

WEBCO INDUSTRIES INC
Form 10-K/A
October 28, 2004

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10 K/A
Amendment 2

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.

Edgar Filing: WEBCO INDUSTRIES INC - Form 10-K/A

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. 2 on Form 10-K/A amends Item 9A 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 and amended on March 4, 2004 by Form 10-K/A - Amendment 1 (the "Annual Report"). This Amendment No. 2 reflects certain wording changes to Item 9A as required by the Sarbanes-Oxley Act of 2002 that were effective August 14, 2003 and does not affect previously reported amounts in the Company's Consolidated Balance Sheets or Consolidated Statements of Operations or Cash Flows.

For convenience and ease of reference, the Company is filing this Annual Report in its entirety, except for certain exhibits previously filed, with the applicable changes. Unless otherwise stated, all information contained in this amendment is as of October 29, 2003, the original filing date of the Annual Report. This Form 10-K/A does not reflect events or transactions occurring after such filing date or modify or update those disclosures in the Annual Report that may have been affected by events or transactions occurring subsequent to such filing date.

As discussed in Note 1A of the Notes to Consolidated Financial Statements, the Form 10-K/A-Amendment 1, filed on March 4, 2004, restated the balance sheet classification of outstanding debt under the Company's Senior Revolving Line of Credit ("LOC") from long-term debt 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 were 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

TABLE OF CONTENTS

	<u>Page</u>
PART I	
Item 1. Business	3
Item 2. Properties	14
Item 3. Legal Proceedings	15
Item 4. Submission of Matters to a Vote of Security Holders	15
PART II	
Item 5. Market for Registrant's Common Stock and Related Stockholder Matters	15
Item 6. Selected Financial Data	16
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations	17
Item 7A. Quantitative and Qualitative Disclosures about Market Risk	24
Item 8. Financial Statements and Supplementary Data	26
Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	46
Item 9A. Controls and Procedures	46

PART III

Edgar Filing: WEBCO INDUSTRIES INC - Form 10-K/A

Item 10. Directors and Executive Officers of the Registrant	46
Item 11. Executive Compensation	46
Item 12. Security Ownership of Certain Beneficial Owners and Management	46
Item 13. Certain Relationships and Related Transactions	47
Item 14. Principal Accountant Fees and Services	47

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8 K	47
---	----

WEBCO INDUSTRIES, INC. AND SUBSIDIARY

FORM 10 K

PART I

ITEM 1. BUSINESS

General

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

The Company's philosophy is to pursue growth and profitability through the identification of niche markets for tubular products where the Company can provide a high level of value-added engineering and customer service in order to become the market leader.

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

Industry Overview

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

The tubing industry was once dominated by the major integrated steel producers. Over time, these integrated producers lost their competitive advantage due to higher cost structures and lagging technology and have largely withdrawn from this segment. While the industry has experienced some consolidation over the last several years and less efficient producers rationalized, the industry continues to be highly fragmented and is comprised of independent producers that occupy relatively focused market niches.

The tubing industry has been affected by several trends that are expected to continue. First, customers' increasing emphasis on just-in-time inventory methods has required tubing producers to increase operating efficiencies to accommodate more frequent, smaller sized orders, and has placed greater emphasis on technology advances, inventory management and cost controls. Second, customers' desire to cut operating costs through the outsourcing of specific processing functions, such as tube manufacturing, has created the opportunity for third-party tubing

producers to replace production from captive mills. The slow-down in the U.S. economy, most notably in the manufacturing sector, the volume of foreign steel imports coming into U.S. markets, current trade tariffs, and domestic over-capacity have caused volatility in the price of finished goods and the cost of steel sheet coil, the principal raw material used in the manufacture of tubing products.

TUBING MANUFACTURING PROCESSES

Manufactured Products

Electric Resistance Carbon Steel Weld Process: The Company maintains inventories of carbon steel sheet coils from which it manufactures tubing using electric resistance welding. This steel is in the form of a continuous sheet, typically 48 to 60 inches wide, between .049 and .500 inches thick, and weighing approximately 15 to 20 tons.

All customer orders for manufactured products are entered into a computerized order entry system, and the appropriate steel coil inventory is selected and scheduled for processing in accordance with the customer's delivery date and product specifications. The Company attempts to maximize efficiency by combining orders to optimize mill production and by ordering the size changes in a manner that reduces the amount of setup time necessary to move from one order to the next.

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

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

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

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

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

Tubing Facilities

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

Edgar Filing: WEBCO INDUSTRIES INC - Form 10-K/A

and specialty tubing products. The third facility in Mannford, Oklahoma, produces stainless steel and high alloy pressure and specialty tubing products.

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

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

INDUSTRY SEGMENTS

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

PRODUCTS

Pressure and Specialty Tubing Products

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

	<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 %

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

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

Over the past two years, the pressure tubing and pipe industry has been impacted by low demand in the petrochemical, pulp and paper and power generation industries. U.S. import tariffs imposed in the spring of 2002 on flat rolled carbon steel and the continuing rationalization of domestic flat rolled carbon steel production, due to steel producer plant closures and bankruptcies, has caused an increase in the price of domestic carbon steel coils, the raw material for the Company's carbon steel tubes. Both the lower demand for finished tubing and the raw material environment has caused pressure tubing margins to decrease. During this period of slow demand, the Company has worked hard to develop and expand its distribution capabilities and expects to relocate from its 58,000 square foot Nederland, Texas, facilities in late-2004 to a leased 125,000 square foot, value-added pressure tube distribution facility in Orange, Texas. The Company is also working to expand its product offerings to the pressure tubing markets, not only in its welding of carbon and stainless pressure tubing, but in pressure tubing acquired from outside sourcing partners. The Company believes that these development activities have positioned it to take advantage of growth opportunities that might be caused by our customers' compliance with Federal regulations regarding refinery emissions and a possible resurgence of power plant construction should such events occur.

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

With increased stainless capacity and expanded capacity in Oil City, the Company has targeted the specialty tubing market as a growth area over the next several years. This market continues to undergo a major change in which final assembly manufacturers (automotive, appliance, etc.) outsource component parts and emphasize just-in-time inventory management to reduce production costs. Webco believes that this market, which is largely comprised of original equipment manufacturers (OEMs), provides an opportunity for the Company to gain market share by utilizing its technological capabilities to offer superior quality, on-time delivery, customer service, and customized products at competitive prices.

Quarterly Effects and Seasonality

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

Backlog

The Company's firm backlog of orders at July 31, 2003 and 2002 were approximately \$34.5 million and \$31.3 million, respectively. Orders, including a portion of the orders considered firm, are generally cancelable by the customer until work has commenced and the Company has committed resources; thereafter, orders are generally cancelable by the customer only upon payment of a cancellation penalty, which may include costs for raw materials, tooling, engineering, etc. The Company's backlog is not necessarily indicative of the expected level of future revenues and can be affected by product mix, since the different markets served by the Company have differing lead times and order flow processes.

Competition

Tubing manufacturing and distribution is a highly competitive market, evidenced by the number of bankruptcies, foreclosures and plant closures over the past several years. While fewer competitors can create new opportunities for the Company, it also demonstrates the impact of foreign imports and the ability of tubing customers to move facilities to foreign countries, both of which can act to decrease demand for domestically manufactured tubing. Companies compete on the basis of price, quality, service and ability to deliver orders on a timely basis. Public data concerning the size of the markets in which the Company participates is not readily available since almost all of the large competitors are privately held or do not provide detailed segment disclosures of their tubing activities. The Company believes that it is a domestic leader in the manufacture and distribution of pressure tubing and certain stainless steel and high alloy tubing products. The Company believes that its manufacturing and distribution capabilities provide a strategic advantage over its competitors. Although the Company has a

Edgar Filing: WEBCO INDUSTRIES INC - Form 10-K/A

small share of the overall specialty tubing market, management believes that it is well positioned to increase its market share over the next several years by continuing to focus on niche applications.

The Company's major competitors include Tubes, Inc. and Lone Star Technologies for carbon pressure tubing, Rath/Gibson Tube, Synalloy Corporation and Associated Tube for stainless pressure products, and LTV-Copperweld, PTCAlliance, Metalmatic, Plymouth Tube, Rath/Gibson, Sharon Tube and Lone Star Technologies for specialty tubing. Certain of these competitors are larger and have access to greater financial resources than the Company. Most of these competitors are unionized.

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

Quality Control

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

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

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

Suppliers

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

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

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

Marketing and Customer Service

The Company's sales and marketing efforts for its products are directed by the Senior Vice President of Tubing Operations, the President of P&J, and Webco's product sales managers. These efforts are supported by its distribution organization, internal and external sales staff and technical services group. The Company also emphasizes the use of its technical and engineering support staff in its product development and marketing efforts. The Company's technical services, operating, engineering, quality, sales, product planning and purchasing staffs work closely with customers and suppliers to develop products that meet specific customer needs. Variables in the product development process include the

Edgar Filing: WEBCO INDUSTRIES INC - Form 10-K/A

steel's microstructure, chemistry, mechanical properties, surface finish, machinability, and product consistency. The Company believes this process is essential to its sales effort and provides the Company with a competitive advantage.

Customers and Distribution

The Company manufactures and distributes tubular products for sale to a diverse group of more than 1,000 customers. No single customer represents in excess of 7.5% of the Company's net sales. The Company's ten largest customers represent approximately 28% of net sales. The majority of the Company's sales are made directly to industrial customers, including manufacturers of heat exchangers, HVAC equipment, appliances, automotive components, power generation equipment, waste heat recovery systems, industrial and commercial boilers, and other durable goods.

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

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

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

Government Regulation

The Company's manufacturing and distribution facilities are subject to many federal, state, and local requirements relating to the protection of the environment. The Company continually examines ways to reduce emissions and waste and reduce costs related to environmental compliance. The Company has an in-house environmental team leading the Company's environmental program. Management's philosophy is to implement environmental controls that meet or exceed current and foreseeable legal requirements. Management believes the Company is in material compliance with all environmental laws, does not anticipate any material expenditure to meet environmental requirements, and generally believes that its processes and products do not present any unusual environmental concerns.

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

The Company is subject to the regulatory and reporting requirements of the Sarbanes-Oxley Act of 2002. Management believes it is in material compliance with the new provisions set forth under the Act. Management does anticipate, however, that current and future compliance with such provisions, including the Section 404 certification of internal controls by our Independent Auditors, will result in increased consulting, audit and legal fees. The ultimate cost of the Company's compliance with the requirements of the Sarbanes-Oxley Act has not been determined, although the most costly provisions will not be required until the Company's fiscal year ended July 31, 2005.

Employees

As of September 30, 2003, the Company employed 850 people. None of the Company's employees are covered by collective bargaining agreements. The Company has never experienced a significant work stoppage and considers its employee relations to be good.

Key-Man Insurance

In January 2003, the Company cashed in two key-man, whole-life insurance policies on F. William Weber, Chairman of the Board and Chief Executive Officer and received cash value proceeds of \$822,000. At July 31, 2003, the Company does not have any outstanding key-man life insurance policies on any of its executives or directors.

FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Report on Form 10-K, including statements preceded by, or predicated upon the words "anticipates", "appears", "believes", "expects", "hopeful", "plans" or "should", constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other

Edgar Filing: WEBCO INDUSTRIES INC - Form 10-K/A

important factors that could cause the actual results, performance or achievements of the Company, or industry results, to differ materially from any future results, performance or achievements expressed or implied herein. Such risks, uncertainties and factors include, among others:

General Economic and Business Conditions

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

Competition from Imports

The volume and pricing of imported tubular products significantly impacts the domestic tubular products market. While U.S. trade tariffs have increased the cost of rolled steel coils, many of the types of products that compete with those manufactured by the Company are not being affected by the tariffs imposed in the spring of 2002. In addition, the strength of the U.S. Dollar, lower labor costs in other countries and volume motives of some foreign importers could create circumstances where product pricing is at levels that are marginally profitable or even unprofitable. The Company believes that import levels and import pricing are affected by, among other things, the strength of the U.S. Dollar, overall worldwide demand for tubular products, global economic conditions, the trade practices of and government subsidies to foreign producers, lower labor costs in other countries and the weakness or absence of governmentally imposed trade restrictions or tariffs in the United States. Given the uncertainty in the U.S. economy and certain economies of Asia, South America and Eastern Europe, competition from foreign imports is expected to continue. Decreases in the strength of the U.S. Dollar will need to be sustained for more than a short period of time in order to meaningfully affect the advantages most foreign importers have over domestic manufacturers.

Changes in Manufacturing Technology

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

Banking Environment

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

Relocation of Domestic Demand and Capacity

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

Raw Material Costs and Availability

The Company's largest component of cost of sales is raw material costs. These costs can vary over time due to changes in steel pricing which are influenced by numerous factors beyond the control of the Company, including general economic conditions, foreign imports, domestic competition, labor costs, labor and environmental laws, import duties and tariffs and other trade restrictions. Typically, the Company attempts to pass these changes in cost on to customers. Because there is a relatively small correlation between the short-term factors driving the finished goods pricing of the Company's products and the cost of its raw materials, changes in raw material pricing in some circumstances will affect margins due to the inability to pass such price increases through to customers. There is believed to be a fairly high long-term correlation between the price of raw materials in the tubing industry and the price to the market for finished tubing. However, reductions in the Company's raw material costs often lag behind pressure on the Company's sales prices or increases in raw material costs may precede increases in the Company's sales prices, if increases are obtainable, thus decreasing the Company's profit margins. Although the Company has long-term relationships with steel coil vendors to hopefully ensure a continued supply of raw material, further price increases could have a significant

Edgar Filing: WEBCO INDUSTRIES INC - Form 10-K/A

impact on profitability and operating cash flows. Increasing raw material prices during a period of soft demand for tubular products can have a significant negative impact on margins due to an inability to raise sales prices accordingly.

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

Industry Capacity

The Company and many of its competitors, in both the stainless and carbon steel tubing markets, expanded production capacity over the past decade to the point of over-capacity in many markets, putting downward pressure on pricing. The influx of foreign goods into the U.S. market further pressured prices and margins and forced some in the industry to exit the business. The Company has added capacity in recent years and continues to look for additional opportunities to do so, but only in connection with strategic opportunities in certain niche markets and where there are benefits related to upgrading manufacturing technology.

Domestic Competition

Tube manufacturing is a highly competitive market in which companies compete on the basis of price, quality, service and ability to deliver orders on a timely basis. The Company has different competitors within each of its markets served, some of which are larger and have greater financial resources than the Company. Sales of some of the Company's products represent a high percentage of the market demand for these products, and could be targeted by competitors. Competition from companies operating under bankruptcy protection also poses a threat to pricing as such companies reduce their cost structure and concentrate on short-term cash flow, generally by significantly lowering their prices to customers.

Loss of Significant Customers and Customer Work Stoppages

The Company sells its tubular products to a diverse group of more than 1,000 customers, the largest of which represents just less than 7.5% of the Company's 2003 net sales. The loss of any significant customer, or a work stoppage at a significant customer or in an important end-use sector, such as automotive, could have an adverse effect on the Company's operating results. In addition, the strength of the U.S. Dollar, lower labor costs in other countries, foreign government subsidies and volume motives of some foreign importers could create circumstances where customers are lost as a result of their inability to remain competitive causing them to relocate to a foreign country or discontinue operations altogether.

Customer Claims

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

Technical and Data Processing Capabilities

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

Insurance costs and availability

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

ITEM 2. PROPERTIES

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

<u>Location</u>	<u>Area</u>	<u>Owned or Leased</u>
Sand Springs, Oklahoma Manufacturing Facility	281,000 square feet 26 acres	Owned
Sand Springs, Oklahoma Distribution Facility	50,000 square feet 18 acres	Owned
Mannford, Oklahoma Manufacturing Facility	138,000 square feet 13 acres	Owned
Nederland, Texas Distribution Facility	25,500 square feet	Long-term lease with a purchase Option of the greater of 93% of FMV or \$475,000
Nederland, Texas Warehouses	32,750 square feet	Month to month leases
Oil City, Pennsylvania Manufacturing Facility	205,000 square feet 8 acres	Owned
Titusville, Pennsylvania Cutting Facility	46,700 square feet	Long-term lease
Titusville, Pennsylvania Warehouse	18,500 square feet	Month to month lease
Sand Springs, Oklahoma Corporate Offices	24,400 square feet	Long-term lease with a Purchase option of \$750,000
Sand Springs, Oklahoma Warehouse	13,500 square feet	Long-term lease
Tulsa, Oklahoma Finning Facility	28,000 square feet	Long-term lease
Glen Ellyn, Illinois P&J Corporate Offices And Distribution Facility	12,700 square feet	Long-term lease
Lyndon, Illinois Distribution Facility	33,700 square feet	Long-term lease
Grand Rapids, Michigan Distribution Facility	38,000 square feet	Long-term lease

The Company considers all of its properties, both owned and leased, together with the related machinery and equipment contained therein, to be well maintained, in good operating condition, and suitable and adequate to carry on the Company's business.

ITEM 3. LEGAL PROCEEDINGS

Edgar Filing: WEBCO INDUSTRIES INC - Form 10-K/A

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

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

There were no matters submitted to Webco security holders during the fourth quarter of fiscal year 2003.

PART II

ITEM 5. MARKET FOR REGISTRANTS COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Webco's common stock is traded on the American Stock Exchange ("AMEX") under the symbol "WEB." At the close of business on September 30, 2003, there were 268 holders of record of Webco's common stock. The quarterly prices of Webco's common stock were as follows:

<u>Fiscal Year 2003:</u>	<u>High</u>	<u>Low</u>
Fourth Quarter	3.25	2.64
Third Quarter	3.50	2.65
Second Quarter	3.75	2.67
First Quarter	3.80	3.00
<u>Fiscal Year 2002:</u>		
Fourth Quarter	5.24	3.75
Third Quarter	5.40	3.10
Second Quarter	3.60	2.30
First Quarter	3.30	1.80

Dividends

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

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,

(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)	-	(.13)	(.02)	(.22)	(.13)
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	% of	Dollar	% of	Dollar	% of
<u>Amount</u>	<u>Net Sales</u>	<u>Amount</u>	<u>Net Sales</u>	<u>Amount</u>	<u>Net Sales</u>
(Dollars in Millions)					

Edgar Filing: WEBCO INDUSTRIES INC - Form 10-K/A

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