WEBCO INDUSTRIES INC
Form 10-Q/A
August 03, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q/A
(Amendment No. 1)

(Mark one)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended April 30, 2004

or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15D OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________________ to ___________________.

Commission File Number: 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 No)
9101 West 21st Street, Sand Springs, Oklahoma	74063
(Address of principal executive offices)	(Zip Code)

(918) 241-1000

(Registrant's telephone number, including area code)

NOT APPLICABLE

(Former name, former address and former fiscal year, if changed since last report)

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.

[X] Yes [ ] No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

[ ] Yes [X] No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date: 7,081,723 shares of Common Stock, $0.01 par value, as of May 31, 2004.

EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A amends Part I, Items 1 and 2 and Part II, Item 6 of the Quarterly Report on Form 10-Q of Webco Industries, Inc. (the "Company") for the third quarter ended April 30, 2004, as filed with the Securities and Exchange Commission on June 14, 2004 (the "Quarterly Report").

For convenience and ease of reference the Company is filing this Quarterly Report in its entirety with the applicable changes. Unless otherwise stated, all information contained in this amendment is as of June 14, 2004, the filing date of the Quarterly Report. This Form 10-Q/A does not reflect events or transactions occurring after such filing date or modify or update those disclosures in the Quarterly Report that may have been affected by events or transactions occurring subsequent to such filing date.

As discussed in Note 1, this Form 10-Q/A restates the April 30, 2004 Unaudited Consolidated Balance Sheet amounts for Deferred Income Tax Asset, Accrued Liabilities and Deferred Income Tax Liability and the April 30, 2004 Unaudited Statement of Cash Flow amounts for Deferred Tax Expense and Accrued Liabilities as set forth in the Quarterly Report for the correction of an inadvertent classification error. The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). The provisions of SFAS No. 109 require the recording of deferred tax assets and liabilities to reflect the expected tax consequences in future years of differences between the tax basis of assets and liabilities and their financial statement carrying amounts. Deferred tax assets are regularly reviewed for recoverability and, if deemed necessary, an appropriate valuation allowance is established based on historical taxable income, projected future taxable income, and the expected timing of the reversals of existing temporary differences. The balance sheet herein has been restated to reclassify the expected timing of certain current and deferred tax items, resulting in an increase to both the Deferred Income Tax Asset and Deferred Income Tax Liability and a reduction in Accrued Liabilities. This change in balance sheet classification does not affect the Unaudited Consolidated Statements of Operations or the net cash provided by operating activities or net increase in cash as set forth in the Unaudited Consolidated Statements of Cash Flows.

WEBCO INDUSTRIES, INC. AND SUBSIDIARIES

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Item 1. Consolidated Financial Statements (Unaudited)

WEBCO INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except par value)
(Unaudited)

	April 30, 2004 (Restated, Note 1)	July 31, 2003
ASSETS		
Current assets:		
Cash	$ 220	$ 189
Accounts receivable, net	28,997	21,781
Inventories	42,104	40,794
Prepaid expenses	908	328
Deferred income tax asset (Restated, Note 1)	2,995	3,318
Total current assets	75,224	66,410
Property, plant and equipment, net	60,451	60,018
Notes receivable from related parties	2,599	2,560
Other assets, net	1,414	1,539
Total assets	$ 139,688	$ 130,527
	======	======

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 18,669	$ 17,216
Accrued liabilities (Restated, Note 1)	7,967	5,676
Current portion of long-term debt	35,448	31,868
Total current liabilities	62,084	54,760
Long-term debt	9,514	12,100
Deferred income tax liability (Restated, Note 1)	13,791	12,603
Commitments and contingencies - Note 4		
Stockholders' equity:		
Common stock, $.01 par value, 12,000,000 shares authorized, 7,081,723 shares issued and outstanding	71	71
Additional paid-in capital	35,744	35,744
Accumulated other comprehensive income, net of tax	86	-
Retained earnings	18,398	15,249
Total stockholders' equity	54,299	51,064
Total liabilities and stockholders' equity	$ 139,688	$ 130,527
	======	======

See accompanying notes to unaudited consolidated financial statements.

WEBCO INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

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

(Unaudited)

	Three months ended April 30,		Nine months ended April 30,	
	2004	2003	2004	2003
Net Sales	$ 55,883	$ 44,704	$ 151,127	$ 132,155
Cost of Sales	46,052	41,380	132,240	117,822
Gross Profit	9,831	3,324	18,887	14,333
Selling, general and administrative expenses	5,173	2,676	11,803	9,393
Income from operations	4,658	648	7,084	4,940
Interest expense	589	535	1,715	1,718
Income before income taxes	4,069	113	5,369	3,222
Provision for income taxes	1,683	46	2,220	1,321

Net income	$ 2,386	$ 67	$ 3,149	$ 1,901
	======	======	======	======
Net income per share:				
Basic	$ .34	$ .01	$ .44	$ .27
	======	======	======	======
Diluted	$ .33	$ .01	$ .44	$ .27
	======	======	======	======
Weighted average common shares outstanding:				
Basic	7,082	7,082	7,082	7,082
	======	======	======	======
Diluted	7,185	7,146	7,164	7,149
	======	======	======	======

See accompanying notes to unaudited consolidated financial statements.

WEBCO INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Unaudited)

	Nine Months Ended April 30,	
	2004	**2003**
	(Restated, Note 1)	
Cash flows from operating activities:		
Net income	$ 3,149	$ 1,901
Adjustments to reconcile net income to net		
cash used in operating activities:		
Depreciation and amortization	5,631	5,184
(Gain) loss on disposition of property, plant and equipment	6	(2)
Deferred tax expense (Restated, Note 1)	1,452	1,024
(Increase) decrease in:		
Accounts receivable	(7,216)	(3,942)
Inventories	(1,310)	(4,314)
Prepaid and Other	(619)	(689)
Increase (decrease) in:		
Accounts payable	365	(3,227)
Accrued liabilities (Restated, Note 1)	2,368	142
Net change from discontinued operation	(77)	(93)
Net cash provided by (used in) operating activities	3,749	(4,016)

Cash flows from investing activities:		
Capital expenditures	(5,916)	(2,352)
Proceeds from sale of property, plant and equipment	3	2
Other	21	844
Net cash used in investing activities	(5,892)	(1,506)
Cash flows from financing activities:		
Proceeds from long-term debt	135,899	125,020
Principal payments on long-term debt	(134,905)	(122,045)
Debt issue costs	(87)	(32)
Increase in book overdrafts	1,267	2,531
Net cash provided by financing activities	2,174	5,474
Net increase (decrease) in cash	31	(48)
Cash, beginning of period	189	212
Cash, end of period	$ 220	$ 164
	======	======

See accompanying notes to unaudited consolidated financial statements.

Note 1 General

The accompanying unaudited consolidated financial statements include the accounts of Webco Industries, Inc. and its wholly owned subsidiaries, Phillips & Johnston, Inc. (P&J) and Webco Tube, Inc. 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 wholly-owned subsidiaries on a consolidated basis. 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. All significant inter-company accounts and transactions have been eliminated in the accompanying financial statements.

The unaudited consolidated financial statements include, in the opinion of management, all adjustments, which are of a normal recurring nature, necessary for the fair presentation of the Company s financial position at April 30, 2004, and results of operations for the three-month and nine-month periods ended April 30, 2004 and 2003 and cash flows for the nine-month periods ended April 30, 2004 and 2003. Results for the three-month and nine-month periods ended April 30, 2004 are not necessarily indicative of results that will be realized for the full 2004 fiscal year. The July 31, 2003, year-end balance sheet was derived from the Company s audited consolidated financial statements, but does not include all disclosures required by generally accepted accounting principles. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes which can be found in the Company's Annual Report on Form 10-K/A for the fiscal year ended July 31, 2003.

The Company s independent auditors have performed a review of these interim financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Pursuant to Rule 436(c) under the Securities Act of 1933, their report of that review should not be considered as part of any registration statements prepared or certified by them within the meaning of Sections 7 and 11 of that Act.

Derivative Financial Instruments - The Company accounts for its natural gas hedge instruments according to FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS Nos. 137, 138 and 149. These statements require that every derivative or hedge instrument be recorded on the balance sheet as either an asset or a liability measured at fair value. The Company formally documents its hedge instruments as hedges of a specific underlying exposure (natural gas prices), as well as the risk management objective and strategy for entering into each hedge transaction. At April 30, 2004, the Company s natural gas hedges had a positive net fair value of $145,000. This amount is included as an other asset on the Company s balance sheet with a corresponding credit balance of $86,000, net of a deferred tax liability of $59,000, reported in stockholders equity as accumulated other comprehensive income, net of tax. See Note 2.

Reclassification of Deferred Taxes - This Form 10-Q/A restates the Company's previously filed Form 10-Q dated June 14, 2004 to amend the April 30, 2004 Unaudited Consolidated Balance Sheet and Unaudited Consolidated Statement of Cash Flows to show the effects of an increase to both the Deferred Income Tax Asset and Deferred Income Tax Liability and a decrease to Accrued Liabilities for the correction of an inadvertent classification error. The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). The provisions of SFAS No. 109 require the recording of deferred tax assets and liabilities to reflect the expected tax consequences in future years of differences between the tax basis of assets and liabilities and their financial statement carrying amounts. Deferred tax assets are regularly reviewed for recoverability and, if deemed necessary, an appropriate valuation allowance is established based on historical taxable income, projected future taxable income, and the expected timing of the reversals of existing temporary differences. The accompanying balance sheet has been restated to reclassify the expected timing of certain current and deferred tax items. This change in balance sheet classification does not affect the Unaudited Consolidated Statements of Operations or the net cash provided by operating activities or net increase in cash as set forth in the Unaudited Consolidated Statements of Cash Flows. The following table provides a summary comparison of the effects of the revisions to the unaudited consolidated balance sheet and statements of cash flows from the amounts previously reported at April 30, 2004:

	April 30, 2004	
	As Reported	As Restated
	(in thousands)	
Unaudited Consolidated Balance Sheets		
Deferred Tax Asset	$ 895	$ 2,995
Total Current Assets	73,124	75,224
Total Assets	137,588	139,688
Accrued liabilities	9,367	7,967
Total current liabilities	63,484	62,084
Deferred income tax liability	10,291	13,791
Total liabilities and stockholders' equity	137,588	139,688
Unaudited Consolidated Statements of Cash Flows		
Deferred tax expense	52	1,452
Accrued liabilities	3,768	2,368

Note 1 General, continued

Stock Options - The Company accounts for stock options granted under its 1994 Stock Incentive Plan (the Plan) using the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based compensation cost is reflected in net income, as all options granted under the Plan were to employees and directors at an exercise price at least equal to the market value of the underlying common stock on the date of grant. The fair value of options reported below has been estimated at the date of grant using the Black-Scholes option pricing model. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation and FASB Statement No. 148, "Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123," to stock-based employee compensation (in thousands, except per share amounts):

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2004	**2003**	**2004**	**2003**
Net income, as reported	$ 2,386	$ 67	$ 3,149	$ 1,901
Less: Total stock-based employee compensation expense determined under fair value based method for all awards	(33)	(44)	(72)	(101)
Pro forma net income	$ 2,353	$ 23	$ 3,077	$ 1,800
Earnings per share:				
Basic-as reported	$ .34	$ .01	$ .44	$ .27
Basic-pro forma	$ .33	$ .00	$ .43	$ .25
Diluted-as reported	$ .33	$ .01	$ .44	$ .27
Diluted-pro forma	$ .32	$ .00	$ .42	$ .25

Note 2 Comprehensive Income

The Company follows FASB Statement No. 130, Reporting Comprehensive Income. This statement requires the reporting of comprehensive income and its components which includes the changes in fair market value of the Company s natural gas hedge contracts. The Company s comprehensive income for the three months and nine months ended April 30, 2004 and 2003 was as follows (in thousands):

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2004	2003	2004	2003
Net Income	$ 2,386	$ 67	$ 3,149	$ 1,901
Increase (decrease) in value of derivative hedging instrument, net of taxes of $64 & $63, respectively	92	-	91	-
Less: Reclassification of derivative hedging settlements to income, net of taxes of $4 & $6, respectively	6	-	9	-
	86	-	82	-
Comprehensive Income	$ 2,472	$ 67	$ 3,231	$ 1,901
	=====	=====	=====	=====

As of April 30, 2004, accumulated other comprehensive income, net of tax, consisted of $86,000 of increase in fair market value on natural gas hedging instruments, net of $59,000 tax expense which is included in deferred income tax liability.

Note 3 - Inventories

At April 30, 2004 and July 31, 2003, inventories were as follows (in thousands):

	April 30,2004	July 31, 2003
Raw materials	$ 17,161	$ 16,412
Work-in-progress	3,462	2,977
Finished goods	18,108	18,285
Maintenance parts and supplies	3,373	3,120
Total inventories	$ 42,104	$ 40,794
	=====	=====

Note 4 Commitments and Contingencies

The Company is party to various lawsuits and claims arising in the ordinary course of business and accrues for such claims when the liability is both probable and the amount can be reasonably estimated. Management, after review and consultation with legal counsel, believes that any results of such litigation and claims would not materially affect the results of operations or the financial position of the Company.

Note 5 - Common Stock and Common Stock Equivalents

Presented below is a reconciliation of the differences between actual weighted average shares outstanding and diluted weighted average shares (in thousands, except per share amounts).

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2004	2003	2004	2003
Basic:				
Weighted average shares outstanding	7,082	7,082	7,082	7,082
Effect of dilutive securities: options	103	64	82	67
Diluted:				
Diluted weighted average shares outstanding	7,185	7,146	7,164	7,149
	=====	=====	=====	=====
Anti-dilutive options outstanding (1):				
Number of options	472	680	596	680
	=====	=====	=====	=====
Weighted average exercise price per share	$ 6.33	$ 5.56	$ 5.85	$ 5.56
	=====	=====	=====	=====

(1) Anti-dilutive options and their average exercise prices were not included in the computation of diluted earnings per share due to the option exercise prices being greater than the average market price of the common stock during the periods reported.

Note 6 - Segment Information

The Company applies the provisions of Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information"(FAS 131). 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 are aggregated for segment determination purposes. As a result, the Company's operations only include one segment related to the manufacturing and distribution of tubular products primarily made of carbon and stainless steel.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

Webco Industries, Inc.

We have reviewed the accompanying condensed consolidated balance sheet of Webco Industries, Inc. and subsidiaries as of April 30, 2004, and the related consolidated statements of operations for the three-month and nine-month periods ended April 30, 2004 and 2003 and cash flows for the nine-month periods ended April 30, 2004 and 2003. These interim financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of July 31, 2003, and the related consolidated statements of operations, stockholders equity and cash flows for the year then ended (not presented herein); and in our report dated September 25, 2003, except for Note 1A, as to which the date is March 4, 2004, we expressed an unqualified opinion on those consolidated financial statements in a report that also included an explanatory paragraph referring to a revision to the balance sheet classification of outstanding debt. In our opinion, the information set forth in the accompanying consolidated balance sheet information as of July 31, 2003 is fairly stated in all material respects in relation to the balance sheet from which it has been derived.

As discussed in the fifth paragraph of Note 1 to the condensed consolidated financial statements, the Company revised its balance sheet as of April 30, 2004, and its related statement of cash flows for the nine-month period ended April 30, 2004, to reclassify certain amounts related to income taxes for the correction of an inadvertent classfication error.

PricewaterhouseCoopers LLP
Tulsa, Oklahoma
June 4, 2004, except for the information in the fifth paragraph in Note 1, as to which the date is August 2, 2004.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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 is to pursue growth and profitability through the development of niche markets within the tubular products industry where the Company can provide a high level of customer service and value-added engineering through the deployment of leading-edge manufacturing and information technology. The Company has three production facilities in Oklahoma and Pennsylvania and five value-added distribution facilities in Oklahoma, Texas, Illinois and Michigan, serving more than 1,000 customers throughout North America.

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 wholly-owned subsidiaries on a consolidated basis.

Current Industry Conditions

The steel industry is characterized by changing customer demand, foreign competition, government influence on raw material and finished good import prices, and financial instability among domestic steel producers. As a result of the declining value of the U.S. dollar to foreign currencies, which has increased the export of domestic carbon steel products and decreased the import of competing foreign products, and the lack of availability and high-cost of steel-making inputs such as coke, scrap metal and energy, an environment has been created where carbon steel sheet coil is dramatically increasing in cost and in some cases is unavailable. Over the past several months, 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 related increased sales prices for the Company s products, which are reflected in the Company s financial statements for the third quarter of fiscal 2004, were matched against lower average-cost carbon steel coil inventories resulting in a significant gross profit increase in the third quarter of fiscal 2004.

Due to shortages in the components for making carbon steel and high export demand, an insufficient supply of carbon steel is available to satisfy domestic demand. 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. There can be no assurances, however, that the Company s carbon and stainless steel requirements will continue to be met, which would negatively impact income from operations and cash flows.

In dealing with the current environment, management has been very assertive in passing 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 such price increases to the extent possible. There can be no assurances that the Company will be able to obtain price increases for its products or pass on surcharges to customers with agreed-upon pricing and margins for those customers may be impaired during this period of high raw material costs. The industry as a whole is being forced to pass along increases to protect its economic viability. The reduced availability of steel coils, in some cases, has limited competitive tubing alternatives for customers and mitigated the excess capacity in the tubing industry, at least for the short-term. The current volatility in the steel industry affects all metals; however, it has impacted carbon steel sheet coil to a much greater degree.

Overview of Financial Results

For the fiscal 2004 third quarter ended April 30, 2004, the Company reported net income of $2,386,000, or $0.33 per diluted share. For the same quarter in fiscal 2003, earnings were $67,000, or $0.01 per diluted share. Net sales for the third quarter of fiscal 2004 were $55.9 million, a 25.0 percent increase over the $44.7 million for the same quarter last year.

Net income for the first nine months of fiscal 2004 was $3,149,000, or $0.44 per diluted share, compared to $1,901,000, or $0.27 per diluted share, for the same period in fiscal 2003. Net sales for the first nine months of the current year amounted to $151.1 million, a 14.3 percent increase over the $132.2 million in the same nine-month period of last year.

The Company s business during the third quarter was largely impacted by two separate business conditions. First, selling prices for finished product were based on the higher costs of coiled steel and were matched against the Company s lower average-cost inventories. Gross profit was 17.6 percent of net sales for the quarter compared to 9.5 percent in the first six months of fiscal 2004. Second, the lack of availability of steel limited the ability of customers to purchase products from the Company s competitors. Tubing industry excess capacity was largely mitigated by the lack of availability of carbon steel coils in the domestic marketplace.

The current environment has been very conducive to positive operating results. The Company does not believe these results are sustainable and margins are expected to return to more historical levels as the average cost of inventories increases to current price levels. The level of operating profitability achieved during the third quarter enabled the Company to afford the higher working capital requirements caused by increasing steel costs, despite borrowing limitations in the Company s revolving line of credit. At such time when steel costs begin to decline, the Company believes it may have the opposite challenge of matching decreasing sales prices with higher average-cost inventories.

Results of Operations for the Three Months Ended April 30, 2004 Compared with the Three Months Ended April 30, 2003

Tubing product sales for the current quarter were $55,883,000, an increase of 25.0 percent from the $44,704,000 for the same quarter last year. The $11,179,000 increase in net sales was due to higher overall prices per ton for the Company s products. Sales prices increased as carbon raw material price increases, surcharges and a limited supply of carbon steel coils continued to drive selling prices in the tubing industry. Shipped tonnages improved 15 percent over the same quarter in fiscal 2003 primarily due to new market opportunities in the OEM and high alloy markets.

Gross profit for Tubing products increased to $9,831,000, or 17.6 percent of net sales, for the third quarter of fiscal 2004 from $3,324,000, or 7.4 percent of net sales, for the same period in fiscal 2003. Gross profit margins in fiscal 2004 were positively impacted by increased sales prices, which reflected higher raw material pricing, being matched against lower average-cost raw materials. As the Company s average-cost raw materials increase towards current replacement cost, gross profit margins are expected to decrease to more historical levels. Although every attempt is made to pass increased raw material costs on to customers, it is not always possible due to price competition or customers with agreed upon pricing in certain markets. Although industry excess capacity still exists in the tubing industry, allocations implemented by domestic carbon steel coil producers largely mitigated this condition. Management does not believe the gross profit margins realized in the third quarter of the current year are sustainable for the long-term.

Selling, general and administrative expenses were $5,173,000 for the third quarter of fiscal 2004 compared to $2,676,000 for the same quarter of fiscal 2003. The current quarter increase was primarily due to a $1,426,000 increase in employee and executive bonus accruals due to improved operating performance. Legal expenses and certain financial advisory costs increased expenses approximately $290,000 while expanded selling activities also increased expenses by approximately $330,000.

Although interest expense increased only slightly to $589,000 from $535,000 for the same quarter last year, a significant increase in interest rates could have a material impact on the Company s results of operations and cash flows. See Part I, Item 3: Quantitative and Qualitative Disclosures about Market Risk of this Form 10-Q for additional information concerning interest rate risk.

Results of Operations for the Nine Months Ended April 30, 2004 Compared with the Nine Months Ended April 30, 2003

Tubing product sales for the nine months ended April 30, 2004 were $151,127,000, an increase of 14.4 percent from the $132,155,000 for the same period last year. The $18,972,000 increase in net sales was largely due to sales prices having increased as steel producers imposed large price increases and surcharges on the supply of carbon steel coils to the market. Shipped tonnages improved 7.7 percent over the same nine months in fiscal 2003, which was primarily due to the development of certain high alloy and OEM markets and the Company s ability to obtain raw materials. Although the tubing industry continues to deal with excess capacity, the limited availability of carbon steel coils has largely mitigated this condition.

Gross profit for tubing products increased to $18,887,000, or 12.5 percent of net sales, for the first nine months of fiscal 2004 from $14,333,000, or 10.8 percent of net sales, for the same period in fiscal 2003. Gross profit margins in fiscal 2004 were positively impacted by increased sales prices, which reflected higher raw material pricing, being matched against lower average-cost raw materials. As the Company s average-cost raw materials increase towards current replacement cost, gross profit margins are expected to decrease to historical levels, assuming selling prices do not increase proportionately.

Selling, general and administrative expenses were $11,803,000 for the first nine months of fiscal 2004 compared to $9,393,000 for the same period in fiscal 2003. The fiscal 2003 nine-month period includes a pre-tax insurance recovery to the Company of $299,000 from a fire at the Oil City facility in 2001. Without the insurance recovery in the prior year period, S,G&A costs increased $2,132,000 primarily due to a $1,206,000 increase in employee and executive bonus accruals resulting from improved operating performance. The increase in employee and executive bonus accruals for the third quarter of fiscal 2004 was offset by a reduction in such accruals for the first six months of fiscal 2004. Legal expenses and certain financial advisory costs increased expenses approximately $325,000 while expanded selling activities also increased expenses by approximately $400,000.

Government Regulation

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 $700,000 during the fifteen months leading up to July 31, 2005 and could exceed $500,000 for each succeeding year thereafter. These costs are in addition to the approximately $350,000 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.

Liquidity and Capital Resources

Net cash provided by operations was $3,749,000 for the nine months ended April 30, 2004 versus $4,016,000 used in operations in the prior year period. Accounts receivable increased $7,216,000 during the current period. The current year period experienced stronger sales compared to the prior year period driving the increase in accounts receivable. Inventories increased $1,310,000 during the nine-month period ended April 30, 2004, but increased $4,314,000 for the period ended April 30, 2003 due to rising steel prices and strategic purchases made in prior year quarters in anticipation of rising prices and higher purchased finished goods inventories. Average inventory turned approximately 4.6 times on an annualized basis during the first nine months of fiscal 2004 due to strong sales during the period. The average inventor