WSI INDUSTRIES, INC.
Form 10-K
November 24, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 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 August 29, 2004 or

[ ] Transition Report Pursuant To Section 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period ended from _________ to _________

Commission File No. 000-00619

WSI INDUSTRIES, INC.
(Exact name of Registrant as specified in its charter)

MINNESOTA	41-0691607
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
213 CHELSEA RD MONTICELLO, MINNESOTA	55362
(Address of principal executing offices)	(Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (763) 295-9202

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 $.10 PER SHARE)
(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, 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 (Section 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 Exchange Act Rule 12b-2).

Yes [ ] No [X]

The aggregate market value of the common shares held by non-affiliates of the Registrant on February 27, 2004, the last business day of the Company's most recently completed second quarter was approximately $6,205,000, based upon the closing sale price on that date of $2.43 as reported by the Nasdaq SmallCap System.

Number of shares outstanding of the Company's common stock, par value $.10 per share, as of November 23, 2004 is 2,557,629.

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Proxy Statement for the annual meeting of shareholders to be held on January 6, 2005 are incorporated by reference into Part III. Form 10-K Report consists of 35 pages (including exhibits); the index to the exhibits is set forth on page 12 .

PART I

ITEM 1. BUSINESS

WSI Industries, Inc. (the "Company") makes its periodic and current reports available free of charge as soon as reasonably practicable after such material is electronically filed with, or furnished to, the Securities and Exchange Commission at www.wsiindustries.com.

OVERVIEW

The Company was incorporated in Minnesota in 1950 for the purpose of performing precision contract machining for the aerospace, communication, and industrial markets. The major portion of Company revenues are derived from machining work for the aerospace/avionics industry and recreational vehicles (ATV and motorcycle) markets.

On February 15, 1999, the Company purchased Taurus Numeric Tool, Inc. ("Taurus"). Taurus is a precision contract machining company that sells primarily to the recreational vehicle and aerospace and avionics markets. The Company's operations consist entirely of the Taurus Subsidiary.

On August 6, 1999, the Company purchased Bowman Tool & Machining, Inc. ("Bowman"). Bowman is a precision contract machining company serving the agriculture and construction industries. On February 22, 2002, the Company completed the asset sale of Bowman Tool & Machining, Inc. to an affiliate of the prior owner.

Contract manufacturing constitutes the Company's entire business.

PRODUCTS AND SERVICES

The Company manufactures metal components in medium to high volumes requiring tolerances as close as one ten-thousandth (.0001) of an inch. These components are manufactured in accordance with customer specifications using materials generally purchased by the Company, but occasionally supplied by the customer.

SALES AND MARKETING

The major markets served by the Company have changed in the past several years because of the Company's decision to sell the Bowman division in fiscal 2002 and concentrate its focus on its Taurus operation. Sales to the agricultural industry were 21% of total Company sales in fiscal year 2002. Sales to the construction/power systems market totaled 10% in fiscal 2002. With the sale of Bowman Tool assets described above, the Company is no longer in the agriculture or construction/power systems markets. Sales to the recreational vehicle market totaled 37%, 74% and 79% in fiscal 2002, 2003 and 2004 respectively. Sales to the aerospace/avionics/defense markets totaled 17%, 15% and 14% in fiscal 2002, 2003 and 2004, respectively.

The Company has a reputation as a dependable supplier capable of meeting stringent specifications to produce quality components at high production rates. The Company has demonstrated an ability to develop sophisticated manufacturing processes and controls essential to produce precision and reliability in its products.

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SEASONALITY

Seasonal patterns in the Company's business are reflections of the Company's customers seasonal patterns since the Company's business is that of a provider of manufacturing services.

CUSTOMERS

Sales in excess of 10 percent of fiscal 2004 consolidated sales were made to Polaris Industries, Inc. and related entities in the amount of $9,107,000 or 79% of Company revenues.

BACKLOG

Approximate dollar backlog at August 29, 2004, October 15, 2003 and August 25, 2002 was $3,091,000, $1,899,000 and $2,634,000, respectively. Backlog is not deemed to be any more significant for the Company than for other companies engaged in similar businesses. The October 15, 2003 backlog date and the end of year August dates for 2004 and 2002 are believed to be comparable. The Company believes that the level of backlog is not necessarily indicative of future yearly sale increases or decreases.

COMPETITION

Although there are a large number of companies engaged in machining, the Company believes the number of entities with the technical capability and capacity for producing products of the class and in the volumes manufactured by the Company is relatively small. Competition is primarily based on product quality, service, timely delivery, and price.

RESEARCH AND DEVELOPMENT; INTELLECTUAL PROPERTY

No material amount has been spent on company-sponsored research and development activities. Patents and trademarks are not deemed significant to the Company.

EMPLOYEES

At August 29, 2004, the Company had 54 employees, none of whom were subject to a union contract. We consider our relationship with our employees to be good.

FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

The Company has no operations in any foreign country. In 2004, 2003 and 2002, sales to a customer in Mexico amounted to $360,000, $693,000 and $1,686,000, respectively.

ITEM 2. PROPERTIES

The Company purchased an existing 49,000 square foot facility located in

Monticello, Minnesota in May 2004 to house its production and its headquarters. The purchase price was $1.9 million and was paid for by a combination of cash and debt. The Company is relocating its existing production facility located in Osseo, Minnesota to the Monticello facility. The Osseo building is leased until February 2005 with monthly rent of approximately $9,600 plus operating expenses and taxes. The Company expects to be fully relocated by the end of its fiscal 2005 second quarter.

The Company considers its manufacturing equipment, facilities, and other physical properties to be suitable and adequate to meet the requirements of its business.

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ITEM 3. LEGAL PROCEEDINGS

The Company is not a party to any material legal proceedings, other than ordinary routine litigation incidental to its business.

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

None.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The common stock of the Company is traded on the Nasdaq SmallCap Market System under the symbol "WSCI."

As of November 8, 2004 there were 506 shareholders of record of the Company's common stock.

The following table sets forth, for the periods indicated, the high and low closing sales price information for our common stock as reported by the Nasdaq SmallCap Market.

	Stock Price	
	High	Low
FISCAL 2004:		
First quarter	$ 3.03	$ 2.30
Second quarter	2.87	2.27
Third quarter	4.03	2.21
Fourth quarter	3.53	2.07
FISCAL 2003:		
First quarter	$ 1.58	$ .60
Second quarter	1.30	.90
Third quarter	1.24	.99
Fourth quarter	3.00	1.15

The Company announced a quarterly dividend program in June 2003 and has paid a quarterly dividend of $0.0375 for each of the six quarters thereafter, with the last dividend being paid on November 17, 2004.

The following table sets forth information regarding our equity compensation plans in effect as of August 29, 2004. Each of our equity compensation plans is an "employee benefit plan" as defined by Rule 405 of Regulation C of the Securities Act of 1933.

Equity Compensation Plan Information

Plan category	Number of shares of common stock to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights
Equity compensation plans approved by shareholders:		
1987 Stock Option Plan		
1994 Stock Plan	5,000	$3.88
	376,500	$2.68
Equity compensation plans not approved by shareholders:		
None	--	--
Total	381,500	$2.70

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(1) The Company's Board of Directors has approved amendments to the Company's 1994 Stock Plan extending the term of the plan for ten years to September 29, 2014 and authorizing an additional 200,000 shares for issuance thereunder. These amendments to the 1994 Stock Plan are subject to approval of the Company's shareholders at the Company's 2005 Annual Meeting of Shareholders.

ITEM 6. SELECTED FINANCIAL DATA

FIVE-YEAR SUMMARY OF OPERATIONS
(In thousands, except for per share information and financial ratios)

	2004	2003	2002	2001
Net sales	$ 11,525	$ 10,793	$ 12,948	$ 20,877
Cost of products sold	10,022	8,704	11,348	17,023
Gross margin	1,503	2,089	1,600	3,854
Selling and administrative expense	1,138	1,412	1,461	2,995
Pension curtailment (gain)	-	-	-	-
Acquisition related noncompete				

and consulting expense	47	100	290	550
Goodwill amortization	-	-	-	337
Relocation and 2nd facility cost	239	-	-	347
Severance expense	-	-	-	-
Fair market value impairment of equipment	-	-	-	151
Loss on sale of subsidiary assets	-	-	2,506	-
Interest and other income	(90)	(78)	(28)	(157)
Interest expense	92	123	363	821
Earnings (loss) from continuing operations before taxes	77	532	(2,992)	(1,190)
Income tax expense (benefit)	28	179	(2,179)	3
Net earnings (loss)	$ 49	$ 353	$ (813)	$ (1,193)
Basic earnings (loss) per share	$ .02	$ .14	$ (.33)	$ (.48)
Average number of common shares	2,554	2,474	2,465	2,465
Diluted earnings (loss) share	$ .02	$ .14	$ (.33)	$ (.48)
Average number of dilutive shares	2,625	2,486	2,465	2,465
Dividends paid per share	$ .15	$ .0375	$ -	$ -
Additional information:				
Financial Data:				
Total plant and equipment additions	$ 2,745	$ 161	$ 613	$ 513
Long-term debt	2,613	648	1,398	4,111
Total assets	11,193	9,174	9,799	16,338
Cash flow from operations	477	1,123	(77)	2,634
Stockholders' equity	7,069	7,392	6,939	7,752
Financial Ratios:				
Current ratio	2.16:1	2.89:1	2.23:1	.78:1
Percentage of long term debt to equity	37%	9%	20%	53%
Book value per basic common share	$ 2.76	$ 2.90	$ 2.81	$ 3.14

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES:

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities.

We believe that the estimates, assumptions and judgments involved in the accounting policies described below have the greatest potential impact on our financial statements, so we consider these to be our critical accounting policies. Because of the uncertainty inherent in these matters, actual results could differ from the estimates we used in applying the critical accounting policies. Within the context of these critical accounting policies, we are not currently aware of any reasonably likely event that would result in materially different amounts being reported.

Allowance for Excess and Obsolete Inventory:

Inventories, which are composed of raw materials, work in process and finished goods, are valued at the lower of cost or market. On a periodic basis, the Company analyzes the level of inventory on hand, its cost in relation to market value and estimated customer requirements to determine whether write-downs for excess or obsolete inventory are required. Actual customer requirements in any future periods are inherently uncertain and thus may differ from our estimates. If actual or expected requirements were significantly greater or lower than the established reserves, we would record a reduction or increase to the obsolescence allowance in the period in which we made such a determination.

Goodwill Impairment:

The Company evaluates the valuation of its goodwill according to the provisions of SFAS 142 to determine if the current value of goodwill has been impaired. To do this the Company determines the discounted present value of anticipated cash flows based on anticipated results of operations for the coming years. If we have changes in events or circumstances, including reductions in anticipated cash flows generated by our operations, goodwill could become impaired which would result in a charge to earnings.

Deferred Taxes:

The Company accounts for income taxes using the liability method. Deferred income taxes are provided for temporary difference between the financial reporting and tax bases of assets and liabilities. A valuation allowance would be set up should the realization of any deferred taxes become less likely than not to occur. The valuation allowance is analyzed periodically by the Company and may result in income tax expense different than statutory rates.

LIQUIDITY AND CAPITAL RESOURCES:

The Company's net working capital at the end of fiscal 2004 was $1,756,000 as compared to $2,139,000 at the end of fiscal 2003. The decrease was due primarily to the Company using cash to pay out $383,000 in dividends to its shareholders. The ratio of current assets to current liabilities decreased to 2.16 to 1.0 from 2.89 to 1.0 in the prior year.

In fiscal 2002, the Company's cash provided from operations was a negative $77,000, but included in that total were Bowman accounts payable and accrued liabilities of $629,000 that were retained as part of the asset sale described in Item 1 Overview. Excluding those payments, the Company would have generated $552,000 of cash from operations in fiscal 2002.

Additions to property, plant and equipment were $2,745,000 in fiscal 2004 compared to $161,000 in 2003 and $613,000 in 2002. These amounts included $593,000 and $607,000 of machinery acquired through capital leases in 2004 and 2002, respectively. The major addition to property plant and equipment in fiscal 2004 was the purchase of the Company's new manufacturing facility located in Monticello, Minnesota. The purchase price was $1.9 million and was paid for by a combination of $190,000 in cash and $1,710,000 in mortgages.

In connection with the facility acquisition, the Company renewed its revolving line credit agreement with its bank. Under the agreement, the Company can borrow up to $1 million depending on the level of accounts receivable and raw material. The agreement expires in December 2004 and has never been accessed. The Company is currently pursuing a renewal of the line beyond December 2004.

Proceeds from the sale of equipment amounted to $3,600 and $4,400 in fiscal 2003 and 2002, respectively.

The Company's total debt was $2,920,000 at August 29, 2004 that consisted of mortgages on its building of $1,700,000 and capital lease obligations secured by production equipment of $1,220,000. In fiscal 2003, the Company elected to payoff its seller subordinated note early. In connection with the prepayment, the Company received a $28,000 discount from the note holder. Current maturities of long-term debt consist of $269,000 due on capital leases and $38,000 on its mortgages. It is management's belief that internally generated funds as well as its revolving line of credit will be sufficient to enable the Company to meet its financial requirements during fiscal 2005.

RESULTS OF OPERATIONS:

Net sales in fiscal 2004 were $11.5 million which is an increase of $732,000 or 7% from fiscal 2003. The primary reason for the sales increase was the improvement in sales from the Company's recreational vehicle market. Net sales in fiscal 2003 were $10.8 million which was a decrease of $2.2 million or 17% from fiscal 2002. The primary reason for the decrease was the asset sale of Bowman Tool in February 2002, and thus the inclusion of a half-year of Bowman sales in 2002 operations. Year-on-year sales for Taurus Numeric Tool (the remaining subsidiary of WSI) increased 28% in fiscal 2003 from approximately $8.4 million in fiscal 2002. This increase in sales resulted from increases in volume in the recreational vehicle market offset by the decline in sales from the aerospace and avionics market.

The Company reported net income in fiscal 2004 of $49,000. The Company's income was negatively affected by start-up expenses in a new program in the Company's recreational vehicle market as well as relocation expense incurred with the move to its new Monticello, Minnesota facility. The Company estimates that it will complete the relocation and be in one building by the end of its fiscal 2005 second quarter.

The Company reported net income of $353,000 or $.14 per diluted share in fiscal 2003. The Company reported a net loss in fiscal 2002 of $813,000 or $.33 per share. Included in the 2002 results were recognition of the loss on the sale of the Bowman assets of $2.5 million and an income tax benefit of approximately $2.2 million. Excluding these two items, the Company incurred a loss from operations of $486,000.

Gross margins in fiscal 2004 were 13.0%, a decrease of 6.4% over fiscal 2003's margin of 19.4% and an increase of .7% over fiscal 2002's margin of 12.3%. The decrease in 2004's margins is largely attributable to start-up expenses of the Company's new program in the recreational vehicle market. The fiscal 2003 increase over 2002 was due to volume efficiencies. Fiscal 2002 margins were hampered in large measure due to volume inefficiencies related to the softness of the aerospace/avionics markets and, correspondingly, due to the non-aerospace/avionics business consisting of higher material content products. Margins in 2002 were also affected by a $255,000 increase in the Company's inventory obsolescence reserve made in the second quarter due to the softening of the aerospace/avionics business.

Selling and administrative expense of $1.4 million in fiscal 2004 was a decrease of $88,000 from fiscal 2003 and $327,000 from fiscal 2002. The decrease in expense in fiscal 2004 was due to lower compensation costs and noncompete payments partially offset by the relocation costs. The decrease in selling and administrative expense in fiscal 2003 was due in part to the inclusion in fiscal 2002 of six months of Bowman administrative expense. WSI's selling and administrative costs were also lower in both 2003 and 2002 due to cost containment measures including reductions in wages and benefits, professional services and cost savings due to the consolidation efforts that were a result of the sale of the Bowman Tool subsidiary assets. The Company's fiscal 2003 fourth quarter selling and administrative expense was negatively affected by a $48,000 charge related to an environmental claim relating to an incident that occurred in 1983 involving a subsidiary of the Company that no longer exists.

Interest expense of $92,000 in fiscal 2004 was $31,000 lower than 2003 and $271,000 lower than 2002. The lower expense is a result of lower average levels of long-term debt during each fiscal year.

In 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001 with early adoption permitted for companies with fiscal years beginning after March 15, 2001. The Company adopted the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of fiscal 2002. Effective with the August 27, 2001 adoption of FAS 142, goodwill is no longer amortized but is instead subject to an annual impairment test. The Company has performed its transitional impairment test in conjunction with its adoption of FAS 142 and determined that no charge is warranted. The Company's primary method of estimating goodwill impairment consisted of a discounted cash flow analysis based on the Company's best estimate of future operations, taking into account variations that might occur with different levels of business.

The Company recorded income tax expense of $28,000, or an effective tax rate of 36%, in 2004. The Company maintained its valuation allowance at zero during 2004. The Company recognized an income tax benefit of $2.2 million in fiscal 2002. Prior to 2002, the Company recorded a valuation allowance for the full amount of the deferred tax assets. The valuation allowance was eliminated in 2002 based on the operating results from the fourth quarter and projections for upcoming years that, in the Company's estimation, would make it more likely than not that it will fully utilize its prior loss carryforwards and tax credits.

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

Statements included in this Management's Discussion and Analysis of Financial Condition and Results of Operations, in the letter to shareholders, elsewhere in the Annual Report, in the Company's Form 10-K and in future filings by the Company with the Securities and Exchange Commission, in the Company's press releases and in oral statements made with the approval of an authorized executive officer which are not historical or current facts are "forward-looking statements." These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The Company wishes to caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made and are not predictions of actual future results. Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from historical earnings and those presently anticipated or projected. The following risks and uncertainties, as well as others not now anticipated, in some cases have affected, and in the future could affect, the Company's actual results and could cause the Company's actual financial performance to differ materially from that expressed in any forward-looking statement: (i) the Company's ability to obtain additional manufacturing programs and retain current programs; (ii) the loss of significant business from any one of its current customers could have a material adverse effect on the Company; (iii) a significant downturn in the industries in which the Company participates could have an adverse effect on the demand for Company services and (iv) the expense associated with compliance with the Sarbanes-Oxley Act of 2002 and the rules promulgated thereunder, including Section 404 of the Act relating to management's report on internal controls. In addition, the Company is materially dependent upon one customer that represented 79% of the Company's revenue in fiscal 2004. The loss of this customer or a significant reduction in business from this customer will have a material adverse effect on the Company. The foregoing list should not be construed as exhaustive and the Company disclaims any obligation subsequently to revise any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

None.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See Consolidated Financial Statements section of this Annual Report on Form 10-K beginning on page 18, attached hereto, which consolidated financial statements are incorporated herein by reference.

QUARTERLY EARNINGS SUMMARY (UNAUDITED)

	Net Sales	Gross Margin	Net Earnings	Basic Earnings Per Share	Diluted Earnings Per Share
FISCAL 2004:					
First quarter	$ 2,806,062	$ 410,657	$ 56,370	$ .02	$ .02
Second quarter	2,615,666	408,203	55,590	.02	.02
Third quarter	3,147,009	411,461	60,745	.02	.02
Fourth quarter	2,956,098	272,304	(123,709)	(.05)	(.05)
FISCAL 2003:					
First quarter	$ 2,434,293	$ 461,463	$ 38,650	$ .02	$ .02
Second quarter	2,359,109	411,835	67,926	.03	.03
Third quarter	3,051,583	615,707	145,942	.06	.06
Fourth quarter	2,947,665	599,675	100,851	.04	.04

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

The Company's Chief Executive Officer, Michael J. Pudil, and Chief Financial

Officer, Paul D. Sheely, have evaluated the Company's disclosure controls and procedures as of the end of the period covered by this report. Based upon that review, they have concluded that these controls and procedures are effective in ensuring that material information related to the Company is made known to them by others within the Company.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There have been no significant changes in internal control financial reporting that occurred during the fiscal period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

Pursuant to General Instruction G (3), the Company omits Part III, Items 10, 11, 12, 13 and 14, as a definitive proxy statement will be filed with the Commission pursuant to Regulation 14(a) within 120 days after August 29, 2004 and such information required by such items is incorporated herein by reference from the proxy statement.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of this report.

1. Consolidated Financial Statements: Reference is made to the Index to Consolidated Financial Statements (page 16) hereinafter contained for all Consolidated Financial Statements.

2. Financial Statement Schedules:

   Schedule II - Valuation and Qualifying Accounts - page 31
   Schedules not listed above have been omitted, because they are either not applicable or not material, or the required information is included in the financial statements or related notes.

3. Exhibits.

Exhibit No.	Description
3.1	Articles of Incorporation as amended, incorporated by reference from Exhibit 3 of the Registrant's Form 10-Q for the quarter ended November 29, 1998.
3.2	Bylaws, as amended - incorporated by reference from Exhibit 3.2 of the Registrant's Form 10-K for the year ended August 25, 2002.
10.1	1987 Stock Option Plan, incorporated by reference from Exhibit 10.4 of the Registrant's Form 10-K for the fiscal year ended August 30, 1987.

10.2	Amendment dated August 31, 1989 to the 1987 Stock Option Plan, incorporated by reference from Exhibit 10.5 of the Registrant's Form 10-K for the fiscal year ended August 27, 1989.
10.3	Washington Scientific Industries, Inc. 1994 Stock Plan, incorporated by reference from Exhibit 4.1 of the Registrant's Form S-8 as registered on May 14, 1999.
10.4	Employment Agreement between Michael J. Pudil and Registrant dated November 4, 1993, is incorporated by reference from Exhibit 10.4 of Registrant's Form 10K for the fiscal year ended August 28, 1994.
10.5	Amendment dated January 9, 1997 to the employment agreement between the Registrant and Michael J. Pudil incorporated by reference from Exhibit 10 of the Registrant's Form 10-Q for the quarter ended February 23, 1997.

10.6	Lease Agreement dated February 15, 1999 between Taurus Numeric Tool, Inc. and Rodney and Reba Winter as included in the Stock Purchase Agreement between Rodney Winter and the Registrant, incorporated by reference from Exhibit 2.1 of Form 8-K filed February 28,1999.
10.7	Employment (change in control) Agreement between Michael J. Pudil and Registrant dated January 11, 2001 incorporated by reference from Exhibit 10.1 of the Registrant's Form 10-Q for the quarter ended May 27, 2001.
10.8	Employment (change in control) Agreement between Paul D. Sheely and Registrant dated January 11, 2001 incorporated by reference from Exhibit 10.2 of the Registrant's Form 10-Q for the quarter ended May 27, 2001.
10.9	Amendment No. 1 to Employment (change in control) Agreement between Michael J. Pudil and Registrant dated November 1, 2002. Incorporated by reference from Exhibit 10.10 of the Registrant's Form 10-K for the year ended August 25, 2002.
10.10	Amendment No. 1 to Employment (change in control) Agreement between Paul D. Sheely and Registrant dated November 1, 2002. Incorporated by reference from Exhibit 10.11 of the Registrant's Form 10-K for the year ended August 25, 2002.
10.11	Board of Directors Retirement Program dated June 25, 1982. Incorporated by reference from Exhibit 10.12 of the Registrant's Form 10-K for the year ended August 25, 2002.
10.12	Purchase Agreement dated as of March 12, 2004 between WSI Industries, Inc. and Remmele Engineering, Inc. Incorporated by reference from Exhibit 10.1 of the Registrant's Form 8-K dated May 3, 2004.
10.13	Promissory Note dated as of May 3, 2004 by WSI Industries, Inc. as debtor and Excel Bank Minnesota as holder in the original principal amount of $1,360,000. Incorporated by reference from Exhibit 10.2 of the Registrant's Form 8-K dated May 3, 2004.
10.14	Loan Agreement dated as of May 3, 2004 between WSI Industries, Inc. and Excel Bank Minnesota. Incorporated by reference from Exhibit 10.3 of the Registrant's Form 8-K dated May 3, 2004.

10.15	Promissory Note dated as of May 3, 2004 by WSI Industries, Inc. as debtor and Monticello Economic Development Authority as holder in the original principal amount of $350,000. Incorporated by reference from Exhibit 10.4 of the Registrant's Form 8-K dated May 3, 2004.
10.16	Loan Agreement dated as of May 3, 2004 between WSI Industries, Inc. and the Monticello Economic Development Authority. Incorporated by reference from Exhibit 10.5 of the Registrant's Form 8-K dated May 3, 2004.
10.17	Mortgage and Security Agreement and Fixture Financing Statement dated as of May 3, 2004 between WSI Industries, Inc. and Excel Bank Minnesota. Incorporated by reference from Exhibit 10.6 of the Registrant's Form 8-K dated May 3, 2004.
10.18	Mortgage dated as of May 3, 2004 between WSI Industries, Inc. and the Monticello Economic Development Authority. Incorporated by reference from Exhibit 10.7 of the Registrant's Form 8-K dated May 3, 2004.
10.19	Second Amendment and Modification of Revolving Line of Credit Loan Agreement and Reaffirmation of Guaranties dated as of May 3, 2004 by and among WSI Industries, Inc., Taurus Numeric Tool, Inc. and WSI Rochester, Inc. and Excel Bank Minnesota. Incorporated by reference from Exhibit 10.7 of the Registrant's Form 8-K dated May 3, 2004.
14.1	Code of Ethics & Business Conduct adopted by the Company on October 29, 2003. Incorporated by reference to Exhibit 14.1 of the Registrant's Annual Report on Form 10-K for the year ended August 31, 2003.
23.1	Consent of Schechter Dokken Kanter Andrews & Selcer Ltd.
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 of the Exchange Act.
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 of the Exchange Act.
32.1	Certificate pursuant to 18 U.S.C. Section 1350.

SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WSI INDUSTRIES, INC.

BY: /s/ Michael J. Pudil

Michael J. Pudil, President and
Chief Executive Officer

BY: /s/ Paul D. Sheely
Paul D. Sheely
Vice President and Treasurer

DATE: November 23, 2004

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

SIGNATURE	TITLE	DATE
/s/ Michael J. Pudil Michael J. Pudil	President, Chief Executive Officer, Director	November 23, 2004
/s/ Paul Baszucki Paul Baszucki	Director	November 23, 2004
/s/ Melvin L. Katten Melvin L. Katten	Director	November 23, 2004
/s/ George J. Martin George J. Martin	Director	November 23, 2004
/s/ Eugene J. Mora Eugene J. Mora	Director	November 23, 2004

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CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULE

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REPORT OF INDEPENDENT AUDITORS

Board of Directors and Shareholders
WSI Industries, Inc.
Monticello, Minnesota

We have audited the consolidated balance sheets of WSI Industries, Inc. and Subsidiaries as of August 29, 2004 and August 31, 2003 and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three-year period ended August 29, 2004. Our audits also included the financial statement schedule listed in the Index at Item 15 (a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of WSI Industries, Inc. and Subsidiaries as of August 29, 2004 and August 31, 2003, and the results of its operations and its cash flows for each of the years in the three-year period ended August 29, 2004, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule for the three years ended August 29, 2004, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ Schechter Dokken Kanter
Andrews & Selcer Ltd

Minneapolis, Minnesota
October 15, 2004

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WSI INDUSTRIES, INC.
AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AUGUST 29, 2004 AND AUGUST 31, 2003

	2004	2003
ASSETS		

CURRENT ASSETS:		
Cash and cash equivalents	$ 294,766	$ 891,218
Accounts receivable, less allowance for doubtful accounts of $10,074 and $10,735, respectively	1,757,282	1,530,811
Net Inventories (Note 3)	923,223	606,262
Prepaid and other current assets	93,394	75,747
Deferred tax assets (Note 7)	198,225	169,387
Total current assets	3,266,890	3,273,425
PROPERTY, PLANT, AND EQUIPMENT, AT COST (NOTE 5):		
Land	819,000	-
Building and improvements	1,175,297	-
Machinery and equipment	6,487,671	5,737,237
Less accumulated depreciation	(4,643,058)	(4,018,638)
Total property, plant, and equipment	3,838,910	1,718,599
DEFERRED TAX ASSETS (NOTE 7)	1,687,931	1,813,270
INTANGIBLE ASSETS (NOTE 11):		
Deferred financing costs, net of accumulated amortization of $2,204	30,859	-
Goodwill and related acquisition costs net of accumulated amortization of $344,812	2,368,452	2,368,452
	$ 11,193,042	$ 9,173,746
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade accounts payable	$ 808,047	$ 403,277
Accrued compensation and employee withholdings	251,343	384,857
Miscellaneous accrued expenses	145,294	150,289
Current portion of long-term debt (Note 4)	306,588	195,720
Total current liabilities	1,511,272	1,134,143
LONG-TERM DEBT, LESS CURRENT PORTION (NOTE 4)	2,613,150	648,008
COMMITMENTS (Note 5)		
STOCKHOLDERS' EQUITY (Note 6):		
Common stock, par value $.10 a share; authorized 10,000,000 shares; issued and outstanding 2,557,629 shares and 2,551,129, respectively	255,763	255,113
Capital in excess of par value	1,837,441	1,826,901
Retained earnings	4,975,416	5,309,581
Total stockholders' equity	7,068,620	7,391,595
	$ 11,193,042	$ 9,173,746

See notes to consolidated financial statements.

WSI INDUSTRIES, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED AUGUST 29, 2004, AUGUST 31, 2003 AND AUGUST 25, 2002

	2004	2003	2002
Net sales (Note 9)	$ 11,524,835	$ 10,792,650	$ 12,948,068
Cost of products sold	10,022,210	8,703,970	11,347,924
Gross margin	1,502,625	2,088,680	1,600,144
Selling and administrative expense	1,423,422	1,511,458	1,750,883
Loss on sale of equipment	-	9,972	-
Loss on sale of subsidiary assets	-	-	2,505,919
Interest and other income	(89,693)	(87,984)	(27,838)
Interest expense	92,339	123,343	363,063
	1,426,068	1,556,789	4,592,027
Income (loss) before income taxes	76,557	531,891	(2,991,883)
Income tax expense (benefit) (Note 7)	27,561	178,522	(2,179,119)
Net income (loss)	$ 48,996	$ 353,369	$ (812,764)
Basic earnings (loss) per share	$ .02	$ .14	$ (.33)
Diluted earnings (loss) per share	$ .02	$ .14	$ (.33)
Cash dividend per share	$ .15	$ .0375	$ -
Weighted average number of common shares outstanding	2,554,489	2,473,535	2,465,229
Weighted average number dilutive common shares outstanding	2,625,238	2,485,961	2,465,229

See notes to consolidated financial statements.

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WSI INDUSTRIES, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	COMMON STOCK SHARES	COMMON STOCK AMOUNT	CAPITAL IN EXCESS OF PAR VALUE	RETAINED EARNINGS	
BALANCE AT AUGUST 26, 2001	2,465,229	$ 246,523	$ 1,640,934	$ 5,864,644	$
Net loss	-	-	-	(812,764)	
BALANCE AT AUGUST 25, 2002	2,465,229	$ 246,523	$ 1,640,934	$ 5,051,880	$
Net earnings	-	-	-	353,369	
Exercise of stock options	100,000	10,000	202,500	-	
Dividends paid	-	-	-	(95,668)	
Repurchase of shares	(14,100)	(1,410)	(16,533)	-	
BALANCE AT AUGUST 31, 2003	2,551,129	$ 255,113	$ 1,826,901	$ 5,309,581	$
Net earnings	-	-	-	48,996	
Exercise of stock options	6,500	650	10,540	-	
Dividends paid	-	-	-	(383,161)	
BALANCE AT AUGUST 29, 2004	2,557,629	$ 255,763	$ 1,837,441	$ 4,975,416	$

See notes to consolidated financial statements.

WSI INDUSTRIES, INC.
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED AUGUST 29, 2004, AUGUST 31, 2003 AND AUGUST 25, 2002

	2004	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 48,996	$
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Loss on sale of subsidiary	-	
Depreciation	624,419	
Amortization	2,204	
Loss on sale of property, plant, and equipment and other assets	-	
Deferred taxes	96,501	
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(226,471)	
Inventories	(316,961)	
Prepaid and other current assets	(17,647)	
(Decrease) increase in accounts payable and accrued expenses	266,261	

Net cash provided by (used in) operating activities	477,302
CASH FLOWS FROM INVESTING ACTIVITIES:	
Additions to property, plant, and equipment	(2,151,376)
Proceeds from sale of equipment and other assets	-
Sale of subsidiary	-
Net cash provided by (used in) investing activities	(2,151,376)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Issuance of long-term debt	1,710,000
Payment of long-term debt	(227,344)
Issuance of common stock	11,190
Dividends paid	(383,161)
Deferred financing costs	(33,063)
Purchase of Company stock	-
Net cash provided by (used in) financing activities	1,077,622
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(596,452)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	891,218
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 294,766
SUPPLEMENTAL CASH FLOW INFORMATION:	
Cash paid during the year for:	
Interest	$ 86,484
Income taxes	-
Noncash investing and financing activities:	
Acquisition of machinery through capital lease	593,355

See notes to consolidated financial statements.

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WSI INDUSTRIES, INC.
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED AUGUST 29, 2004, AUGUST 31, 2003 AND AUGUST 25, 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business Description - WSI Industries, Inc. is involved in the precision contract metal machining business primarily serving the recreational vehicle, aerospace/avionics and computer industries.

Fiscal Year - WSI Industries, Inc. and Subsidiaries' (the Company) fiscal years represent a 52- to 53-week period ending the last Sunday in August. Fiscal 2003 consisted of 53 weeks while fiscal 2004 and 2002 each consisted of 52 weeks.

Basis of Presentation - The consolidated financial statements include the accounts of WSI Industries, Inc. and its subsidiaries. All material intercompany balances and transactions have been eliminated.

Cash and Cash Equivalents - Cash and cash equivalents include cash on hand, bank account balances and money market investments including debt obligations issued by the U. S. Government or its agencies and corporate obligations. At times bank balances exceed federally insured limits. Cash equivalents are carried at cost plus accrued interest which approximates fair value.

Inventories - Inventories are stated at the lower of cost (first-in, first-out method) or market. Inventory costs consist of material, direct labor, and manufacturing overhead.

Depreciation - The cost of substantially all machinery and equipment, and buildings and improvements are being depreciated using the straight-line method. The estimated useful lives of the assets are as follows:

Machinery and equipment	3 to 10 years
Building and improvements	15 to 40 years

The Company evaluates long-term assets on a periodic basis in compliance with Statement of Financial Accounting Standards (SFAS) No. 121, Accounting for the Impairment of Long-lived Assets when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets carrying amount.

Income Taxes - The Company accounts for income taxes using the liability method. Deferred income taxes are provided for temporary differences between the financial reporting and tax bases of assets and liabilities.

Revenue Recognition - Revenues from sales of product are recorded generally upon shipment. The Company has an agreement with a customer to provide product on a consignment basis. In this case, revenues are recognized when the customer notifies the Company that it has consumed the product. Credit losses relating to customers have been minimal and within management's expectations. Based on management's evaluation of uncollected accounts receivable at the end of each year, bad debts are provided for on the allowance method. Accounts are considered delinquent if they are 120 days past due. The Company mitigates its credit risk by performing credit checks and actively pursuing past due accounts.

Use of Estimates - The preparation of financial statements in conformity with U. S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates made in those financial statements consist of estimates related to the impairment of goodwill as well as to the valuation allowance connected to the deferred tax assets.

Earnings per Share - Basic earnings per share is computed using the weighted average number of common shares outstanding. Diluted earnings per share is computed using the combination of dilutive common share equivalents and the weighted average number of common shares outstanding.

Stock Options - The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, but applies Accounting Principles Board Opinion No. 25 (APB 25) and related interpretation in accounting for its plans. Under APB 25, when the exercise price of employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. In fiscal 2004, 245,000 shares of stock options were excluded from the diluted earnings per share computation due to their anti-dilutive effect. In fiscal 2003 and 2002, the number of shares excluded were 184,000 and 431,000, respectively.

2. DIVESTITURE

On February 22, 2002, the Company completed the asset sale of one of its subsidiaries, Bowman Tool & Machining, Inc., to W. Bowman Consulting Company, an affiliate of the prior owner of Bowman. The Company received approximately $3.1 million in cash from the sale, with the buyer also assuming another $3.4 million in long-term debt (including capital leases) in exchange for substantially all the assets of Bowman Tool. The buyer also assumed any remaining liabilities associated with amounts due on the non-compete and employment agreements that were a result of the original 1999 Bowman acquisition. The Company retained approximately $629,000 in accounts payable and accrued liabilities that were not part of the sale.

The Company recognized a loss from the sale of Bowman of approximately $2.5 million. The loss consisted of the $6.7 million in cash and debt assumed offset by accounts receivable and inventory purchased of $1.25 million, net book value of property and equipment purchased of $3.8 million, goodwill also of $3.8 million as well as $350,000 of costs associated with closing the deal. The sale was completed at the close of the last business day of the second quarter of fiscal 2002 so the consolidated statement of operations and cash flows reflect six months of activity for Bowman in fiscal 2002.

3. INVENTORIES

Inventories consist primarily of raw material, work-in-process (WIP) and finished goods. The following table breaks out the values in each category net of the inventory valuation allowances of $409,249 and $422,930 at August 29, 2004 and August 31, 2003, respectively:

	August 29, 2004	August 31, 2003
Raw material	$277,359	$185,785
WIP	359,432	211,188
Finished goods	286,432	209,289
	$923,223	$606,262

4. DEBT

Long-term debt consists of the following:

	August 29, 2004	August 31, 2003
Mortgages	1,699,897	-

Capitalized lease obligations (Note 5)	1,219,841	843,728
	2,919,738	843,728
Less current portion	306,588	195,720
Long-term debt$	2,613,150	$ 648,008

The Company purchased land and a building located in Monticello, Minnesota in May 2004. In connection with the purchase, the Company entered into two mortgages. The first mortgage was with its bank for $1,360,000 that matures on May 1, 2014. The mortgage has an initial interest rate of 5.37% with a provision that the rate will adjust on May 3, 2009 to a rate 2.5% above the monthly yield on United States Treasury five-year securities. The mortgage requires monthly principal and interest payments of $8,307 based on a 25-year amortization schedule. The mortgage is secured by all assets of the Company.

The Company also entered into a mortgage with the City of Monticello Economic Development Authority (EDA). The EDA mortgage is subordinated to the bank mortgage, carries an interest rate of 2% and matures May 1, 2009. The mortgage also requires monthly principal and interest payments of $1,483 based on a 25-year amortization schedule.

Maturities of long-term debt are as follows:

Fiscal years ending August:	
2005	$ 306,588
2006	256,227
2007	274,729
2008	262,938
2009	444,448
Thereafter	1,374,808

Line of Credit:

Concurrent with the mortgage, the Company renewed its revolving credit agreement with the bank. Under the agreement, the Company can borrow up to $1 million, with the loan being collateralized by all assets of the Company. The agreement expires December 31, 2004 and has restrictive provisions requiring minimum net worth, current and debt service coverage ratios as well as a maximum ratio of debt to tangible net worth. At August 29, 2004, the Company was in compliance with these provisions. Interest on any amounts borrowed under the agreement would be at the bank's base rate (4.5% at August 29, 2004). During fiscal 2004, the Company did not access the line.

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5. COMMITMENTS

Leases - Included in the consolidated balance sheet at August 29, 2004 are cost and accumulated depreciation on equipment subject to capitalized leases of $2,404,838 and $1,271,471 respectively. At August 31, 2003, the amounts were $1,788,730 and $1,053,719, respectively.

The present value of the net minimum payments on capital leases as of August 29, 2004 is as follows:

Fiscal years ending August:	
2005	$ 344,235
2006	275,903
2007	275,902
2008	245,773
2009	123,463
Thereafter	180,485
Total minimum lease payments	1,445,761
Less amount representing interest	225,920
Present value of net minimum lease payments	1,219,841
Current portion	268,964
Capital lease obligation, less current portion	$ 950,877

The Company leases its Osseo, Minnesota facility under an operating lease that expires in February 2005 with a monthly base rent of $9,640. Operating expenses and real estate taxes are paid by the Company.

The Company also leases a storage facility under an operating lease that expires in November 2004 with a monthly rent of $2,013.

Future minimum lease payments for operating leases are:

Fiscal years ending August:	
2005	$68,948
Total minimum lease payments	$64,948

Rent expense of approximately $143,000, $144,000 and $286,000 have been charged to operations for the years ended August 29, 2004, August 31, 2003 and August 25, 2002, respectively.

6. STOCK OPTIONS

Stock Options - In fiscal 1988, the 1987 stock option plan was approved and 175,000 shares of common stock were reserved for granting of options to officers, key employees, and directors. No shares remain available for grant from this plan since the term of grant is limited to ten years from the date of the plan.

In fiscal 1995, the 1994 stock option plan was approved and 250,000 shares of common stock were reserved for granting of options to officers, key employees, and directors. During fiscal 1999, the plan was amended to reserve an additional 200,000 shares. At August 29, 2004, 49,166 shares remained reserved and available for grant under the plan.

Option transactions during the three years ended August 29, 2004 are summarized as follows:

	1987 Stock Option Plan		1994 Stock Option Plan	
	Shares	Average Price	Shares	Average Price
Outstanding at August 26, 2001	109,000	$ 2.20	316,500	$ 4.44
Granted	-		103,000	1.43
Lapsed or Cancelled	-		(97,500)	5.04
Outstanding at August 25, 2002	109,000	2.20	322,000	3.30
Granted	-		60,000	1.22
Lapsed	-		(54,000)	4.46
Exercised	(100,000)	2.13	-	
Outstanding at August 31, 2003	9,000	3.04	328,000	2.78
Granted	-		65,000	2.75
Lapsed	-		(14,000)	4.17
Exercised	(4,000)	2.00	(2,500)	1.28
Outstanding at August 29, 2004	5,000	$ 3.88	376,500	$ 2.68

The following pro forma information has been determined as if the Company had accounted for its stock options under the fair value method of SFAS 123. The fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following assumptions for grants issued during fiscal 2004, fiscal 2003 and fiscal 2002 as set forth in the table below. The estimated fair value of the options is amortized to expense over the options' vesting period.

	2004	2003	2002
Dividend yield	5.5%	5%	None
Expected volatility	76.29%	77.47%	60.9%
Risk free interest rate	3.4%-4.2%	3.25%-4.4%	3%-4%
Expected term	5-10 years	5-10 years	5-10 years

The Company's net income and income per share would be adjusted to the pro forma amounts as follows:

	Years ended		
	August 29, 2004	August 31, 2003	August 25, 2002

Net Income (loss):			
As reported	$ 48,996	$ 353,369	$ (812,764)
Less: Total Stock based compensation expense determined under fair value based method for all awards	(76,098)	(33,287)	(94,685)
Pro forma	$ (27,102)	$ 320,082	$ (907,449)

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Income (loss) per basic common share:			
As reported	$ .02	$ .14	$ (.33)
Pro forma	$ (.01)	$ .13	$ (.37)
Income per diluted common share:			
As reported	$ .02	$ .14	$ (.33)
Pro forma	$ (.01)	$ .13	$ (.37)

As of August 29, 2004, there were 148,500 options outstanding with exercise prices between $1.22 and $1.44, 106,000 options outstanding with exercise prices between $2.00 and $2.94, 54,000 shares with exercise prices between $3.00 and $3.88 and 73,000 options outstanding with exercise prices between $4.13 and $5.50. At August 29, 2004, outstanding options had a weighted-average remaining contractual life of 6 years.

The number of options exercisable as of August 29, 2004, August 31, 2003 and August 25, 2002 were 319,500, 270,000 and 354,000, respectively, at weighted average share prices of $2.79, $3.11, and $3.28 per share, respectively.

7. INCOME TAXES

Income tax expense (benefit) consisted of the following:

	Years Ended		
	August 29, 2004	August 31, 2003	August 25, 2002
Current:			
Federal	$ (68,940)	$ -	$ -
State	-	-	4,300
	(68,940)	-	4,300
Deferred:			
Federal	94,501	167,437	(2,090,861)
State	2,000	11,085	(92,558)
Total	$ 96,501	$ 178,522	$ (2,183,419)

A reconciliation of the federal income tax provision at the statutory rate with actual taxes provided on (loss) earnings from continuing operations is as follows:

	Years Ended		
	August 29, 2004	August 31, 2003	August 25, 2002
Ordinary federal income tax statutory rate	34.0%	34.0%	(35.0%)
Limitation on (utilization of) tax assets	-	-	35.0
Change in valuation allowance	-	-	(72.2)
State income taxes net of federal tax effect	2.6	2.1	(2.1)
Other	(.6)	(2.5)	1.5
Taxes provided	36.0%	33.6%	(72.8)%

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Deferred income taxes are provided for the temporary differences between the financial reporting and tax bases of the Company's assets and liabilities. Temporary differences, net operating loss carryforwards, and valuation allowances comprising the net deferred taxes on the balance sheet are as follows:

	August 29, 2004	August 31, 2003
DEFERRED TAX ASSETS		
Accrued liabilities	$ 43,815	$ 10,414
Inventory valuation accruals	139,145	143,796
Net operating loss carryforwards	1,463,242	1,497,073
Tax credit carryforwards	505,750	576,638
Other	141,794	140,382
	2,293,746	2,368,303
DEFERRED TAX LIABILITIES		
Tax depreciation and amortization greater than book	(407,590)	(385,646)
Net deferred tax assets	1,886,156	1,982,657
Valuation allowance	-	-
Net Deferred Tax Asset	$ 1,886,156	$ 1,982,657

The valuation allowance for net deferred tax assets was eliminated in 2002. The elimination was based on improved operating results in the fourth quarter of 2002, as well as projected operating results for 2003 and beyond. Correspondingly, the Company determined that it was more likely than not that it will be able to generate taxable income in the future to offset these deductions and carryforwards.

As of August 29, 2004, the Company had federal net operating loss carryforwards of approximately $4,210,000 expiring in 2009-2022. Also as of August 29, 2004, the Company had $454,000 in federal alternative minimum tax (AMT) credit carryforward and approximately $52,000 in other credit carryforward. The AMT credits are available to offset future tax liabilities only to the extent that the Company has regular tax liabilities in excess of AMT tax liabilities.

8. EMPLOYEE BENEFITS

The Company maintains a 401(k) profit sharing and retirement savings plan that all employees are eligible to participate in. Contributions charged to operations for fiscal 2004, 2003, and 2002, were $88,788, $78,822 and $102,233, respectively.

9. INFORMATION CONCERNING SALES TO MAJOR CUSTOMERS

The Company had sales to three customers that exceeded 10 percent of total sales during any one of fiscal years 2004, 2003 or 2002 as listed below:

	Fiscal Year Sales		
Customer	2004	2003	2002
#1	$9,107,000	$8,034,000	$4,782,000
#2	-	-	4,119,000
#3	741,000	950,000	1,314,000

The Company had accounts receivable from its largest customer of $1,314,000 and $1,078,000 at August 29, 2004 and August 31, 2003, respectively.

10. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

	2004	2003	2002
Net Income (Loss)	$ 48,996	$ 353,369	$ (812,764)
Denominator for earnings per share:			
Weighted average shares; denominator for basic earnings per share	2,554,489	2,473,535	2,465,229
Effect of dilutive securities; employee and nonemployee options	70,749	12,426	-

Dilutive common shares; denominator for diluted earnings per share	2,625,238	2,485,961	2,465,229
Basic (loss) income per share	$ .02	$ .14	$ (.33)
Dilutive income (loss) per share	$ .02	$ .14	$ (.33)

11. GOODWILL AND INTANGIBLE ASSETS

In 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, effective for fiscal years beginning after December 15, 2001 with early adoption permitted for companies with fiscal years beginning after March 15, 2001. Under the new rules, goodwill and intangible assets deemed to have indefinite lives will no longer be amortized but will be subject to annual impairment tests in accordance with the statements. Other intangible assets will continue to be amortized over their useful lives.

The Company adopted the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of fiscal 2002. Effective with the August 27, 2001 adoption of FAS 142, goodwill is no longer amortized but is instead subject to an annual impairment test. The company has performed its transitional impairment test in conjunction with the adoption of FAS 142 and determined that no charge is warranted.

Goodwill and other intangible assets resulting from acquisitions of business and the formation of the Company consist of goodwill of $2,119,669 (net of accumulated amortization of $308,595), and organization costs of $248,783 (net of accumulated amortization of $36,217) at each year end.

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The Company recorded $33,063 of deferred financing costs incurred in connection with the mortgages described in Note 4. The costs are being amortized over five years on a straight-line basis with the Company incurring $6,613 per year of amortization expense over that period.

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WSI INDUSTRIES, INC. AND SUBSIDIARIES

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

DESCRIPTION	BALANCE AT BEGINNING OF PERIOD	NET ADDITIONS CHARGED TO COST AND EXPENSES	NET DEDUCTIO

Reserves deducted from assets to which it applies:

ALLOWANCE FOR DOUBTFUL ACCOUNTS:			
Year ended August 25, 2002	$ 27,500	$ 0	$ 16
Year ended August 31, 2003	$ 10,753	$ 0	$
Year ended August 29, 2004	$ 10,735	$ 0	$
ALLOWANCE FOR EXCESS OR OBSOLETE INVENTORY:			
Year ended August 25, 2002	$ 263,372	$ 301,327	$ 47
Year ended August 31, 2003	$ 517,380	$ 0	$ 94
Year ended August 29, 2004	$ 422,930	$ 0	$ 13

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