WEBCO INDUSTRIES INC
Form 10-K
October 29, 2004

Table of Contents

**U.S. SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-K**

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

OR

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

Commission File No. 0-23242

**WEBCO INDUSTRIES, INC.**

(Exact name of registrant as specified in its charter)

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

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

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

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

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

**DOCUMENTS INCORPORATED BY REFERENCE:** None



**WEBCO INDUSTRIES, INC. AND SUBSIDIARIES**

**TABLE OF CONTENTS**

Table of Contents

**WEBCO INDUSTRIES, INC. AND SUBSIDIARY**
**FORM 10-K**

## PART I

### ITEM 1. BUSINESS

#### General

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

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

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

#### Recent Events

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

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

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

Table of Contents

**Industry Overview**

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

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

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

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

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

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

Table of Contents

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

**TUBING MANUFACTURING PROCESSES**

**Manufactured Products**

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

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

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

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

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

Table of Contents

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

**Tubing Facilities**

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

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

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

**INDUSTRY SEGMENTS**

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

Table of Contents

## PRODUCTS

### Tubing Products

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

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

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

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

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

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

and/or finned to customer specifications at the distribution warehouses. The Company believes that its combination of manufacturing and distribution capabilities for carbon steel, alloy steel and stainless steel provides a strategic advantage over its competitors.

Table of Contents

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

**Quarterly Effects and Seasonality**

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

**Backlog**

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

**Competition**

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

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

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

Table of Contents

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

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

**Quality Control**

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

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

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

**Suppliers**

The Company purchases steel sheet coil from a number of primary steel producers including, but not limited to, Nucor, Wheeling-Pittsburgh Steel Corp., ISG, Duferco, Steel Technologies and Gallatin Steel for carbon steel, and Allegheny, North American Stainless and Outokumpu for stainless steel. Webco monitors and purchases some raw material from foreign sources as economic conditions dictate. However, the greatest percentage of Company purchases is from domestically located plants and suppliers. The Company orders steel to specified physical characteristics and chemistry. By purchasing in large quantities at consistent predetermined intervals, Webco is able to

obtain quality raw materials at competitive prices. All increments of the cost of purchasing and landing steel are continuously monitored, reviewed and acted upon. Interruptions in supply from its main suppliers could impact the landed cost of new purchases and/or cause production and delivery delays.

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

Table of Contents

suppliers for finished goods, however, interruptions in supply could impact customer deliveries and the cost of new purchases.

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

**Marketing and Customer Service**

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

**Customers and Distribution**

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

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

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

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

**Government Regulation**

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

Table of Contents

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

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

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

**Employees**

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

**Key-Man Insurance**

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

**FORWARD-LOOKING STATEMENTS**

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

**General Economic and Business Conditions**

Many of the Company s products are sold to industries that experience significant fluctuations in demand based on economic conditions or other matters beyond their control. No assurance can be given that the Company will be able to increase or maintain its level of sales in periods of economic stagnation or downturn, government regulation, war, terrorist attack or other potential disruptions. Furthermore, no assurance can be

Table of Contents

given that the Company will not incur significant losses on accounts receivable or inventory as a result of unanticipated events or an economic downturn.

**Competition from Imports**

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

**Changes in Manufacturing Technology**

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

**Banking Environment**

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

**Relocation of Domestic Demand and Capacity**

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

Table of Contents

**Raw Material Costs and Availability**

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

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

**Industry Capacity**

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

**Domestic Competition**

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

13

Table of Contents

**Loss of Significant Customers and Customer Work Stoppages**

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

**Customer Claims**

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

**Technical and Data Processing Capabilities**

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

**Insurance costs and availability**

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

Table of Contents

**ITEM 2. PROPERTIES**

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

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

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

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

Table of Contents

## ITEM 3. LEGAL PROCEEDINGS

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

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

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

# PART II

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

### Price Range of Common Stock

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

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

### Dividend Policy

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

### Issuer Purchases of Equity Securities

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

Table of Contents

## ITEM 6. SELECTED FINANCIAL DATA

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

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

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

| | 2004 | 2003 | 2002 | 2001 | 2000 |
|---|---|---|---|---|---|
| **Income Statement Data:** | | | | | |
| Net sales | $212,527 | $175,769 | $156,294 | $148,279 | $142,293 |
| Gross profit | 31,380 | 17,794 | 18,815 | 14,932 | 19,105 |
| Income from operations (2) | 14,344 | 5,468 | 7,849 | 2,314 | 4,822 |
| Income (loss) from continuing operations | 7,218 | 1,918 | 2,996 | (1,494) | 536 |
| Loss from discontinued operation (1) | | | (908) | (108) | (1,561) |
| Net income (loss) | 7,218 | 1,918 | 2,088 | (1,602) | (1,025) |
| Net income (loss) per common share basic: | | | | | |
| Continuing operations | 1.02 | .27 | .42 | (0.21) | .08 |
| Discontinued operation (1) | | | (.13) | (0.02) | (0.22) |
| Net income (loss) | 1.02 | .27 | .29 | (0.23) | (0.14) |
| Net income (loss) per common share diluted: | | | | | |
| Income (loss) from continuing operations | 1.01 | .27 | .42 | (0.21) | .08 |
| Loss from discontinued operation (1) | | | (.13) | | |