operation, in the footnotes to the consolidated financial statements of this Form 10-K for additional information regarding this matter.

Liquidity and Capital Resources

Net cash provided by (used in) operations was $3.4 million, $(1.3) million, and $12.0 million in fiscal 2004, 2003 and 2002, respectively. Inventories increased year-over-year in 2004, 2003 and 2002. The $8.8 million inventory increase in 2004 is primarily the result of higher carbon steel raw material prices and increased business levels in the specialty tubing markets. The $6.5 million inventory increase in 2003 is largely the result of increased business levels in the specialty tubing markets and higher carbon steel raw material prices. The increase in inventory in 2002 was the result of overall increases in raw material prices and the Company s decision to make strategic volume purchases in anticipation of rising prices. Accounts receivable increased $6.1 million in 2004 as a result of increased sales primarily driven by higher selling prices. Accounts receivable increased $3.0 million in 2003 primarily as a result of increased sales volumes.

Table of Contents

Accounts payable and accrued liabilities increased in 2004 due to higher inventory costs and accrued profit sharing and bonuses. Accounts payable decreased in 2003, but was largely offset by an increase in book overdrafts included in financing activities. Accounts Payable increased in 2002 primarily as a result of the increase in inventory. Over the past two years, the Company has on average turned its steel inventories approximately 4.5 times per year.

Net cash used in investing activities was $6.2 million, $2.6 million and $2.7 million in fiscal 2004, 2003 and 2002, respectively. Fiscal 2004 capital spending was primarily related to the building expansion along with related weld mill technology upgrades at the Company s stainless facility. Fiscal 2003 is net of cash value proceeds of $822,000 from cashing in two key man, whole life insurance policies on F. William Weber, Chairman of the Board and Chief Executive Officer. Capital spending in 2003 was primarily focused on information technology and the continued investment in stainless tube making capabilities. Capital spending in 2002 was limited to upgrading existing equipment with improved technology and mill additions at the Company s stainless plant.

The Company s capital requirements have historically been to fund equipment purchases and for general working capital needs resulting from the growth that the Company has experienced. The Company has followed an aggressive capital expenditure plan as part of its growth strategy and to enable it to continue to be a leader in tubular manufacturing technologies. In the past, the Company has funded its capital growth expenditures with a combination of cash flow from operations and debt. Capital spending in 2005 will focus on the continued expansion and deployment of technology investments and the development of value-added capabilities for our increased carbon capacity, and normal facility maintenance spending. Capital spending for 2005 is expected to be in the range of $5.0 to $6.0 million for the year. The Company currently intends to retain earnings to support this strategy and does not anticipate paying dividends in the foreseeable future.

On October 15, 2004, the Company entered into a new senior credit facility (the Credit Facility) to refinance its then existing senior debt with the Company s primary lender. The Credit Facility provides for a term loan of $18 million, and a revolving line of credit of $50 million. The maturity date of the Credit Facility is October 15, 2009 and it is collateralized by substantially all of the Company s assets. The Company may have borrowings and outstanding letters of credit ($1,025,000 of letters of credit were outstanding at October 15, 2004) under the revolving credit facility of up to the lesser of $50 million or an amount determined by a formula based on the amount of eligible inventories and accounts receivable. Principal payments on the term loan of $214,300, plus interest, are due each month until maturity. In addition to the scheduled principal payments, the Company is required to make additional principal payments on the term loan based on 50 percent of the Company s excess cash flow per quarter not to exceed $257,100 per quarter, or $1,800,000 on a cumulative basis over the term of the debt facility, beginning with the quarter ending October 31, 2004. Like the Company s prior facility, the new Credit Facility contains covenants regarding debt coverage, capital expenditures and dividends and requires the Company to maintain a minimum excess borrowing base availability. The increased borrowing capacity of the revolving credit facility is intended to enable Webco to fund the higher levels of working capital required in the current high-cost steel environment. Webco anticipates using a portion of the term loan to fund the Company s previously announced reverse stock split transaction and related matters.

The accompanying consolidated balance sheet has been adjusted to show a long-term portion of debt for the amount not expected to be paid during fiscal 2005 under the new term loan. As of July 31, 2004, the Company had $9.1 million outstanding on the senior debt facility term loan and $37 million on the related revolving line of credit, which were subsequently refinanced as noted above. At July 31, 2004, only $4,000 ($2,900,000 at September 30, 2004) was available for borrowing on the refinanced line of credit. Under the terms of the new agreement an additional $4,500,000 would have been available at July 31, 2004. Future minimum payments under the senior debt facility term loan are $2,734,000 in fiscal 2005, $2,572,000 in fiscal 2006, $2,572,000 in fiscal 2007 and $1,259,000 in fiscal 2008.

22

Table of Contents

Accounting principles require current classification of revolving lines of credit that permit borrowings on a long-term basis when the line of credit contains both a lock-box arrangement, whereby remittances to the lockbox automatically pay down the outstanding line of credit, and loan terms that allow the lender to declare the loan in default on a subjective basis. This accounting treatment is required regardless of the legal maturity date of the revolving credit arrangement. The Company s line of credit, which matures October 15, 2009, contains such features and accordingly, the accompanying financial statements classify outstanding borrowings under the line of credit as Current portion of long-term debt .

Similar to the prior facility, the Company s new debt facility contains covenants regarding debt coverage and the ratio of liabilities to equity. The covenants also limit capital expenditures and dividends and require the Company to maintain a minimum excess availability on its revolving loan. As of July 31, 2004, the Company was in compliance with all such covenants under the existing facility, and would have been in compliance with all such covenants in the new debt facility had it been in place.

The new debit facility also contains restrictions related to the Company s proposed reverse stock-split transaction. In order to proceed with the reverse stock-split, the Company must have a minimum excess availability of $7.0 million on its revolving loan after giving effect to the transaction and is limited to $2.0 million of new advances to management shareholders for purposes of settling loans with third parties secured by Company stock. Total cash required to complete the transaction is estimated to be in the range of $3.5 to $5.0 million.

P&J also has a separate line of credit agreement for $1,500,000, which matures on November 30, 2004. As of July 31, 2004, there was $500,000 outstanding on the line of credit and $1,000,000 was available for borrowing.

The Company has arranged financing with various public agencies related to the Oil City facility, of which, $1.9 million is outstanding at July 31, 2004. The agency loans are collateralized by the underlying real estate and certain equipment. The loans mature over a 1 to 7 year period and bear interest at rates ranging from 3 to 5 percent.

The Company has various equipment loans with other financing companies, of which, $505,000 is outstanding at July 31, 2004. The loans are collateralized by the underlying equipment and mature over a 1 to 5 year period and bear interest at rates ranging up to 6 percent.

In addition to the above debt arrangements, the Company leases certain buildings and machinery and equipment under non-cancelable operating leases. Under certain of these leases the Company is obligated to pay property taxes, insurance, repairs and other costs related to the leased property.

Table of Contents

The following table sets forth the future minimum payments required under the above debt and lease agreements at July 31, 2004:

	Payments Due by Fiscal Year						
Contractual Obligations	**2005**	**2006**	**2007**	**2008**	**2009**	**Thereafter**	**Total**
Senior Long-Term Debt (1)	$ 2,734	$2,572	$2,572	$1,259	$	$	$ 9,137
Senior Line of Credit (2)	36,972						36,972
Public Agency Long-Term Debt	301	299	307	308	240	429	1,884
P&J Line of Credit	500						500
Purchase Commitments (3)	51,380						51,380
Operating Leases (4)	2,062	1,881	1,646	1,398	1,023	860	8,870
Other	181	147	87	85	5		505
Total Cash Obligations	$94,130	$4,899	$4,612	$3,050	$1,268	$1,289	$109,248

(1) - Future minimum payments under the Company s Senior Long-Term Debt agreement have been adjusted to conform to the new arrangement which matures on October 15, 2009 as described above.

(2) - Accounting principles require current classification of revolving lines of credit that permit borrowings on a long-term basis when the line of credit contains both a lock-box arrangement, whereby remittances to the lockbox automatically pay down the outstanding line of credit, and loan terms that allow the lender to declare the loan in default on a subjective basis. This accounting treatment is required regardless of the legal maturity date of the revolving credit arrangement. The Company s line of credit, which matures October 15, 2009, contains such features and accordingly, the accompanying financial statements have presented the outstanding borrowings under the line of credit to Current portion of long-term debt .

(3) - The Company enters into purchase commitments with steel vendors as part of the ordinary course of business and is currently committed on outstanding purchase orders for inventory.

(4) - The Company expects to relocate from its Nederland, Texas distribution and warehouse facilities in November 2004 to a 125,000 square foot facility in Orange, Texas, that is being leased on a long-term basis. Future minimum payments under the new 15 year lease, not included in the table, are expected to be approximately $290,000 in 2005; $386,000 in each of years 2006 through 2009; and $3,961,000 thereafter. Future minimum payments for the facilities being replaced, which are included in the table, amount to $66,000 in 2005 and $39,000 in 2006.

Management believes its current capital structure is adequate for current operations and to allow for planned capital additions and improvements. Interest rate increases or lack of capital availability could limit capital spending or the working capital necessary to take advantage of growth opportunities.

Related Party Transactions

The reader should refer to Part II, Item 8: Note 12 Related Party Transactions, in the footnotes to the consolidated financial statements of this Form 10-K for information regarding such transactions during 2004 and 2003.

Table of Contents

Critical Accounting Policies

The Company s consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. Critical accounting policies require the application of significant judgment by management in selecting the appropriate assumptions for calculating financial estimates that are believed to be reasonable based on the information available. By their nature, these judgments are subject to an inherent degree of uncertainty and financial estimates, and related assumptions, do affect the reported amounts of assets, liabilities, revenues and expenses for the periods presented. There can be no assurances that actual results will not differ from those estimates. These judgments are based on historical experience, terms of existing purchase arrangements, observance of trends in the industry, information provided by customers and information provided from outside sources, as appropriate. The Company believes its most critical accounting policies are as follows:

Revenue Recognition The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 104, Revenue Recognition in Financial Statements (SAB 104). SAB 104 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the fee is fixed or determinable; and (4) collectibility is reasonably assured. Company product is made to customer or industry specifications at an agreed upon price that is typically specified in the customer s purchase order. Title to the product passes to the customer at the time of shipment along with all the risks and rewards of ownership. Customer orders are not released for shipment unless the customer is in good credit standing with the Company, which is internally evaluated by the Company s credit manager on an on-going basis. Should changes in conditions cause management to determine these criteria are not met for certain future transactions, revenue recognition would be delayed until such time as the transactions become realizable and fully earned.

Inventories The Company values inventory at the lower of the actual cost to purchase and/or manufacture or the current estimated market value of the inventory. Cost for raw materials, work-in-process, finished goods and maintenance parts and supplies are determined on the weighted average cost method. The Company regularly reviews inventory quantities on hand and reduces the carrying value of such inventories if circumstances dictate by recording a provision for excess and obsolete inventory based primarily on inventory aging and forecasts of product demand and pricing. The steel industry is characterized by changing customer demands, government influence on raw material and finished good import prices, as evidenced by steel tariffs, and lack of, or excess, steel availability that could result in significant increases or decreases in inventory pricing or increases in excess or obsolete inventory quantities on hand. The Company s estimates of future product demand may prove to be inaccurate or raw material prices may decrease to levels below average inventory cost, in which case the provision required for excess and obsolete inventory may have to be increased or decreased accordingly. Although every effort is made to ensure the accuracy of internal forecasting, any significant changes in demand or finished good and raw material prices could have a significant impact on the carrying value of the Company s inventory and reported operating results.

Self-Insurance Reserves The Company self-insures both a medical coverage program and an Oklahoma workers compensation program for its employees. The determination of reserves and expenses for these benefits is dependent on claims experience and the selection of certain assumptions used by actuaries in evaluating incurred, but not yet reported, amounts. Reserves for claims under both programs are accrued based upon the Company s estimate of the aggregate liability for claims (including claims incurred, but not yet reported). Significant changes in actual experience under either program or significant changes in assumptions may materially affect self-insured medical or workers compensation reserves and future expense.

Accounting for Certain Long-Lived Assets The Company evaluates its long-lived assets for impairment in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (FAS 144). When recoverability is in question, the Company reviews its long-lived assets for impairment based on estimated future non-discounted cash flows attributable to the assets. In the event such cash flows are not expected to be sufficient to recover the recorded value of the assets, the

Table of Contents

assets are written down to their estimated fair values. While the Company believes its estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect the evaluations.

Deferred Taxes The Company recognizes deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax basis of assets and liabilities. Deferred tax assets are regularly reviewed for recoverability and, if deemed necessary, an appropriate valuation allowance is established based on historical taxable income, projected future taxable income, and the expected timing of the reversals of existing temporary differences. If the Company were unable to generate sufficient future taxable income, or if there is a material change in the actual effective tax rates or time period within which the underlying temporary differences become taxable or deductible, the Company could be required to establish a valuation allowance against all or a significant portion of the deferred tax assets, thus resulting in a substantial increase in the effective tax rate and a material adverse impact on net income.

New Accounting Pronouncements

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities (FAS 149). FAS 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under FAS No. 133, Accounting for Derivative Instruments and Hedging Activities . This statement is effective for the fiscal year ending July 31, 2003. The Company has adopted the provisions of FAS 149 to account for its natural gas hedging activities in its consolidated financial statements.

In December 2003, the FASB issued a revised FASB Interpretation No. 46 (FIN 46R), Consolidation of Variable Interest Entities, An Interpretation of Accounting Research Bulletin No. 51 (FIN 46), which was originally issued in January 2003 and provided guidance on identifying entities controlled by means other than through voting rights and how to determine when and which business entity should consolidate the variable interest entities (VIE). FIN 46R requires an investor who absorbs the majority of the expected losses and receives a majority of the expected returns, or both, of a VIE to consolidate the assets, liabilities and results of operations of the VIE. A VIE is an entity in which the equity investors do not have a controlling interest or the equity investment at risk is insufficient to finance the entity s activities without receiving additional subordinated financial support from other parties. FIN 46R, as amended, was applicable for public companies that have an interest in a VIE or a potential variable entity, which is commonly referred to as a special-purpose entity (SPE), for periods ending after December 15, 2003. The adoption of FIN 46R did not have a significant impact on the Company s consolidated financial statements.

Outstanding Litigation

The Company is party to various lawsuits and claims arising in the ordinary course of business. Management, after review and consultation with legal counsel, believes that any liability resulting from these matters would not materially affect the results of operations or the financial position of the Company. The Company maintains liability insurance against risks arising out of the normal course of business.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk The Company s primary risk relates to changes in interest rates on its long-term debt under its senior debt facility. At July 31, 2004, the senior debt facility represented $46.1 million of the total debt outstanding of $49.0 million. A significant amount of the remaining debt of $2.9 million bears interest at fixed rates between 3 and 6 percent. The Company s senior term and revolving debt bear interest at a floating rate based on the London Interbank Offered Rate (LIBOR) or the Prime Rate. Accordingly, the Company believes the carrying value of its variable rate, long-term debt approximates fair value. The Company has not entered into derivative contracts or other financial instruments for speculative or trading purposes. Furthermore, the Company has not used financial instruments in the past, such as interest rate swaps or hedges, to minimize the impact of interest rate fluctuations on earnings and cash flow, however, management may use such instruments if warranted based on estimates of future interest rates. Using the average outstanding long-term debt under the senior debt facility for fiscal 2004 of $46 million, a one percent change in the floating rates would change annual cash flow and earnings before income taxes by approximately $460,000.

Inventory Risk Due to the lack of availability of carbon steel coils and the increase in world-wide demand for steel and scrap, the Company s cost of carbon steel coils increased dramatically in fiscal 2004. The Company s short-term ability to raise prices to its customers is often not as related to the change in the cost of its steel coil raw materials as it is to the availability of steel and competition that exists in the markets into which the tubing is being sold. The Company s ability to keep prices at levels to sustain profitability when the cost of carbon steel coils begins to decline may prove to be difficult, which could result in unrealizable inventory values and a decline in profit margins. Although every effort is made to ensure the accuracy of internal forecasting, any significant changes in demand or finished good and raw material prices could have a significant impact on the value of the Company s inventory and reported operating results. Significant increases in the availability of steel could cause a decrease in the selling prices of the Company s products as well as declines in the cost of steel. Such conditions could result in decreased margins or cause carrying value of inventory to be in excess of realizable sales values.

Natural Gas Price Risk The Company uses natural gas in significant quantities as part of its manufacturing processes. From time to time, the Company experiences significant increases and decreases in the price of natural gas. The Company s ability to raise prices to offset increasing gas costs may prove to be difficult, which could result in declines in profit margins. During the first quarter of fiscal 2004, the Company entered into various fixed price and NYMEX swap contracts in order to manage natural gas risk. Contract terms range from 6 months to 3 years at prices ranging from $5.03 per mcf to $6.20 per mcf. Contracts will essentially lock in prices for 5,000 mcf per month from October 2004 through April 2005 and 10,000 mcf per month from November 2004 through September 2006. Management believes such contracts are warranted based on estimates of future prices and the amount of natural gas used by the Company. The average amount of natural gas used per month in fiscal 2004 was 34,000 mcf at an average price of $5.35 per mcf.

Table of Contents

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Webco Industries, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders equity and cash flows present fairly, in all material respects, the financial position of Webco Industries, Inc. and subsidiaries at July 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended July 31, 2004, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the index appearing under item 15(a)(2), presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

Tulsa, Oklahoma
October 28, 2004

Table of Contents

WEBCO INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
July 31, 2004 and 2003
(Dollars in thousands, except share amounts and par value)

	2004	2003
ASSETS		
Current assets:		
Cash	$ 1,203	$ 189
Accounts receivable, net	27,911	21,781
Inventories, net	49,639	40,794
Prepaid expenses	358	328
Deferred income tax asset	2,664	3,318
Total current assets	81,775	66,410
Property, plant and equipment, net	59,621	60,018
Notes receivable from related parties	2,613	2,560
Other assets, net	1,422	1,539
Total assets	$145,431	$130,527
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 14,666	$ 17,216
Accrued liabilities	9,586	5,676
Current portion of long-term debt Note 5	40,688	31,868
Total current liabilities	64,940	54,760
Long-term debt Note 5	8,310	12,100
Deferred income tax liability	13,725	12,603
Commitments and contingencies - Note 7		
Stockholders equity:		
Common stock, $.01 par value, 12,000,000 shares authorized, 7,081,723 outstanding	71	71
Additional paid-in capital	35,744	35,744
Accumulated other comprehensive income, net of tax	174	
Retained earnings	22,467	15,249
Total stockholders equity	58,456	51,064

Total liabilities and stockholders equity	$145,431	$130,527

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

WEBCO INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Years Ended July 31, 2004, 2003 and 2002
(Dollars and shares in thousands, except per share amounts)

	2004	2003	2002
Net Sales	$212,527	$175,769	$156,294
Cost of Sales	181,147	157,975	137,479
Gross Profit	31,380	17,794	18,815
Selling, general and administrative expenses	17,036	12,326	12,546
Litigation award			1,580
Income from operations	14,344	5,468	7,849
Interest expense	2,318	2,216	2,988
Income before income taxes	12,026	3,252	4,861
Provision for income taxes	4,808	1,334	1,865
Income from continuing operations	7,218	1,918	2,996
Loss on discontinued operation, net of tax			(908)
Net income	$ 7,218	$ 1,918	$ 2,088
Net income (loss) per common share - basic:			
Continuing operations	$ 1.02	$ .27	$ .42
Discontinued operation			(.13)
Net income	$ 1.02	$ .27	$ .29
Net income (loss) per common share - diluted:			
Continuing operations	$ 1.01	$ .27	$ .42
Discontinued operation			(.13)
Net income	$ 1.01	$ .27	$ .29

Weighted average common shares outstanding:			
Basic	7,082	7,082	7,077
Diluted	7,162	7,147	7,151

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

WEBCO INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
For the Years Ended July 31, 2004, 2003 and 2002
(Dollars in thousands)

	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total Stockholders Equity
Balances, July 31, 2001	$ 71	$35,732	$	$11,243	$47,046
Proceeds from stock options exercised		12			12
Net Income				2,088	2,088
Balances, July 31, 2002	71	35,744		13,331	49,146
Net Income				1,918	1,918
Balances, July 31, 2003	71	35,744		15,249	51,064
Net Income				7,218	7,218
Other Comprehensive Income:					
Increase in value of derivative hedging instruments, net of taxes of $142			205		205
Reclassification of derivative hedging settlements to income, net of taxes of $21			(31)		(31)
Comprehensive Income					7,392
Balances, July 31, 2004	$ 71	$35,744	$ 174	$22,467	$58,456

The accompanying notes are an integral part of the consolidated financial statements.

Table of Contents

WEBCO INDUSTRIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended July 31, 2004, 2003 and 2002
(Dollars in thousands)

	2004	2003	2002
Cash flows from operating activities:			
Net income	$ 7,218	$ 1,918	$ 2,088
Adjustments to reconcile net income to net Cash provided by (used in) operating activities:			
Loss on disposal of discontinued operation			914
Depreciation and amortization	7,370	6,991	7,250
(Gain) loss on disposition of Property, plant and equipment		(6)	7
Deferred tax expense	1,655	977	1,252
(Increase) decrease in:			
Accounts receivable	(6,130)	(3,010)	501
Inventories	(8,845)	(6,487)	(1,728)
Prepaid expenses	(83)	(99)	(1)
Increase (decrease) in:			
Accounts payable	(1,725)	(1,287)	1,053
Accrued liabilities	4,013	(149)	636
Net change from discontinued operation	(103)	(118)	35
Net cash provided by (used in) operating activities	3,370	(1,270)	12,007
Cash flows from investing activities:			
Capital expenditures	(6,263)	(3,455)	(3,210)
Proceeds from sale of property, plant and equipment	12	13	8
Repayment of stockholder advances			50
Other	24	810	434
Net change from discontinued operation			(11)