

WEBCO INDUSTRIES INC
Form 10-K/A
March 04, 2004

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10 K/A

Amendment 1

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended July 31, 2003

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
(State or other jurisdiction
of incorporation or organization)

73 1097133
(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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S K (Sec. 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.

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

As of September 30, 2003, the aggregate market value of the voting stock held by non-affiliates of the registrant was \$8,431,000.

On September 30, 2003, the number of shares outstanding of the registrant's common stock, \$.01 par value, was 7,081,723 shares.

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DOCUMENTS INCORPORATED BY REFERENCE: Portions of the Proxy Statement for the registrant's 2003 Annual Meeting of Stockholders are incorporated by reference into Items 10, 11, 12, 13 and 14 of Part III of this Form 10-K.

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-K/A amends Items 6, 7, 8 and 15 of the Annual Report on Form 10-K of Webco Industries, Inc. (the "Company") for the fiscal year ended July 31, 2003 as filed with the Securities and Exchange Commission on October 29, 2003 (the "Annual Report"). This Form 10-K/A does not reflect events occurring after the filing of the original Annual Report or modify or update those disclosures affected by subsequent events.

As discussed in Note 1A, this Form 10-K/A restates the balance sheet classification of outstanding debt under the Company's Senior Revolving Line of Credit ("LOC") from long-term to current liabilities. 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 LOC, 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 LOC, which matures May 1, 2005, contains such features and accordingly, the accompanying financial statements have been restated to reclassify outstanding borrowings under the LOC to "Current portion of long-term debt". This change in balance sheet classification does not affect the Consolidated Statements of Operations or Consolidated Statements of Cash Flows.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY

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WEBCO INDUSTRIES, INC. AND SUBSIDIARY

FORM 10 K

PART II

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, 2003, 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/A.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY

Selected Financial Data

For the Years Ended July 31,

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(Dollars in thousands, except per share data)

| Income Statement Data: | <u>2003</u> | <u>2002</u> | <u>2001</u> | <u>2000</u> | <u>1999</u> |
|--|-------------|--------------|---------------|---------------|--------------|
| Net sales | \$ 175,769 | \$ 156,294 | \$ 148,279 | \$ 142,293 | \$ 135,058 |
| Gross profit | 17,794 | 18,815 | 14,932 | 19,105 | 20,965 |
| Income from operations (2) | 5,468 | 7,849 | 2,314 | 4,822 | 7,084 |
| Income (loss) from continuing operations | 1,918 | 2,996 | (1,494) | 536 | 2,823 |
| Loss from discontinued operation (1) | - | (908) | (108) | (1,561) | (947) |
| Net income (loss) | 1,918 | 2,088 | (1,602) | (1,025) | 1,876 |
| Diluted earnings (loss) per share: | | | | | |
| Income (loss) from continuing operations | .27 | .42 | (0.21) | .08 | .40 |
| Loss from discontinued operation (1) | <u>-</u> | <u>(.13)</u> | <u>(0.02)</u> | <u>(0.22)</u> | <u>(.13)</u> |
| Net income (loss) | .27 | .29 | (0.23) | (0.14) | .27 |

Balance Sheet Data:

| | | | | | |
|---|-----------|----------|----------|-----------|-----------|
| Working capital (restated) | \$ 11,650 | \$ 7,218 | \$ 9,949 | \$ 12,456 | \$ 19,731 |
| Total assets | 130,527 | 123,928 | 128,347 | 130,123 | 120,481 |
| Long term debt (net of current portion) (restated) | 12,100 | 15,222 | 25,740 | 26,306 | 27,131 |
| Stockholders' equity | 51,064 | 49,146 | 47,046 | 48,648 | 49,673 |

(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/A.

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

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/A.

Overview

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.

The Company continues to make significant technology investments and develop its revenue base in selected niche markets. The Company experienced continued revenue growth during the year ended July 31, 2003, primarily due to improved volumes across all facilities, despite the difficult economy.

In May 2002, the Company sold substantially all of the assets of its QuikWater Division and treated the disposal as a discontinued operation. The reader should refer to Note 4 - Discontinued Operation, in the footnotes to the consolidated financial statements of this Form 10-K/A for additional information regarding this matter.

Results of Operations

The following table sets forth certain income statement data for each of the three years in the period ended July 31, 2003 (certain amounts may not calculate due to rounding):

| <u>2003</u> | | <u>2002</u> | | <u>2001</u> | |
|-------------------------|--------------------------|-------------------------|--------------------------|-------------------------|--------------------------|
| Dollar <u>Amount</u> | % of <u>Net Sales</u> | Dollar <u>Amount</u> | % of <u>Net Sales</u> | Dollar <u>Amount</u> | % of <u>Net Sales</u> |

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(Dollars in Millions)

| | | | | | | |
|--|---------|--------|---------|--------|---------|--------|
| Net sales | \$175.8 | 100.0% | \$156.3 | 100.0% | \$148.3 | 100.0% |
| Gross profit | 17.8 | 10.1 | 18.8 | 12.0 | 14.9 | 10.0 |
| Selling, general and administrative expenses | 12.3 | 7.0 | 12.5 | 8.0 | 12.6 | 8.5 |
| Income from operations (1) | 5.5 | 3.1 | 7.9 | 5.1 | 2.3 | 1.6 |

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

Fiscal 2003 Compared with Fiscal 2002

Pressure and Specialty 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 is 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 continues to depress the specialty tubing markets, which is reflected in the Company's gross profit margin percentages for fiscal 2003.

Gross profit for Pressure and Specialty 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 is 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 continue 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.

Selling, general and administrative expenses were \$12.3 million in fiscal 2003 compared with \$12.5 million in fiscal 2002. The second quarter of the current year includes 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 is 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 free operating cash flow was used to fund higher inventory levels and capital expenditures during 2003. 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 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.

The steel industry is characterized by changing customer demands, foreign competition, government influence on raw material and finished good import prices, as evidenced by trade tariffs, and financial instability among domestic steel producers. Due to tariffs on carbon steel coils and the rationalization of some domestic steel production, the Company's cost of carbon steel coils increased in fiscal 2003. The Company's ability to pass these increased costs on 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 intense competition that exists in the markets into which the tubing is being sold.

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 and an additional \$300,000 that could be realized based on future earnings of the new entity over

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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/A for additional information regarding this matter.

Fiscal 2002 Compared with Fiscal 2001

Pressure and Specialty Tubing Product sales increased \$8.0 million, or 5.4 percent, to \$156.3 million in 2002 from \$148.3 million in 2001. The increase in net sales is primarily the result of the additional production gained from the Oil City, Pennsylvania expansion, new market opportunities and improved pressure tubing volumes. Pricing pressure remained strong throughout the specialty stainless tubing markets. Tonnages were depressed in the prior year due to the disruptions to the operations at the Oil City plant as a result of the expansion construction at that location for much of the year.

Gross profit for Pressure and Specialty Tubing Products increased to \$18.8 million, or 12.0 percent of net sales, in 2002 from \$14.9 million, or 10.1 percent of net sales, in 2001. The increase is a function of Oil City being fully operational after the major expansion was completed during the third quarter of fiscal 2001. Shipped tonnages improved 5.5% over fiscal 2001 mostly due to new market opportunities, production efficiencies and improved pressure tubing volumes. In fiscal 2001, a one-week suspension at the Sand Springs facility in August and higher operating expenses at the Oil City facility due to the on-going plant construction negatively impacted margins. Margins were further reduced by higher natural gas prices at all facilities during fiscal 2001.

Selling, general and administrative expenses were basically unchanged at \$12.5 million in fiscal 2002 compared with \$12.6 million in fiscal 2001. The Company did realize a reduction of \$499,000 in information technology expenses during fiscal 2002 as a result of cost saving measures implemented during fiscal 2001. This decrease was partially offset by a decline in sales commission income of \$180,000. The Company also realized a \$236,000 gain on the sale of real estate that was included as part of selling, general and administrative expenses in 2001.

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 2002 decreased to \$2,988,000 (net of \$35,000 capitalized) from \$4,731,000 (net of \$375,000 capitalized) in fiscal 2001. The decrease in interest prior to interest capitalization is the result of the average level of debt under the bank Loan and Security Agreement decreasing \$6.7 million to \$41.8 million for 2002 as compared with \$48.5 million for 2001. In addition, the average interest rate decreased to 5.96 percent in 2002 from 8.87 percent in 2001. 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. Lower borrowing levels resulted from improved operating cash flow and the Company's focus on debt reduction and working capital management. LIBOR, much like the prime rate, experienced significant decreases during calendar year 2001, which led to the reduction in the average interest rate. However, 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.

Liquidity and Capital Resources

Net cash (used in) provided by operations was \$(1.3) million, \$12.0 million and \$3.2 million in fiscal 2003, 2002 and 2001, respectively. Inventories increased in 2003 and 2002 while decreasing in 2001. 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. Inventories decreased in 2001 primarily due to management's efforts to reduce raw material inventory levels at the manufacturing facilities, which was partially offset by increases in finished goods levels. Accounts receivable increased \$3.0 million in 2003 as a result of increased sales volumes. 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 three years, the Company has on average turned its steel inventories approximately 4 times per year.

Net cash used in investing activities was \$2.6 million, \$2.7 million and \$5.4 million in fiscal 2003, 2002 and 2001, respectively. Fiscal 2003 includes the 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. During the third quarter of fiscal 2001, the Company completed the expansion of the Oil City facility, which included the installation of a new mill along with other supporting equipment and plant construction.

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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. Capital spending in 2004 will focus on the continued expansion and deployment of technology investments for stainless tube-making, development of value-added capabilities for our increased carbon capacity, and normal facility maintenance spending. Capital spending for 2004 is expected to be in the range of \$3.5 to \$5.5 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.

The Company's senior debt facilities with its primary lender provide for a term loan of \$15.5 million, and a revolving line of credit of \$32 million (\$38 million as amended on September 16, 2003). As of July 31, 2003, the Company had \$12.2 million outstanding on the senior debt facility term loan and \$28.8 million on the related revolving line of credit. The maturity date of both the term loan and the revolver is May 1, 2005 and the loans are collateralized by substantially all of the Company's assets. The Company may have borrowings and outstanding letters of credit under the revolving credit facility up to the lesser of \$38 million or an amount determined by a formula based on the amount of eligible inventories and accounts receivable. At July 31, 2003, \$2.1 million (\$5.7 million at September 30, 2003) was available for borrowing on the line of credit under the terms of the note agreement. Principal payments on the term loan of \$184,500, plus interest, are due each month until maturity. Along with the scheduled principal payments, the Company is required to make additional principal payments on the term loan based on 50 percent of excess cash flow not to exceed \$221,500 per quarter, or \$2,658,000 on a cumulative basis over the term of the debt facility. As of July 31, 2003, the Company has made \$886,000 of additional principal payments. An additional payment of \$199,500 will be made during the second quarter of 2004 based on the Company's performance in the fourth quarter of 2003.

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 LOC, 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 LOC, which matures May 1, 2005, contains such features and accordingly, the accompanying financial statements have been restated to reclassify outstanding borrowings under the LOC to "Current portion of long-term debt".

The Company is subject to various restrictive covenants, including requirements to maintain a minimum debt coverage ratio. The covenants also limit capital expenditures and dividends and require the Company to maintain a minimum borrowing base availability. As of July 31, 2003 the Company was in compliance with all such covenants under the existing facility.

The Company has arranged financing with various public agencies related to the Oil City facility, of which, \$2.2 million is outstanding at July 31, 2003. The agency loans are collateralized by the underlying real estate and certain equipment. The notes mature over a 2 to 8 year period and bear interest at rates ranging from 3 to 5 percent.

The Company has various equipment loans with its primary lender and other financing companies, of which, \$592,000 is outstanding at July 31, 2003. 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.

P&J has a line of credit agreement for \$2,000,000 and a term loan of \$500,000 with its primary lender. As of July 31, 2003, P&J had \$87,000 outstanding on the term loan and no amounts under the line of credit. The line of credit matures on November 30, 2003, and the term loan matures in April 2004. Both loans are collateralized by P&J's assets. At July 31, 2003, \$2.0 million was available for borrowing under the line of credit.

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.

The following table sets forth the future minimum payments required under the above debt and lease agreements at July 31, 2003:

| <u>Contractual Obligations</u> | <u>Payments Due by Fiscal Year</u> | | | | | | <u>Total</u> |
|--------------------------------|------------------------------------|-------------|-------------|-------------|-------------|-------------------|--------------|
| | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>Thereafter</u> | |
| Senior Long-Term Debt | \$ 2,436 | \$ 9,779 | \$ - | \$ - | \$ - | \$ - | \$ 12,215 |
| Senior Line of Credit (1) | 28,848 | - | - | - | - | - | 28,848 |
| Public Agency Long-Term Debt | 342 | 301 | 299 | 307 | 308 | 669 | 2,226 |
| P&J Long-Term Debt | 87 | - | - | - | - | - | 87 |
| P&J Line of Credit | - | - | - | - | - | - | - |
| Operating Leases | 1,754 | 1,668 | 1,369 | 1,132 | 895 | 1,439 | 8,257 |

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| | | | | | | | |
|------------------------|------------|------------|------------|-----------|-----------|----------|------------|
| Other | <u>155</u> | <u>151</u> | <u>134</u> | <u>75</u> | <u>72</u> | <u>5</u> | <u>592</u> |
| Total Cash Obligations | \$ 33,622 | \$ 11,899 | \$ 1,802 | \$ 1,514 | \$ 1,275 | \$ 2,113 | \$ 52,225 |
| | ===== | ===== | ===== | ===== | ===== | ===== | ===== |

(1) - 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 LOC, 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 LOC, which matures May 1, 2005, contains such features and accordingly, the accompanying financial statements have been restated to reclassify outstanding borrowings under the LOC to "Current portion of long-term debt".

In the past, the Company has funded its capital growth expenditures with a combination of cash flow from operations and debt. Capital spending plans for fiscal year 2004 primarily consist of further additions at the stainless plant and minor projects and normal maintenance spending, which is expected to be in the range of \$3.5 to \$5.5 million for the year. 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.

The Company enters into purchase commitments with steel vendors as part of the ordinary course of business. The Company is currently committed on outstanding purchase orders for inventory approximating \$21.7 million.

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/A for information regarding such transactions during 2003 and 2002.

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. 101, Revenue Recognition in Financial Statements (SAB 101), as amended by SAB 101A and 101B. SAB 101 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 and 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 the numbers 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 current steel tariffs, and financial instability among domestic steel producers 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, in which case the provision required for excess and obsolete inventory may have been understated or overstated. 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 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 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 December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123" (FAS 148). FAS 148 is effective for fiscal years ending after December 15, 2002. This statement amends Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" and amends Accounting Principles Board Opinion No. 28 Interim Financial Reporting . FAS 148 does not change the provisions of FAS 123 that permit entities to continue applying the intrinsic value method of APB 25, "Accounting for Stock Issued to Employees" ("APB 25"). Since the Company applies APB 25, the Company's accounting for stock-based compensation will not change as a result of FAS 148. FAS 148 does require certain new disclosures in both annual and interim financial statements, which are effective for the fiscal year ending July 31, 2003 and are included in Note 1 of these financial statements. The new interim disclosure provisions were effective beginning with the Company's third quarter ended April 30, 2003.

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 does not expect FAS 149 to have a significant impact on its consolidated financial statements.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting For Certain Financial Instruments with Characteristics of both Liabilities and Equity" (FAS 150). FAS 150 requires financial statement issuers to classify financial instruments that require a transfer of assets, and that meet the definition of liabilities in FASB Concepts Statement No. 6 (CON 6) and other recognition criteria in FASB Concepts Statement No. 5 (CON 5), as liabilities. The Statement also requires that certain obligations that could be settled by issuance of an entity's equity but lack other characteristics of equity be reported as liabilities even though the obligation does not meet the definition of liabilities in CON 6. This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for interim periods beginning after June 15, 2003. The Company does not expect FAS 150 to have a significant impact on its consolidated financial statements.

On November 25, 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34" ("FIN 45"). FIN 45 clarifies the requirements of FASB Statement No. 5, Accounting for Contingencies (FAS 5), relating to the guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees. For guarantees that fall within the scope of FIN 45, the Interpretation requires that guarantors recognize a liability equal to the fair value of the guarantee upon its issuance. The Interpretation's provisions for initial recognition and measurement should be applied on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The guarantor's previous accounting for guarantees that were issued before the date of FIN 45's initial application may not be revised or restated to reflect the effect of the recognition and measurement provisions of the Interpretation. The disclosure requirements are effective for financial statements of both interim and annual periods that end after December 15, 2002. The Company does not believe FIN 45 will be material to its consolidated financial statements as the Company is currently not a Guarantor under any guarantee arrangements.

On January 17, 2003, the FASB issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities, An Interpretation of Accounting Research Bulletin No. 51 (FIN 46). FIN 46 provides 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). Consolidation applies to entities in which the equity investor does not have a controlling financial interest or the equity investment at risk is insufficient to finance that entity's activities in the absence of other subordinated financial support from other parties. The Company does not believe FIN 46 will be material

to its consolidated financial statements as the Company is currently not a party to any variable interest entities.

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 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT AUDITORS

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 subsidiary at July 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended July 31, 2003, 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 auditing standards generally accepted in the United States of America which 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.

As discussed in Note 1A to the consolidated financial statements, the Company has revised its Consolidated Balance Sheets at July 31, 2003 and 2002, to reclassify its debt outstanding under the Company's Senior Revolving Line of Credit from long-term to current liabilities.

PricewaterhouseCoopers LLP

Tulsa, Oklahoma

September 25, 2003, except for the information in Note 1A, as to which the date is March 1, 2004.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY CONSOLIDATED BALANCE SHEETS July 31, 2003 and 2002

(Dollars in thousands, except share amounts and par value)

| <u>ASSETS</u> | <u>2003</u> | <u>2002</u> |
|------------------------------------|---------------------|--------------|
| | (Restated, Note 1A) | |
| Current assets: | | |
| Cash | \$ 189 | \$ 212 |
| Accounts receivable, net | 21,781 | 18,564 |
| Inventories, net | 40,794 | 34,307 |
| Prepaid expenses | 328 | 281 |
| Deferred income tax asset | <u>3,318</u> | <u>2,553</u> |
| Total current assets | 66,410 | 55,917 |
| Property, plant and equipment, net | 60,018 | 62,974 |

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| | | |
|---------------------------------------|--------------|--------------|
| Notes receivable from related parties | 2,560 | 2,508 |
| Other assets, net | <u>1,539</u> | <u>2,529</u> |
| Total assets | \$ 130,527 | \$ 123,928 |
| | ===== | ===== |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | | |
|---|---------------|---------------|
| Current liabilities: | | |
| Accounts payable | \$ 17,216 | \$ 17,673 |
| Accrued liabilities | 5,676 | 5,788 |
| Current portion of long term debt (Restated, Note 1A) | <u>31,868</u> | <u>25,238</u> |
| Total current liabilities | 54,760 | 48,699 |
| Long term debt (Restated, Note 1A) | 12,100 | 15,222 |
| Deferred income tax liability | 12,603 | 10,861 |
| 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 |
| Retained earnings | <u>15,249</u> | <u>13,331</u> |
| Total stockholders' equity | <u>51,064</u> | <u>49,146</u> |
| Total liabilities and stockholders' equity | \$ 130,527 | \$ 123,928 |
| | ===== | ===== |

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

**WEBCO INDUSTRIES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Years Ended July 31, 2003, 2002 and 2001
(Dollars and shares in thousands, except per share amounts)**

| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--|----------------|----------------|----------------|
| Net Sales | \$ 175,769 | \$ 156,294 | \$ 148,279 |
| Cost of Sales | <u>157,975</u> | <u>137,479</u> | <u>133,347</u> |
| Gross Profit | 17,794 | 18,815 | 14,932 |
| Selling, general and administrative expenses | 12,326 | 12,546 | 12,618 |
| Litigation award | <u>-</u> | <u>1,580</u> | <u>-</u> |
| Income from operations | 5,468 | 7,849 | 2,314 |

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| | | | |
|---|-------------------|-------------------|---------------------|
| Interest expense | <u>2,216</u> | <u>2,988</u> | <u>4,731</u> |
| Income (loss) before income taxes | 3,252 | 4,861 | (2,417) |
| Provision (benefit) for income taxes | <u>1,334</u> | <u>1,865</u> | <u>(923)</u> |
| Income (loss) from continuing operations | 1,918 | 2,996 | (1,494) |
| Loss on discontinued operation, net of tax | <u>-</u> | <u>(908)</u> | <u>(108)</u> |
| Net income (loss) | \$ 1,918 ===== | \$ 2,088 ===== | \$ (1,602) ===== |
| Net income (loss) per common share - basic: | | | |
| Continuing operations | \$.27 | \$.42 | \$ (.21) |
| Discontinued operation | <u>-</u> | <u>(.13)</u> | <u>(.02)</u> |
| Net income (loss) | \$.27 ===== | \$.29 ===== | \$ (.23) ===== |
| Net income (loss) per common share - diluted: | | | |
| Continuing operations | \$.27 | \$.42 | \$ (.21) |
| Discontinued operation | <u>-</u> | <u>(.13)</u> | <u>(.02)</u> |
| Net income (loss) | \$.27 ===== | \$.29 ===== | \$ (.23) ===== |
| Weighted average common shares outstanding: | | | |
| Basic | 7,082 ===== | 7,077 ===== | 7,074 ===== |
| Diluted | 7,147 ===== | 7,151 ===== | 7,074 ===== |

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

WEBCO INDUSTRIES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
For the Years Ended July 31, 2003, 2002 and 2001
(Dollars in thousands)

| | Common <u>Stock</u> | Additional Paid-In <u>Capital</u> | Retained <u>Earnings</u> | Total Stockholders' <u>Equity</u> |
|---------------------------------------|------------------------|--------------------------------------|--------------------------|--------------------------------------|
| Balances, July 31, 2000 | \$ 71 | \$ 35,732 | \$ 12,845 | \$ 48,648 |
| Net loss | <u>-</u> | <u>-</u> | <u>(1,602)</u> | <u>(1,602)</u> |
| Balances, July 31, 2001 | 71 | 35,732 | 11,243 | 47,046 |
| Proceeds from stock options exercised | - | 12 | - | 12 |

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| | | | | |
|-------------------------|----------------|----------------|----------------|----------------|
| Net Income | <u> -</u> | <u> -</u> | <u> 2,088</u> | <u> 2,088</u> |
| Balances, July 31, 2002 | 71 | 35,744 | 13,331 | 49,146 |
| Net Income | <u> -</u> | <u> -</u> | <u> 1,918</u> | <u> 1,918</u> |
| Balances, July 31, 2003 | \$ 71 | \$ 35,744 | \$ 15,249 | \$ 51,064 |
| | ===== | ===== | ===== | ===== |

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

WEBCO INDUSTRIES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended July 31, 2003, 2002 and 2001
(Dollars in thousands)

| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--|----------------|-----------------|----------------|
| Cash flows from operating activities: | | | |
| Net income (loss) | \$ 1,918 | \$ 2,088 | \$ (1,602) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | |
| Loss on disposal of discontinued operation | - | 914 | - |
| Depreciation and amortization | 6,991 | 7,250 | 6,140 |
| (Gain) loss on disposition of | | | |
| Property, plant and equipment | (6) | 7 | (203) |
| Deferred tax expense (benefit) | 977 | 1,252 | (1,070) |
| (Increase) decrease in: | | | |
| Accounts receivable | (3,010) | 501 | (1,871) |
| Inventories | (6,487) | (1,728) | 2,299 |
| Prepaid expenses | (99) | (1) | (279) |
| Increase (decrease) in: | | | |
| Accounts payable | (1,287) | 1,053 | (206) |
| Accrued liabilities | (149) | 636 | (305) |
| Net change from discontinued operation | <u>(118)</u> | <u>35</u> | <u>317</u> |
| Net cash provided by (used in) operating activities | <u>(1,270)</u> | <u>12,007</u> | <u>3,220</u> |
| Cash flows from investing activities: | | | |
| Capital expenditures | (3,455) | (3,210) | (6,478) |
| Proceeds from sale of property, plant and equipment | 13 | 8 | 1,038 |
| Repayment of stockholder advances | - | 50 | - |
| Other | 810 | 434 | 12 |
| Net change from discontinued operation | <u>-</u> | <u>(11)</u> | <u>(9)</u> |
| Net cash used in investing activities | <u>(2,632)</u> | <u>(2,729)</u> | <u>(5,437)</u> |
| Cash flows from financing activities: | | | |
| Proceeds from long-term debt | 166,650 | 147,508 | 137,862 |
| Principal payments on long-term debt | (163,357) | (157,000) | (135,979) |
| Proceeds from stock options exercised | - | 12 | - |
| Debt issue costs | (82) | (690) | (140) |
| Increase (decrease) in book overdrafts | <u>668</u> | <u>115</u> | <u>(170)</u> |
| Net cash provided by (used in) financing activities | <u>3,879</u> | <u>(10,055)</u> | <u>1,573</u> |
| Net increase (decrease) in cash | (23) | (777) | (644) |
| Cash, beginning of period | <u>212</u> | <u>989</u> | <u>1,633</u> |

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| | | | |
|--|----------|----------|----------|
| Cash, end of period | \$ 189 | \$ 212 | \$ 989 |
| | ===== | ===== | ===== |
| Supplemental disclosure of cash flow information: Interest paid, net of amount capitalized of \$22, \$35, and \$375 in 2003, 2002 and 2001, respectively | \$ 2,236 | \$ 3,240 | \$ 4,816 |
| | ===== | ===== | ===== |
| Income taxes paid | \$ 68 | \$ 10 | \$ 150 |
| | ===== | ===== | ===== |

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

WEBCO INDUSTRIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS - Webco is a full service manufacturer of high-quality carbon steel and stainless steel tubing products designed to industry and customer specifications. Webco is also a value-added distributor of these and other metal tubular products. Webco's tubing products consist primarily of pressure tubing, including heat exchanger tubing, boiler tubing and pipe, and specialty tubing for use in durable and capital goods markets. The Company's subsidiary, P&J, represents several manufacturers who produce various specialty tubular products made from copper, brass, aluminum, stainless and carbon steel, among others. This access to additional tubing products allows the Company to better serve its customers by offering a full range of tubular products. The Company, headquartered in Sand Springs, Oklahoma, 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.

PRINCIPLES OF CONSOLIDATION - The consolidated financial statements include the accounts of Webco Industries, Inc. (Webco or together with its subsidiary, the Company) and its wholly owned subsidiary Phillips & Johnston, Inc. ("P&J"), a Chicago based sales organization and value-added processor of tubular products. All significant intercompany accounts and transactions have been eliminated in the accompanying financial statements. In May, 2002, the Company sold substantially all of the assets of its QuikWater Division and the disposal was treated as a discontinued operation. As a result, the following footnotes have been adjusted to conform to the restated financial statements. The reader should refer to Note 4 - Discontinued Operation for additional information regarding this matter.

ACCOUNTING ESTIMATES - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

CONCENTRATIONS - The Company maintains its cash in bank deposit accounts, which at times may exceed the federal insurance limits. As of July 31, 2003 and 2002, the Company had cash in banks totaling \$1,530,000 and \$814,000, respectively, in excess of federal depository insurance limits. The Company has not experienced any losses on such accounts in the past.

BOOK OVERDRAFTS - Included in accounts payable at July 31, 2003 and 2002, are outstanding checks in excess of bank deposits totaling \$1,072,000 and \$404,000, respectively.

ACCOUNTS RECEIVABLE - Accounts receivable represent short term credit granted to the Company's customers for which collateral is generally not required. Accounts receivable at July 31, 2003 and 2002, are net of an allowance for uncollectible amounts of \$636,000 and \$663,000, respectively.

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 records a provision for excess and obsolete inventory based primarily on inventory aging and forecasts of product demand and pricing. Inventories at July 31, 2003 and 2002 are net of reserves for obsolescence of \$1,665,000 and \$1,580,000, respectively.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

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PROPERTY, PLANT AND EQUIPMENT - Property, plant and equipment is stated at historical cost and includes interest capitalized on major construction projects. Gains or losses on sales and retirements of property are reflected in operations. Depreciation is computed using the straight line method over the following estimated useful lives: buildings and improvements - 10 to 40 years, machinery and equipment - 3 to 25 years, computer equipment and software 3 to 7 years, and furniture and fixtures - 3 to 10 years. Repair and maintenance costs are expensed as incurred.

Depreciation expense for the years ended July 31, 2003, 2002 and 2001, amounted to \$6,729,000, \$6,998,000 and \$6,140,000, respectively. Fully depreciated assets still in use at July 31, 2003 and 2002, amounted to \$11,469,000 and \$15,625,000, respectively.

ACCOUNTING FOR CERTAIN LONG-LIVED ASSETS - The Company evaluates its assets for impairment in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144). The Company reviews its long-lived assets for impairment based on estimated future nondiscounted 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 assets are written down to their estimated fair values. The Company adopted the provisions of FAS 144 in accounting for the discontinued operation in the period ended April 30, 2002 (Note 4). In addition, the other provisions of FAS 144 regarding impairment did not have an impact on the financial position and results of operations of the Company.

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. The reader should refer to Note 7 in these financial statements for additional information on this matter.

REVENUE RECOGNITION - The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements (SAB 101), as amended by SAB 101A and 101B. SAB 101 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 and determinable; and (4) collectibility is reasonably assured. Company product is made to customer or industry specifications at an agreed upon price as typically specified in the customer purchase order. Title passes to the customer at the point 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 the transactions become realizable and fully earned. In addition, the Company recognizes outbound freight expense and shipping and handling costs as a component of cost of sales, while amounts charged to customers for such costs are included in revenue.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

EARNINGS PER SHARE - Earnings per share are calculated based on the number of weighted average common shares outstanding, including the effect of dilutive options when applicable, in accordance with the computation, presentation and disclosure requirements of Financial Accounting Standards Board Statement No. 128, "Earnings Per Share" (SFAS No. 128).

STOCK-BASED COMPENSATION - The Company accounts for its 1994 Stock Incentive Plan (the Plan) under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees , and related interpretations. No stock-based compensation cost is reflected in net income, as all options granted under the Plan had an exercise price at least equal to the market value of the underlying common stock on the date of grant. For purposes of pro forma disclosures, the estimated fair value of the options calculated using the Black-Scholes option valuation model is amortized to expense over the vesting period (See Note 9 for additional information). The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation and FASB Statement No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123", to stock-based employee compensation:

| | For Years Ended July 31, | | |
|---|--|--------------|--------------|
| | (Dollars in thousands, except per share amounts) | | |
| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
| Net income (loss), as reported | \$ 1,918 | \$ 2,088 | \$ (1,602) |
| Less: Total stock-based employee compensation expense determined under fair value based method for all awards | <u>(144)</u> | <u>(160)</u> | <u>(141)</u> |

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| | | | |
|-----------------------------|----------|----------|------------|
| Pro forma net income (loss) | \$ 1,774 | \$ 1,928 | \$ (1,743) |
| | ===== | ===== | ===== |
| Earnings (loss) per share: | | | |
| Basic-as reported | \$.27 | \$.30 | \$ (.23) |
| Basic-pro forma | \$.25 | \$.27 | \$ (.25) |
| Diluted-as reported | \$.27 | \$.29 | \$ (.23) |
| Diluted-pro forma | \$.25 | \$.27 | \$ (.25) |

INCOME TAXES - The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). The provisions of SFAS No. 109 require the recording of deferred tax assets and liabilities to reflect the expected tax consequences in future years of differences between the tax basis of assets and liabilities and their financial statement carrying amounts. 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 operating results. The reader should refer to Note 6 in these financial statements for additional information on this matter.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

NEW ACCOUNTING PRONOUNCEMENTS - In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123" (FAS 148). FAS 148 is effective for fiscal years ending after December 15, 2002. This statement amends Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation" and amends Accounting Principles Board Opinion No. 28 - Interim Financial Reporting. FAS 148 does not change the provisions of FAS 123 that permit entities to continue applying the intrinsic value method of APB 25, "Accounting for Stock Issued to Employees" ("APB 25"). Since the Company applies APB 25, the Company's accounting for stock-based compensation will not change as a result of FAS 148. FAS 148 does require certain new disclosures in both annual and interim financial statements. The new required annual disclosures are effective for the fiscal year ending July 31, 2003 and are included in Note 1 of these financial statements. The new interim disclosure provisions were effective for the Company's third quarter ended April 30, 2003.

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 does not expect FAS 149 to have a significant impact on its consolidated financial statements.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting For Certain Financial Instruments with Characteristics of both Liabilities and Equity" (FAS 150). FAS 150 requires financial statement issuers to classify financial instruments that require a transfer of assets, and that meet the definition of liabilities in FASB Concepts Statement No. 6 (CON 6) and other recognition criteria in FASB Concepts Statement No. 5 (CON 5), as liabilities. The Statement also requires that certain obligations that could be settled by issuance of an entity's equity but lack other characteristics of equity be reported as liabilities even though the obligation does not meet the definition of liabilities in CON 6. This Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for interim periods beginning after June 15, 2003. The Company does not expect FAS 150 to have a significant impact on its consolidated financial statements.

On November 25, 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and Rescission of FASB Interpretation No. 34" ("FIN 45"). FIN 45 clarifies the requirements of FASB Statement No. 5, Accounting for Contingencies (FAS 5), relating to the guarantor's accounting for, and disclosure of, the issuance of certain types of guarantees. For guarantees that fall within the scope of FIN 45, the Interpretation requires that guarantors recognize a liability equal to the fair value of the guarantee upon its issuance. The Interpretation's provisions for initial recognition and measurement should be applied on a prospective basis to guarantees issued or modified after December 31, 2002, irrespective of the guarantor's fiscal year-end. The guarantor's previous accounting for guarantees that were issued before the date of FIN 45's initial application may not be revised or restated to reflect the effect of the recognition and measurement provisions of the Interpretation. The disclosure requirements are effective for financial statements of both interim and annual periods that end after December 15, 2002. The Company does not believe FIN 45 will be material to its consolidated financial statements as the Company is currently not a Guarantor under any guarantee arrangements.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

On January 17, 2003, the FASB issued FASB Interpretation No. 46, Consolidation of Variable Interest Entities, An Interpretation of Accounting Research Bulletin No. 51 (FIN 46). FIN 46 provides 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). Consolidation applies to entities in which the equity investor does not have a controlling financial interest or the equity investment at risk is insufficient to finance that entity's activities in the absence of other subordinated financial support from other parties. The Company does not believe FIN 46 will be material to its consolidated financial statements as the Company is currently not a party to any variable interest entities.

1A. RECLASSIFICATION OF SENIOR REVOLVING LINE OF CREDIT

The Company has restated the balance sheet classification of outstanding debt under the Company's Senior Revolving Line of Credit ("LOC") from long-term to current liabilities. 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 LOC, 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 LOC, which matures May 1, 2005, contains such features and accordingly, the accompanying financial statements have been restated to reclassify outstanding borrowings under the LOC to "Current portion of long-term debt". This change in balance sheet classification does not affect the Consolidated Statements of Operations or Consolidated Statements of Cash Flows.

The following table illustrates the effect of the reclassification of the LOC on the Company's balance sheet at July 31, 2003 and 2002:

| | <u>As previously reported</u> | | <u>As Restated</u> | |
|-----------------------------------|-------------------------------|-------------|--------------------|-------------|
| | <u>2003</u> | <u>2002</u> | <u>2003</u> | <u>2002</u> |
| Current portion of long term debt | \$ 3,020 | \$ 3,135 | \$ 31,868 | \$ 25,238 |
| | ===== | ===== | ===== | ===== |
| Long term debt | \$ 40,948 | \$ 37,325 | \$ 12,100 | \$ 15,222 |
| | ===== | ===== | ===== | ===== |

2. INVENTORIES

Inventories, net of reserves for obsolescence, at July 31, 2003 and 2002, consisted of the following:

| | <u>2003</u> | <u>2002</u> |
|--------------------------------|------------------------|--------------|
| | (Dollars in thousands) | |
| Raw materials | \$ 16,412 | \$ 13,341 |
| Work in process | 2,977 | 1,538 |
| Finished goods | 18,285 | 16,637 |
| Maintenance parts and supplies | <u>3,120</u> | <u>2,791</u> |
| Total inventories | \$ 40,794 | \$ 34,307 |
| | ===== | ===== |

3. PROPERTY, PLANT AND EQUIPMENT

Net property, plant and equipment at July 31, 2003 and 2002, consisted of the following:

| | <u>2003</u> | <u>2002</u> |
|---------------------------------|------------------------|--------------|
| | (Dollars in thousands) | |
| Land | \$ 1,247 | \$ 1,247 |
| Buildings and improvements | 18,233 | 18,487 |
| Machinery and equipment | 82,003 | 83,202 |
| Computer equipment and software | 7,863 | 9,410 |
| Furniture and fixtures | 1,252 | 1,130 |
| Construction in progress | <u>1,089</u> | <u>1,264</u> |
| | 111,687 | 114,740 |

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| | | |
|--|---------------|---------------|
| Less accumulated depreciation and amortization | <u>51,669</u> | <u>51,766</u> |
| Net property, plant and equipment | \$ 60,018 | \$ 62,974 |
| | ===== | ===== |

WEBCO INDUSTRIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

4. DISCONTINUED OPERATION

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 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 years' results of the QuikWater segment have been classified as discontinued. A pre-tax 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.

Net sales and loss from the discontinued operation were as follows for fiscal years 2002 and 2001:

| | <u>2002</u> | <u>2001</u> |
|--|------------------------|-----------------|
| | (Dollars in thousands) | |
| Net Sales | \$ <u>1,912</u> | \$ <u>3,481</u> |
| Pre-tax loss from operations of discontinued | (550) | (175) |
| Segment | | |
| Pre-tax loss on disposal of business segment | (914) | - |
| Income tax benefit | <u>556</u> | <u>67</u> |
| Loss on discontinued operation, net of tax | \$ (908) | \$ (108) |
| | ===== | ===== |

Assets and liabilities of the discontinued operation were as follows:

| | <u>July 31, 2003</u> | <u>July 31, 2002</u> |
|--|------------------------|----------------------|
| | (Dollars in thousands) | |
| Other current assets | \$ - | \$ 3 |
| Current liabilities | <u>(125)</u> | <u>(250)</u> |
| Net assets (liabilities) of discontinued operation | \$ (125) | \$ (247) |
| | ===== | ===== |

WEBCO INDUSTRIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

5. LONG TERM DEBT

Long term debt at July 31, 2003 and 2002, consisted of the following:

| | <u>2003</u> | <u>2002</u> |
|-------------------------------------|------------------------|-------------|
| | (Dollars in thousands) | |
| Senior long-term debt (A) | \$ 12,215 | \$ 15,316 |
| Senior revolving line of credit (A) | 28,848 | 22,103 |
| Revolving loan (C) | - | 200 |

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| | | |
|--|---------------|---------------|
| Real estate and equipment term loans (D) | 2,226 | 2,548 |
| Other (E) | <u>679</u> | <u>293</u> |
| | 43,968 | 40,460 |
| Less current maturities (Restated (B)) | <u>31,868</u> | <u>25,238</u> |
| | | |
| Long term debt | \$ 12,100 | \$ 15,222 |
| | ===== | ===== |

Based upon the borrowing rates currently available to the Company for borrowings with similar terms and average maturities, the Company believes that the carrying amount of its long-term debt approximates fair value.

(A) The Company has a \$15.5 million term loan and a \$32 million (\$38 million as amended on September 16, 2003) revolving line of credit with its primary lender group. The term loan and revolving line of credit bear interest at the prime rate (4.0% at July 31, 2003) plus 1.50% in the case of the term loan or plus 1.25% in the case of revolving loan advances. At the Company's option, borrowings under any facility can bear interest at LIBOR (1.1% at July 31, 2003) plus 3.25% in the case of the term loan or plus 3.0% in the case of revolving loan advances. Interest rate margin percentages are currently at the lowest level and (percentage paid over prime or LIBOR) may change depending on Company performance and the achievement of certain covenant ratio levels and borrowing base availability. These loans mature on May 1, 2005, and are collateralized by substantially all of the Company's assets. Principal payments on the term loan of \$184,500, plus interest, are due each month until maturity. Along with the scheduled principal payments, the Company is required to make additional principal payments on the term loan based on 50 percent of excess cash flow not to exceed \$221,500 per quarter, or \$2,658,000 on a cumulative basis over the term of the debt facility. As of July 31, 2003, the Company has made \$886,000 of additional principal payments. The Company may have borrowings and outstanding letters of credit (\$1,025,000 at July 31, 2003) under the revolving credit facility up to the lesser of \$38 million or an amount determined by a formula based on the amount of eligible inventories and accounts receivable. The Company pays a commitment fee of 0.25% per annum on any unused and available line of credit and a fee of 3.0% on the outstanding amount of letters of credit. At July 31, 2003, \$2.1 million was available for borrowing under the line of credit. Pursuant to the terms of the loan agreement, the Company is subject to various restrictive covenants, including requirements to maintain a minimum debt coverage ratio. The covenants also limit capital expenditures and dividends and require the Company to maintain a minimum borrowing base availability. In addition, the loan agreement provides for acceleration of the loans, at the option of the lender, if F. William Weber and Dana S. Weber fail to possess the power to direct or cause the direction of management and policies of the Company, or the Weber Family ceases to own at least 35 percent of the outstanding voting stock, or upon the occurrence of a material adverse change in the operations or financial condition of the business. All financial covenants are measured on the basis of the Company without consolidating its wholly owned subsidiary, P&J.

(B) Restated to reclassify the Company's Senior Revolving Line of Credit. See Note 1A above.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

(C) P&J has a line-of-credit agreement for \$2,000,000. The line of credit matures on November 30, 2003, bears interest at the lesser of prime rate (4.0% at July 31, 2003) or LIBOR (1.1% at July 31, 2003) plus 2%, and is collateralized by P&J's assets and guaranteed by Webco.

(D) These loans were entered into with various public agencies payable in monthly installments aggregating approximately \$32,000, including interest, at rates ranging from 3 to 5 percent. The notes are collateralized by the underlying real estate and/or equipment and mature over a 2 to 8 year period.

(E) The Company has various equipment loans with its primary lender and other financing companies payable in monthly installments of approximately \$25,000, including interest, at rates ranging up to 7.5 percent. The notes are collateralized by the underlying equipment and mature over a 1 to 5 year period.

At July 31, 2003, the aggregate future maturities of long term debt are as follows: 2004 \$3,020,000; 2005 \$39,079,000; 2006 \$433,000; 2007 - \$382,000; 2008 - \$380,000; and thereafter - \$674,000.

6. INCOME TAXES

The provision for income taxes for fiscal 2003, 2002 and 2001 consists of the following:

| | | |
|------------------------|-------------|-------------|
| <u>2003</u> | <u>2002</u> | <u>2001</u> |
| (Dollars in thousands) | | |

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| | | | |
|------------------------------------|------------|------------|--------------|
| Current: | | | |
| Federal | \$ - | \$ - | \$ - |
| State | 357 | 57 | 80 |
| Deferred: | | | |
| Federal | 874 | 1,618 | (897) |
| State | <u>103</u> | <u>190</u> | <u>(106)</u> |
| Total income tax expense (benefit) | \$ 1,334 | \$ 1,865 | \$ (923) |
| | ===== | ===== | ===== |

The actual income tax expense (benefit) for fiscal 2003, 2002 and 2001 differs from income tax based on the federal statutory rate (34%) due to the following:

| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--|------------------------|-------------|-------------|
| | (Dollars in thousands) | | |
| Expected tax expense (benefit) | \$ 1,106 | \$ 1,653 | \$ (822) |
| State income taxes, net of federal benefit | 304 | 194 | (97) |
| Other | <u>(76)</u> | <u>18</u> | <u>(4)</u> |
| Total income tax expense (benefit) | \$ 1,334 | \$ 1,865 | \$ (923) |
| | ===== | ===== | ===== |

WEBCO INDUSTRIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

At July 31, 2003 and 2002, deferred tax assets and deferred tax liabilities consisted of the following:

| | <u>2003</u> | <u>2002</u> |
|--|------------------------|--------------|
| | (Dollars in thousands) | |
| Net current deferred tax assets: | | |
| Accounts receivable | \$ 242 | \$ 252 |
| Inventories | 405 | 681 |
| Accrued liabilities | 1,555 | 1,620 |
| Operating loss carry forwards | <u>1,116</u> | <u>-</u> |
| Net current deferred tax asset | \$ 3,318 | \$ 2,553 |
| | ===== | ===== |
| Net non-current deferred tax assets (liabilities): | | |
| Property plant and equipment | \$ (13,881) | \$ (13,831) |
| General business credit carry forward | 62 | 62 |
| Alternative minimum tax credit carry forward | 452 | 452 |
| State operating loss carry forwards | 492 | - |
| State tax credits | 272 | 258 |
| Operating loss carry forwards | <u>-</u> | <u>2,198</u> |
| Net non-current deferred tax liability | \$ (12,603) | \$ (10,861) |
| | ===== | ===== |

At July 31, 2003, the Company has operating loss carry forwards for regular tax purposes of approximately \$2,900,000, which expire in 2015 to 2016.

7. COMMITMENTS AND CONTINGENCIES

LITIGATION - In August 1997, the Company filed an action against a vendor relating to certain cut-off equipment sold to the Company, which did not perform to specifications. The case sought recoveries for the cost of the equipment and other incidental and consequential damages, including lost profits, suffered by the Company. On May 27, 1999 a jury awarded the Company \$1.1 million on its claims. Both the

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Company and the vendor appealed the verdict. In January 2002, The Tenth Circuit Court of Appeals entered a decision in the case. The Company's award was affirmed and increased to add prejudgment interest, but the Company's petition to re-consider the exclusion of other incidental and consequential damages was denied. The total judgment of \$1.58 million was collected, and neither party is expected to appeal the decision.

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

LEASES - The Company leases certain buildings and machinery and equipment under non-cancelable operating leases. Under certain of these leases the Company is required to pay property taxes, insurance, repairs and other costs related to the leased property. At July 31, 2003, future minimum payments under non-cancelable leases accounted for as operating leases are \$1,754,000 in 2004; \$1,668,000 in 2005; \$1,369,000 in 2006; \$1,132,000 in 2007; and \$895,000 in 2008. Total rent expense for all operating leases was \$3,322,000, \$3,109,000 and \$2,916,000 in 2003, 2002 and 2001, respectively.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

SELF INSURANCE - The Company maintains a hospitalization and medical coverage program for its employees. Claims under this program are limited to annual losses of \$75,000 per participant plus an additional aggregating deductible of \$85,000 for losses in excess of the per participant limit, and aggregate annual claims of up to \$2,000,000 through the use of a stop loss insurance policy. Additionally, the Company self insures Oklahoma workers' compensation claims up to \$300,000 per occurrence and retains a maximum aggregate liability of \$1,000,000 per one year policy term with respect to all occurrences. The Company has a performance bond in the amount of \$550,000 on file with the State of Oklahoma Workers' Compensation Court, as required by self-insurance regulations. Provisions 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). The total reserve for self-insurance medical and workers' compensation was \$1,026,000 and \$1,103,000 at July 31, 2003 and 2002, respectively.

PURCHASE COMMITMENTS - At July 31, 2003 the Company was committed on outstanding purchase orders for inventory approximating \$21.7 million.

8. EMPLOYEE BENEFIT PLANS

The Company maintains a 401 K benefit plan covering all employees meeting certain service requirements. The plan includes a cash, or deferred compensation, arrangement permitting elective contributions to be made by the participants. Company contributions are made at the discretion of the Board of Directors and are made in cash to the participants' accounts. Company contributions were \$411,000, \$308,000 and \$346,000 in fiscal 2003, 2002 and 2001, respectively.

9. STOCKHOLDERS' EQUITY AND STOCK OPTIONS

In January 1994, the Company's stockholders approved the 1994 Stock Incentive Plan (the "Plan"), in which directors, employees and consultants are eligible to participate. Four types of benefits may be granted in any combination under the Plan: incentive stock options, non qualified stock options, restricted stock and stock appreciation rights. The Plan also provides for certain automatic grants to outside directors. All options expire ten years from the date of grant (except in the case of 10 percent shareholders, which expire five years from the date of grant) and are exercisable at a price which is at least equal to fair market value on the date of grant (110% of fair market value in the case of 10 percent shareholders). The employee options vest evenly over a period of two to five years from the date of grant. The maximum number of shares of common stock with respect to which incentive stock options, non qualified stock options, restricted stock, and stock appreciation rights that may be issued under the Plan is 1,050,000.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Activity under the Plan for the last three fiscal years was as follows:

| Number of <u>Shares</u> | Weighted Average <u>Exercise Price</u> |
|-------------------------|---|
|-------------------------|---|

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| | | |
|------------------------|-----------------|--------|
| Balance, July 31, 2000 | 731,500 | \$5.85 |
| Granted | 138,000 | \$1.60 |
| Forfeited | <u>(61,500)</u> | \$5.88 |
| Balance, July 31, 2001 | 808,000 | \$5.12 |
| Granted | 15,000 | \$2.80 |
| Exercised | (8,000) | \$1.50 |
| Forfeited | <u>(79,500)</u> | \$5.61 |
| Balance, July 31, 2002 | 743,500 | \$5.07 |
| Granted | 92,000 | \$3.34 |
| Forfeited | <u>(5,400)</u> | \$5.16 |
| Balance, July 31, 2003 | 830,100 | \$4.87 |

=====

Outstanding options and exercisable options at July 31, 2003 were as follows:

| <u>Exercise Prices</u> | <u>Number Of Shares</u> | <u>Weighted Average Remaining Contractual Life</u> | <u>Weighted Average Exercise Price</u> |
|------------------------|---------------------------------|--|--|
| Outstanding: | | | |
| \$1.44 - \$2.80 | 151,000 | 7.5 years | \$1.77 |
| \$3.31 - \$5.75 | 302,500 | 6.7 years | \$4.07 |
| \$6.13 - \$8.75 | 376,600 | 3.4 years | \$6.76 |
| Exercisable: | | | |
| \$1.44 - \$2.80 | 138,700 | 7.4 years | \$1.68 |
| \$3.31 - \$5.75 | 169,020 | 6.0 years | \$4.33 |
| \$6.13 - \$8.75 | 375,020 | 3.4 years | \$6.76 |

As of July 31, 2002 and 2001, exercisable options were 604,220 and 433,820, respectively, with weighted average exercise prices of \$5.14 and \$6.20, respectively.

The Company has elected to follow APB Opinion No. 25, Accounting for Stock Issued to Employees, in accounting for its employee stock options rather than the alternative fair value accounting provided for under SFAS No. 123, Accounting for Stock-Based Compensation. Under APB No. 25, because the exercise price of the Company's stock options is at least equal to the market price of the underlying stock on the date of grant, no compensation expense is recognized in the Company's financial statements. Pro forma information regarding net income and earnings per share is required by SFAS No. 123. This information is required to be determined as if the Company had accounted for its employee stock options granted subsequent to July 31, 1995, under the fair value method of that statement.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

The fair value of options granted in fiscal years 2003, 2002 and 2001 reported below has been estimated at the date of grant using a Black-Scholes option pricing model with the following assumptions:

| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|-------------------------|-------------|-------------|-------------|
| Weighted average life | 4.3 years | 6.0 years | 4.1 years |
| Risk-free interest rate | 3.12-3.56% | 5.34% | 5.52-6.0% |
| Expected volatility | 61% | 63% | 59% |
| Expected dividend yield | None | None | None |

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in the opinion of management, the existing models do not necessarily provide a reliable single measure of fair value of its options. The weighted average estimated fair value of employee stock options, whose exercise price equals the market value on the grant date, granted during 2003, 2002 and 2001 was \$1.68, \$1.75 and \$0.81 per share, respectively. There were no options granted in 2003, 2002 or 2001 with an exercise price exceeding market value on the grant date.

10. EARNINGS PER SHARE

Presented below is a reconciliation of the differences between actual weighted average shares outstanding, which are used in computing basic earnings per share, and diluted weighted average shares, which are used in computing diluted earnings per share.

| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|---|-----------------------|-------------|-------------|
| | (Shares in thousands) | | |
| Basic EPS: | | | |
| Weighted average shares outstanding | 7,082 | 7,077 | 7,074 |
| Effect of dilutive securities: Options | <u>65</u> | <u>74</u> | <u>-</u> |
| Diluted EPS: | | | |
| Diluted weighted average shares outstanding | 7,147 | 7,151 | 7,074 |
| | ===== | ===== | ===== |
| Anti-dilutive options outstanding (1): | | | |
| Number of options | 679 | 596 | 808 |
| Weighted average exercise price | \$ 5.56 | \$ 5.89 | \$ 5.12 |

(1) Anti-dilutive options and their average exercise prices were not included in the computation of diluted earnings per share due to either a loss in the period or the option exercise prices being greater than the average market price of the common shares.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

11. SEGMENT INFORMATION

The Company applies the provisions of Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information"(FAS 131). Prior to the quarter ended April 30, 2002, the Company had two reportable segments: Tubing Products and QuikWater, representing the Company's two strategic business units offering different products. However, as discussed in Note 5, the QuikWater segment was disposed of on May 10, 2002 leaving one remaining segment. 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. As a result of the QuikWater disposal, the Company's continuing operations only include activities related to the manufacturing and distribution of tubular products principally made of carbon and stainless steel.

The Company produces tubing for a wide variety of markets and end-use applications. The percentage breakdown of net sales of the Company's main products was as follows for the last three fiscal years:

| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
|--------------------------|-------------|-------------|-------------|
| Specialty tubing | 64 % | 59 % | 61 % |
| Pressure tubing and pipe | 32 | 38 | 35 |
| Freight, scrap and other | <u>4</u> | <u>3</u> | <u>4</u> |
| Total | 100 % | 100 % | 100 % |

12. RELATED PARTY TRANSACTIONS

In October 1995, the Company entered into an agreement with an entity owned by the majority stockholders to subcontract certain manufacturing services. Beginning in late 2000, the Company contracted with the same entity to subcontract the production of QuikWater units, which ceased with the disposal of QuikWater in May 2002. No payments were made by the Company in 2003 while \$423,000 was paid in fiscal 2002. In addition, the Company charges this entity for certain services and technical assistance. During fiscal year 2003, the Company had billed charges of \$21,000 and received payments of \$12,000. The outstanding receivable balance was \$885,000 and \$876,000 at July 31, 2003 and 2002, respectively. As of the end of fiscal year 2003, the Company had discontinued all sharing of such services with this entity.

The Company purchases certain specialty packaging and shipping materials from an entity sold by the principal stockholder during the first quarter of fiscal 2003. Payments of \$113,500 and \$135,800 were made by the Company in fiscal 2003 and 2002, respectively. In addition, the

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Company charges this entity for certain shared benefits and services, including telephone and technical assistance. During fiscal year 2003, the Company had billed charges of \$1,000 and received payments of \$5,000. There was no outstanding receivable balance at July 31, 2003 and \$4,000 at July 31, 2002. The principal stockholder continues to serve on the entity's board of directors and holds a note receivable, with full recourse, from the new owners.

The Company leases its distribution facility in Nederland, Texas from an entity owned by certain Company executives. The amount of the monthly lease payments was determined at the beginning of the lease by an independent evaluation. During 2003, 2002 and 2001, lease expense under the agreement totaled approximately \$65,000 in each year.

WEBCO INDUSTRIES, INC. AND SUBSIDIARY NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Advances were made from time to time during fiscal 1998 and prior years (none during 1999-2003) to the principal stockholder with the highest amount outstanding being \$1,200,000 in 2003 and 2002. The balance outstanding at July 31, 2003 and 2002, was \$1,200,000. The advance is evidenced by a five-year promissory note from the principal stockholder and is collateralized by Company stock and is also a personal obligation. The note bears interest at 3.97 percent and is payable at maturity of the note on June 30, 2007. Accrued interest on the note receivable was \$711,000 and \$663,000 at July 31, 2003 and 2002, respectively, and is included in notes receivable from related parties in the accompanying balance sheet.

Other advances on various terms were made to certain executives prior to fiscal 2000, with the highest amounts outstanding being \$518,000 in 2003 and 2002. The balance outstanding at July 31, 2003 and 2002 was \$518,000. Certain of the advances are collateralized by shares of the Company's common stock and are also personal obligations of the respective officers. The advances are evidenced by five-year promissory notes bearing interest at 3.97 percent and maturing on December 31, 2006. Accrued interest on the notes receivable from related parties totaled \$28,000 and \$24,000 at July 31, 2003 and 2002, respectively, and is included in notes receivable from related parties in the accompanying balance sheet.

WEBCO INDUSTRIES, INC. SUPPLEMENTAL CONSOLIDATED QUARTERLY FINANCIAL DATA (UNAUDITED)

(Dollars and shares in thousands, except per share data)

| | Quarters Ended | | | | Total Year |
|--|-----------------------|-------------|-------------|-------------|-----------------------|
| | October 31, | January 31, | April 30, | July 31, | |
| | <u>2002</u> | <u>2003</u> | <u>2003</u> | <u>2003</u> | |
| 2003 | | | | | |
| Net sales | \$ 44,313 | \$ 43,138 | \$ 44,704 | \$ 43,614 | \$ 175,769 |
| Gross profit | 5,804 | 5,205 | 3,324 | 3,461 | 17,794 |
| Income from operations | 2,195 | 2,097 | 648 | 528 | 5,468 |
| Net income | 963 | 871 | 67 | 17 | 1,918 |
| Net income per diluted share | \$.13 | \$.12 | \$.01 | \$ - | \$.27 |
| Weighted average shares outstanding, diluted | 7,153 | 7,148 | 7,146 | 7,141 | 7,147 |

| | Quarters Ended | | | | Total Year |
|---|-----------------------|-------------|-------------|-------------|-----------------------|
| | October 31, | January 31, | April 30, | July 31, | |
| | <u>2001</u> | <u>2002</u> | <u>2002</u> | <u>2002</u> | |
| 2002 | | | | | |
| Net sales | \$ 39,834 | \$ 38,204 | \$ 40,151 | \$ 38,105 | \$ 156,294 |
| Gross profit | 4,721 | 4,387 | 5,234 | 4,473 | 18,815 |
| Income from operations | 1,653 | 2,938 | 1,601 | 1,657 | 7,849 |
| Income from continuing Operations, net of tax | 441 | 1,343 | 559 | 653 | 2,996 |
| | (32) | (10) | (773) | (93) | (908) |

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| | | | | | |
|--|--------|--------|----------|--------|--------|
| Loss from discontinued operation, net of tax | | | | | |
| Net income (loss) | 409 | 1,333 | (214) | 560 | 2,088 |
| Net income (loss) per diluted share: | | | | | |
| Continuing operations | \$.06 | \$.19 | \$.08 | \$.09 | \$.42 |
| Net income (loss) | \$.06 | \$.19 | \$ (.04) | \$.08 | \$.29 |
| Weighted average shares outstanding, diluted | 7,127 | 7,139 | 7,185 | 7,182 | 7,151 |

The sum of earnings per share for the four quarters may not equal the total earnings per share for the year due to changes in the average number of common shares outstanding and rounding.

Quarterly figures for fiscal year 2002 have been restated to reflect the Company's divestiture of the QuikWater Division on May 10, 2002. The Company sold substantially all of the assets of this segment. 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, the results of the QuikWater segment have been classified as discontinued, and prior periods have been restated. The restatement had no effect on net income (loss). 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/A for additional information regarding this matter.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8 K

(a) The following documents are filed as part of this report:

(1) Financial Statements of Webco Industries, Inc. which are included in Part II,

Item 8:

Report of Independent Auditors

Consolidated Balance Sheets - July 31, 2003 and 2002

Consolidated Statements of Operations - Years ended July 31, 2003, 2002 and 2001

Consolidated Statements of Stockholders' Equity - Years ended July 31, 2003, 2002 and 2001

Consolidated Statements of Cash Flows - Years ended July 31, 2003, 2002 and 2001

Notes to Consolidated Financial Statements

Supplemental Consolidated Quarterly Financial Data (Unaudited)

(2) Financial Statement Schedule:

**WEBCO INDUSTRIES, INC.
SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS**

For the Three Years Ended July 31, 2003

(In thousands)

| <u>Description</u> | Balance at Beginning of <u>Period</u> | <u>Additions</u> | | (1) <u>Deductions</u> | Balance at End of <u>Period</u> |
|--|--|---|-------------------------------------|--------------------------|------------------------------------|
| | | Charged to Costs and <u>Expenses</u> | Charged to Other <u>Accounts</u> | | |
| Allowance for bad debts: | | | | | |
| 2001 | \$ 237 | \$ 387 | - | \$ (4) | \$ 620 |
| 2002 | 620 | 410 | - | (367) | 663 |
| 2003 | 663 | 287 | - | (314) | 636 |
| Reserve for inventory obsolescence: | | | | | |

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| | | | | | |
|------|--------|----------|---|------------|--------|
| 2001 | \$ 566 | \$ 1,314 | - | \$ (1,027) | \$ 853 |
| 2002 | 853 | 2,477 | - | (1,750) | 1,580 |
| 2003 | 1,580 | 1,558 | - | (1,473) | 1,665 |

(1) Amounts represent accounts receivable write-offs, net of recoveries, or inventory disposals.

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS
ON FORM 8 K - Continued**

(3) Exhibits:

Exhibit

Number Exhibit Description

3 (i) Form of Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3(i) to the Company's Registration Statement on Form S 1, No. 33-72994).

3 (ii) By Laws (incorporated by reference to Exhibit 3(ii) to the Company's Registration Statement on Form S 1, No. 33-72994).

10.1 1994 Stock Incentive Plan, as amended (incorporated by reference to the Company's Registration Statement on Form S 8, No. 333-91754).

10.2 Lease, dated October 22, 1996, between the Company and Baker Performance Chemicals Incorporated (incorporated by reference to Exhibit 10.3 to the Company's Form 10-K/A dated July 31, 1997, File No. 0-23242).

10.3 Employment Agreement expiring December 31, 2002, between the Company and Christopher L. Kowalski (incorporated by reference to Exhibit 10.7 to the Company's Form 10-K dated July 31, 1998, File No. 0-23242).

10.4 Lease, dated March 16, 1998, between the Company and Tubular Properties, Ltd. (incorporated by reference to Exhibit 10.8 to the Company's Form 10-K dated July 31, 1998, File No. 0-23242).

10.5 Agreement and Plan of Reorganization dated as of June 29, 1998 by and among Webco Industries, Inc., P&J Acquisition Corp., Phillips & Johnston, Inc., Christopher L Kowalski and Robert N. Pressly (incorporated by reference to Exhibit 99.1 to the Company's Form 8-K dated June 29, 1998, File No. 0-23242).

10.6 Loan Agreement, dated December 1, 1998, between the Pennsylvania Economic Development Financing Authority and Webco Industries, Inc. (incorporated by reference to Exhibit 10.11 to the Company's Form 10-Q dated January 31, 1999, File No. 0-23242).

10.7 Sale of assets of QuikWater Division dated as of May 10, 2002 by and among Webco Industries, Inc. and Quik Water Systems, Inc.(Acquisition Corp.) (incorporated by reference to the Company's Form 8-K dated May 10, 2002, File No. 0-23242).

10.8 Loan and Security Agreement, dated as of June 14, 2002, between American National Bank and Trust Company of Chicago, as agent, certain financial institutions as lender, and the Company (incorporated by reference to Exhibit 99.2 to the Company's Form 8-K dated June 14, 2002, File No. 0-23242).

10.9 Amendment No. 2 to Loan and Security Agreement dated June 14, 2002, between American National Bank and Trust Company of Chicago, as agent, certain financial institutions as lender, and the Company (incorporated by reference to Exhibit 10.9 to the Company's Form 10-K dated July 31, 2003, File No. 0-23242).

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS
ON FORM 8 K - Continued**

Exhibit

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Number **Exhibit Description**

10.10 Employment Agreement expiring September 30, 2006 for F. William Weber (incorporated by reference to Exhibit 10.10 to the Company's Form 10-K dated July 31, 2003, File No. 0-23242).

10.11 Employment Agreement expiring September 30, 2006 for Dana S. Weber (incorporated by reference to Exhibit 10.11 to the Company's Form 10-K dated July 31, 2003, File No. 0-23242).

10.12 Employment Agreement expiring September 30, 2006 for David E. Boyer (incorporated by reference to Exhibit 10.12 to the Company's Form 10-K dated July 31, 2003, File No. 0-23242).

10.13 Employment Agreement expiring September 30, 2006 for Michael P. Howard (incorporated by reference to Exhibit 10.13 to the Company's Form 10-K dated July 31, 2003, File No. 0-23242).

14 Code of Ethics (incorporated by reference to Exhibit 14 to the Company's Form 10-K dated July 31, 2003, File No. 0-23242).

23.1 * Consent of PricewaterhouseCoopers LLP.

31.1 * Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 * Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 * Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 * Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* - Filed herewith.

(b) Reports on Form 8 K:

 Items 7 and 9 disclosure dated March 5, 2003 in connection with second quarter press release.

 Items 7 and 9 disclosure dated March 14, 2003 in connection with second quarter 10-Q filing.

 Items 7, 9 and 12 disclosure dated May 30, 2003 in connection with third quarter press release.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WEBCO INDUSTRIES, INC.

March 4, 2004

By: /s/ F. William Weber
F. William Weber
Chairman, Chief Executive
Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

March 4, 2004

By: /s/ F. William Weber
F. William Weber
Chairman, Chief Executive
Officer and Director

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March 4, 2004 By: /s/ Dana S. Weber
Dana S. Weber
President, Chief Operating Officer
and Director

March 4, 2004 By: /s/ Michael P. Howard
Michael P. Howard
Chief Financial Officer

March 4, 2004 By: /s/ Christopher L. Kowalski
Christopher L. Kowalski
President-Phillips & Johnston, Inc.
and Director

March 4, 2004 By: /s/ Jack D. McCarthy
Jack D. McCarthy
Director

March 4, 2004 By: /s/ Kenneth E. Case
Kenneth E. Case
Director

March 4, 2004 By: /s/ Bradley S. Vetal
Bradley S. Vetal
Director