LUFKIN INDUSTRIES, INC.

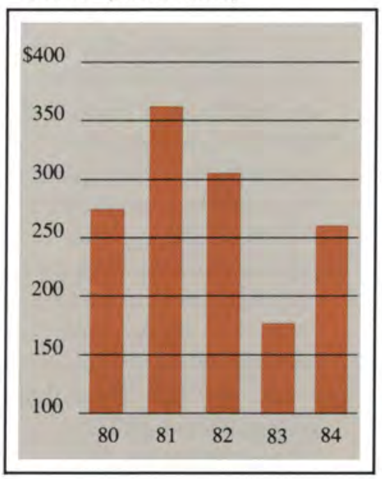
1984 ANNUAL REPORT

Financial Highlights

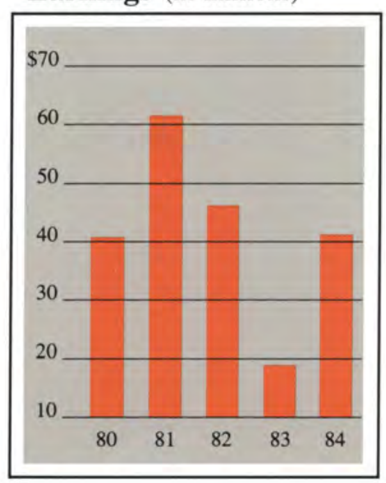
(In thousands of dollars, except per share data)

Years ended December 31	**1984**	1983	1982	1981	1980
Net sales	**$258,006**	$170,406	$309,664	$364,443	$273,936
Net earnings	**40,973**	19,573	46,957	62,697	40,682
Net earnings per share	**23.83**	11.38	27.12	36.02	23.37
Total assets	**285,134**	266,065	260,224	247,478	186,085
Long-term debt	**2,000**	2,500	3,000	3,500	4,000
Cash dividends per share	**10.00**	9.00	10.00	9.00	6.50
Book value per share	**142.21**	128.38	125.99	109.88	82.87

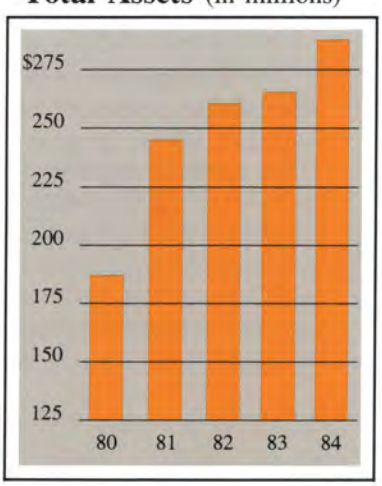
Sales (in millions)



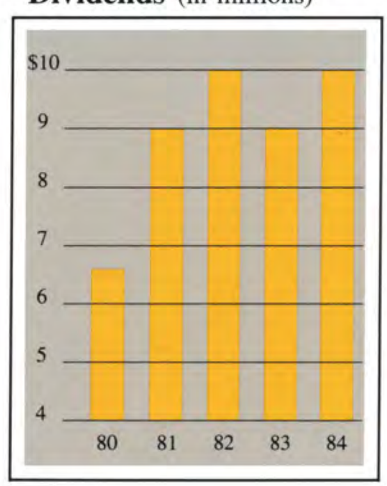
Earnings (in millions)



Total Assets (in millions)



Dividends (in millions)



< **This LUFKIN sits astride a Wyoming prairie**

Front Cover: A LUFKIN Mark II works beneath a beautiful Wyoming sky

To Our Shareholders

As we recovered from 1983 and entered 1984 in a somewhat improved business climate, the biggest challenge your Company faced was to operate the plant in a profitable manner at the lower level of business. Cutting costs without loss of product quality became the watchword of every department.

This was achieved by the dedicated efforts of management and the employees they inspired to work toward this goal.

As the year progressed and business improved, the Company was able to re-hire approximately 500 people. This helped the Company meet its production schedules; it certainly helped those who were employed; and it was a boon to the community as well.

Net sales in 1984 were the fourth highest and net earnings were the third best in the Company's history. Sales totaled $258 million compared to $170.4 million in 1983, and earnings were about $41 million compared to $19.6 million in 1983.

Total assets in 1984 climbed to $285 million, increasing from $266 million in 1983. Book value per share reached $142.21 in 1984, up from $128.38 per share in 1983. Net earnings per share in 1984 were $23.83 compared to $11.38 in 1983. These figures show what an improvement 1984 was over 1983.

The Machinery Division was responsible for $168 million net sales in pumping units and $21 million in industrial and marine gearing.

The Trailer Division had the best year in its history, shipping a total of 3,584 trailers, including 2,693 vans, 698 flatbeds and 193 dump trailers for total net sales of $61.7 million. This compared to total sales of $36.6 million in 1983.

The Industrial Supplies had total net sales of $7.2 million, up slightly from $7 million in 1983. This figure does not include 1984 sales of $4.4 million to the other Divisions of the Company.

We have one of the largest foundry and machine operations in the South and much of the equipment on which we produce our products is considered high technology.

We have between 55 and 60 numerically controlled machines throughout our plant; these are extremely complicated machines operated by computers. The operations of the machines are not so difficult but the people who program them must be trained; the employees operating the machines must be trained to understand what the machines are doing; and the maintenance employees must be trained to keep them operating. We continually have training sessions underway to meet these needs.

We feel that all employees should continue to educate themselves to find their places in this high-tech world. Of all the fringe benefits we have offered, we believe the educational opportunities we have provided to our employees will, in the long run, be the most important element to enhance the long-term growth of our Company and the betterment of life for our employees.

Improvements are on-going throughout our Company. Although we have invested millions during the past few years for tools and equipment, we must continue to reduce costs and become more efficient. In 1985, we plan to invest approximately $15 million toward new machine tools, expansions and production development.

When we finish our current expansion plans in the foundry operations, we actually will have four foundries—the new ductile iron facility, the small castings facility, the gear housing area and the large castings facility. They will almost be separate yet they will have common melting. The same type of manufacturing procedures will be evident in the structural steel plant and in the machining and assembling operations.

When all of these improvements are in place, it will mean we can provide our customers with service, quality, reliability and real value; provide our employees with opportunities to upgrade their skills; and provide our shareholders with improving profitability.

We are hopeful and optimistic about 1985. We believe business in general will continue to be good in all of our Divisions. We expect the Trailer Division to continue to improve its position in the truck-trailer industry. The Industrial Supplies Division has set a goal of $12 million in total sales, averaging $1 million per month. The Machinery Division should have total sales about the same as 1984, with pumping unit domestic and Canadian sales improving while export sales will be more difficult to obtain due to nationalization and foreign competition.

All in all, your Company is strong—strong financially, strong in dedicated employees and strong in its reputation of producing the best products in its line on the market today. We gladly welcome the challenges of 1985.

R.L. Poland
Chairman and Chief
Executive Officer

F.B. Stevenson
President and Chief
Operating Officer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FILTER

Machinery Division

The Machinery Division of Lufkin Industries is comprised of several component operations whose products are oilfield pumping units and industrial and marine gearing. These components are the foundry operations, machining and assembling operations, steel fabrication, final assembling and shipping operations, product design engineering, machinery sales and service and many support groups such as materials and information systems management, and many others.

The Machinery Division accounted for $189.1 million of the company's 1984 net sales, a 49 percent increase over 1983 net sales. In 1984, sales of pumping units and related oilfield equipment increased 55 percent, while gear products sales increased 16 percent. This Division was responsible for 73 percent of the company's sales and 90 percent of its operating income in 1984.

The challenges of 1984 in all segments of the Machinery Division were focused on attaining some normalcy in production. The prior boom years followed by a harsh recession were not examples of standard manufacturing processes to be followed in the business climate of 1984.

Foundry Operations

The largest capital expenditure in the foundry operations in 1984 was for completion of engineering and beginning construction to convert the counterweight foundry to a new ductile iron facility. The present building, sand system and arc furnace melting system will be utilized. A new digitime holding furnace and an all new molding system will be installed.

This new facility will be one of the most highly automated foundries of this type in the world. Completion is scheduled in early 1985, with the system in the testing phase by April, 1985. This new facility should be integrated into the present system by mid-1985.

Another major project in the foundry operations was the beginning of the renovation of the small castings facility. It is expected that this renovation will provide the opportunity to produce in Lufkin all small castings used in the company's products. Presently, about 50 per cent of the needed small castings are purchased from outside sources.

The renovation converted the facility to two automated molding centers. The first phase included the installation of a new automatic molding machine, a five-ton electric channel holding furnace and an electric melting furnace which are used to melt alloyed iron for utility castings, as well as for developmental work with new alloys. These are in operation now.

The second phase of this modernization was begun in October, 1984, with the purchase of an impact molding system which features a new and innovative molding process to compact sand. The one impact molding system will replace six jolt squeeze machines in the current small castings facility while producing four times the castings output.

Machining and Assembling Operations

The business climate which followed the downturn in 1982 and 1983, changed the manufacturing concepts at

A 67,000 h.p. gear is largest ever built by LUFKIN

Employees seek answers to produce better castings

‹Innovations in foundry operations reduced costs, enhanced quality

MACHINERY DIVISION

Lufkin Industries. It is a cell manufacturing concept, which is machining to assembly. This is simply a system whereby manufactured parts are linked in a controlled flow-through to an assembly area.

Various areas of the plant have been re-arranged to achieve manufacturing cells. One entire building has been divided into two areas—the gear reducer assembly and the sub-assembly areas.

In the sub-assembly area, one machine is the key to the entire operation. It is a multiple pallet machining center installed in 1984 which cost approximately $500,000 and which produces the parts for the center bearing assembly for a pumping unit. The saddle, center bearing and two retainers for the center bearing assembly are produced in sets on this one machine. Each part is machined, then removed and assembled. The same employee who does the assembly tends the machine which is equipped with special automated features to eliminate the need for operator intervention. The finished assembly is then placed on the exit conveyor to the shipping area.

Dramatic results have been achieved. Production time for bearing carriers dropped from 15 days to about one day; housings dropped from 20 days to about 1.4 days. At the same time, LUFKIN quality was maintained absolutely.

These same manufacturing concepts will be continued in 1985. On order is a $1.5 million crank machining center which is scheduled for delivery late in 1985, and is expected to be operational during the first quarter of 1986. This manufacturing center will do the milling, boring and cutting the keyway operations on a pumping unit crank in one setting, reducing by about two-thirds the overall time formerly required.

In the industrial gear manufacturing facility improvements continued, including modifications to the gear test stand. Added to the existing 880 h.p. electric motor was a new 1,000 h.p. motor, and the test stand floor was extended to handle a double arrangement of motors.

During 1984, the largest gear in LUFKIN's 45-year history of manufacturing gears was built. This was a 67,050 horsepower gear for a customer's plant in Canada. The previous largest gear was a 36,000 horsepower unit for the National Aeronautics Space Administration.

Steel Fabrication, Final Assembly and Shipping Operations

When business began to get back to normal, studies were made to eliminate non-value-added costs. This was achieved in five areas, namely quality, forecasting, scheduling, product design and manufacturing methods. Unquestionably, quality had to be maintained regardless. Some minor product design changes enhanced the manufacturing processes. However, the results achieved from the forecasting and scheduling studies were far-reaching.

More than 12,000 parts go into a pumping unit. Narrowing this number down by eliminating all the small parts, nuts and bolts, etc., there are 6,975 different structural parts. Of that number, there are 67 major pieces that account for 72 percent of all the pumping units sold.

In the gear box assembly area, parts arrive by conveyors

Conveyors, overhead lines bring parts for crank pin assembly

Multiple pallet machining center is hub of manufacturing cell >

Machinery Division

From there, three different blocks of data covering 100 percent of the plant's inventory were put into a computer which a planner could use in forecasting and scheduling. For the past 18 months, the planner has been better than 90 percent accurate in predicting what the customer would purchase.

This means that the Company's sales force can sell pumping units for delivery in three days, except on about three percent of the orders that require special engineering or parts purchased from outside sources.

This also means a drastic reduction in the amount of inventory the Company must carry, which reduces costs.

Product Design Engineering

This department began 1984 with a new experimental pumping unit named the low profile unit. This unit was designed to go under sprinkling systems irrigating agricultural fields. It was put into production in early 1984. Four different sizes of this unit are now available.

Another unit the engineering group investigated in 1984 was a slant hole pumping unit. Sometimes wells are so shallow that there is not enough room to whipstock. Wells can be drilled on the slant, sometimes as much as 45 degrees. There was a market in Venezuela for such a unit but before the unit could be produced, the tariffs had been imposed. The unit then was produced by the Company's joint venture company in Venezuela, where several units are now installed.

Also during 1984, the conventional crank-balanced line of units was redesigned to provide a two-point support system. That design improved the unit structurally at no additional cost to the customer. It is anticipated that this design change will be incorporated throughout the pumping unit line during 1985.

Machinery Sales and Service

In 1984, the sales department faced the challenges of domestic price structures, increased pressure and problems in the export business and maintaining the Company's marketing sales approach.

Many smaller pumping unit manufacturers emerged during the boom years prior to 1982. When the downturn came in the oil industry, several of these marginal manufacturers found it necessary to liquidate their inventories at acute price reductions.

LUFKIN did not choose to fracture its price structure in an attempt to meet this competition. The structure had been maintained during the boom period and it would continue to remain intact even though it was higher in the current market. However, quality, service and delivery continued to be factors in the market place and LUFKIN registered its fourth best sales year in its 83-year history.

The Company began 1985 with a backlog of orders and it appears that an increase in sales over 1984 is a possibility. However, the world price of oil is a real factor in LUFKIN's business, and unless prices stabilize somewhere above $25 per barrel, this could change the outlook.

Computer terminals are common throughout plant

Before shipment, touch-up painting adds luster to a quality product

‹Parts awaiting finishing are stored for quick retrieval


J.B. HUNT
J.B. HUNT
TRANSPORT, INC.
LOWELL, ARK.

Trailer Division

The Trailer Division had its largest sales volume in one year in 1984, totaling $61.7 million, up from the second largest year in 1983 with sales of $36.6 million.

This was a dramatic turn-around from the desperate years of 1980, 1981, 1982 and the first half of 1983, when the truck-trailer industry nationwide was in the doldrums. However, late in 1982, the United States Congress passed the Surface Transportation Act which allowed longer and wider trailers on interstate highways. This was the stimulus the truck-trailer industry needed. For more than three years prior to this Act, the industry had purchased few trailers for their fleets. The passage of that legislation spurred the industry to replace the older, smaller trailers with new and larger trailers.

The engineering department designed a new high cube van which would meet the specifications of the anticipated transportation act. This van was ready when the orders began to come in for the larger trailers.

The customer who placed the most orders with the Trailer Division was J.B. Hunt Transportation, Inc. Hunt's first order in 1983 was for 200 trailers, followed by another order for 390 trailers, followed by other orders for several hundred trailers in 1984.

In addition to the new high cube van, the Trailer engineering department designed a new light weight, high strength flatbed trailer, called the Feather Light.

The dump trailer business remained about the same in 1984 as it was in 1983, due in part to the slump in highway construction. However, some states have increased taxes for the specific purpose of upgrading their highways which, hopefully, will increase dump trailer business in 1985.

There were a lot of firsts for the Trailer Division in 1984, in addition to its largest total sales volume ever. It had its largest sales volume of both new and used trailers; its largest sales volume of van trailers in one year; and its largest single-month billing in one year. Also the largest number of van trailers produced in one year totaled 2,693; and the largest volume of parts and service sales was recorded by one branch. The Memphis branch had more than $1 million sales during 1984.

The outlook for 1985 appears good with a backlog of orders on hand. Van production is booked until May, with good orders into July.

The Trailer Division employs some 48 sales, service and parts personnel in its home and branch offices in eight locations. These are Atlanta, Georgia; Oklahoma City, Oklahoma; Memphis, Tennessee; and Dallas, San Antonio, Houston, Lubbock and Lufkin, Texas.

A new Feather Light flatbed trailer was produced in 1984

Changes to Pierce Rivet machine upgraded production

‹ J.B. Hunt was LUFKIN's largest single customer in 1984

Industrial Supplies Division

Sales volume for the Industrial Supplies Division was the second highest in the history of the Division. Sales totaled $7.2 million.

All segments of this Divison increased in 1984 compared to 1983, including the pole line hardware, plumbing fixtures, and heavy hardware and industrial supplies. About 60 percent of the Division's sales are in the industrial items, 20 percent in pole line hardware and 20 percent in plumbing fixtures supplies.

Although high interest rates kept single home construction depressed, sales of plumbing fixtures increased due to apartment and condominium construction which increased somewhat over 1983. If interest rates continue to drop, single home construction is expected to rebound and this Division expects to get its share of the business in 1985.

In 1984, this Division took a close look at its approximately 30,000 items in its warehouse. Inactive stock was removed, either by sales or contributions to charitable organizations or schools. Some items were dropped, or increased, and in some instances dual lines were added.

Particular attention was given to the needs of the Company's Machinery and Trailer Divisions. Intensive efforts were made to discover what new stock could be added to meet their needs. Increases in this area in 1985 are anticipated.

New products are looked at continually. Plans are to be in the gases business in 1985, selling oxygen, acetylene, etc. gases to the retail market. Company trucks are being outfitted for hauling the filled bottles from Houston to be exchanged with empties from customers. The Division does not expect to fill bottles, only to exchange them. An area in one section of the warehouse is being prepared for this business for access to the retail customer. Since the Division sells many items for the welder, the addition of the gases will enhance this segment of the business.

The supplies business is extremely competitive. To maintain and increase its share of the market, the Mill Supplies Division concentrates on giving more to customers by prompt and reliable deliveries, competitive prices and a variety of items stocked for immediate needs.

Supplies are shipped to cities within 150-mile radius of Lufkin

Some 30,000 items are stocked by Industrial Supplies

Pole line hardware business increased to utilities ›


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LUFKIN

Financial Review & Financial Statements

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‹ **Snow-covered mountains frame this air-balanced unit**

FINANCIAL REVIEW

Description of Business

The Company was incorporated under the laws of Texas on March 4, 1902 and has since that date maintained its principal office and manufacturing facilities in Lufkin, Texas. The Company's operations are divided into three divisions, the Machinery Division, Trailer Division and Industrial Supplies Division, which correspond to the Company's principal industry segments.

Machinery Division

The Company's Machinery Division designs, manufactures, sells, and services various tynes of oilfield pumping units as well as industrial and marine gears. Lufkin manufactures four basic types of pumping units: an air balanced unit; a beam balanced unit; a crank balanced unit; and a Mark II Unitorque unit. The basic differences between the four types relate to the counterbalancing system. The depth of a well and the desired fluid production determine the type of counterbalancing configuration that is required. There are numerous sizes and combinations of Lufkin oilfield pumping units within the four basic types. The Company's gears (speed increasers and reducers) are designed, manufactured, and sold primarily for use in marine propulsion units and for use in conjunction with machinery in heavy industries such as the steel, rubber, paper and sugar industries. The Company produces numerous sizes and combinations of gears.

The Company manufactures most of the component parts used in its products and purchases the raw materials and outside manufactured parts from a variety of suppliers on an order basis. The inventory of the Machinery Division consists primarily of raw materials and component parts which are generally assembled into finished products to fill specific customer orders. These finished products are sold by the division's own employees directly to the domestic petroleum, manufacturing and ship-building industries.

Oilfield pumping units are the Company's primary products sold in export. These sales, other than to Canada, are made principally through foreign sales representatives, licensees and distributors. During 1984, foreign sales accounted for approximately 17 percent of the Company's total net sales. While foreign sales are generally more profitable, they are subject to the risk of fluctuations in foreign import duties and taxes.

The domestic and international markets for the products of the Company's Machinery Division are highly competitive with price, quality and the speed of delivery being important factors. While the Company believes that it is one of the larger manufacturers of sucker rod pumping units in the United States, manufacturers of other types of units (submersibles and hydraulics) have a significant share of the total pumping unit market. The Company does not believe it is a significant factor in the gear market.

Trailer Division

The Company designs, manufactures, sells and services a variety of van, flatbed, and dump trailers, ranging in length from 24 to 50 feet and having capacities up to 75,000 pounds in flatbeds, 60,000 pounds in vans, and 30 cubic yards in dump trailers. Manufacturing operations are keyed mainly to specific customer orders.

The Trailer Division is also involved in repairing and selling used trailers which the Company receives in connection with the sale of its new trailers. The Company has trailer sales and service facilities in Atlanta, Georgia; Oklahoma City, Oklahoma; Memphis, Tennessee; and Lufkin, Dallas, San Antonio, Houston and Lubbock, Texas.

The Company uses a sales force of approximately 30 employees to distribute its trailers, primarily in the south. The Company also markets trailers through dealers. The Company trailers are sold to a large number of customers, including trucking concerns operating nationally.

The truck trailer market is extremely competitive and the Company's products compete directly with those of other manufacturers, a number of which are larger and have greater resources than the Company. Price, quality, speed of delivery, and financing are primary competitive factors. The Company does not believe it is a significant factor in the market for truck trailers either in the South or nationally.

Industrial Supplies Division

The Industrial Supplies Division is essentially a wholesale supplier of heavy hardware items, plumbing fixtures, pole line hardware and miscellaneous industrial items.

The division's sales are made at the Company's facilities in Lufkin through five salesmen. Sales are primarily in the East Texas area and the division is not a substantial factor in the markets in which it competes.

General Information

Properties. The Company's major manufacturing facilities are located in and near Lufkin and are owned in fee.
Machinery Division—The Machinery Division is located on approximately 150 acres and includes a foundry, machine shop, structural shops, assembly shops and warehouses.

The Company also has a plant in Nisku, Canada which produces structural parts for pumping units. These parts are then assembled with parts shipped from Lufkin and are delivered to the Company's Canadian customers.
Trailer Division—The Company's trailer manufacturing facilities are located on a 60-acre portion of a 400-acre tract of land owned in fee by the Company and consists of one large building with a floor area of approximately eight acres. The plant operations are highly automated and consist principally of fabrication, welding and assembly activities.
Industrial Supplies Division—The Industrial Supplies Division has one warehouse which is located in Lufkin and contains approximately 120,000 square feet. A portion of this space is used for administrative operations.
Employees. The Company employs approximately 2,800 people, of whom approximately 1,900 are hourly paid. The Company has an open shop contract with three labor unions, all members of the AFL-CIO, which runs to September 30, 1986. The Company considers employee relations to be satisfactory.

Information on Voting Stock

There is no active market in the Company's common stock. As of February, 1985, the Company had approximately 1,200 record holders of its common stock.

Lufkin has paid cash dividends for 45 consecutive years. Total dividend payments were $17,192,000 in 1984 and $15,473,000 in 1983.

Stockholders will vote on increasing the authorized common stock to 4,000,000 shares and authorizing 2,000,000 shares of preferred stock at their annual meeting in April, 1985.

Quarterly Financial Data

In millions, except per share data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1984				
Net sales	$51.5	$61.0	$64.6	$80.9
Gross income	13.3	14.5	17.7	19.6
Net earnings	6.2	6.6	17.6***	10.6
Earnings per share	3.61	3.83	10.23***	6.16
Dividends per share	2.50	2.50	2.50	2.50*
1983				
Net sales	$33.4	$33.2	$44.9	$58.9
Gross income	5.5	4.7	10.6**	21.9**
Net earnings	2.1	1.6	5.0	10.9
Earnings per share	1.20	.93	2.94	6.31
Dividends per share	3.00	2.00	2.00	2.00

*Dividend distributed on January 3, 1985 to stockholders of record on December 1, 1984.

**A liquidation of LIFO inventories occurring during the third and fourth quarters of 1983 resulted in an increase in gross income during these quarters.

***Third quarter net earnings were increased by $8,397,000 as a result of a credit to income tax expense reflecting the change in the tax law (Tax Reform Act of 1984) which allowed the undistributed earnings of the Company's DISC subsidiary to be treated as previously taxed income, and therefore, escape tax permanently.

Additional Financial Information

Stockholders may obtain additional financial information for the year ended December 31, 1984 from the Company's Form 10-K Report filed with the Securities and Exchange Commission. A copy of this report may be obtained by written request to The Secretary, Lufkin Industries, Inc., P.O. Box 849, Lufkin, Texas 75901.

This report is presented for the general information of the stockholders and not in connection with the sale or offer to sell or solicitation of any offer to buy any securities nor is it intended as a representation by the Company of the value of any of its securities.

Business Segment Information

(In thousands of dollars)	1984	1983	1982
Net sales:			
Machinery Division			
Pumping units	**$168,070**	$108,577	$244,041
Gears	**21,043**	18,213	36,062
Trailer Division	**61,708**	36,585	22,671
Industrial Supplies Division	**7,185**	7,031	6,890
Total net sales	**258,006**	170,406	309,664
Operating income:			
Machinery Division	**42,154**	25,376	75,383
Trailer Division	**4,827**	317	(613)
Industrial Supplies Division	**61**	333	427
Total operating income	**47,042**	26,026	75,197
Assets:			
Machinery Division	**141,336**	128,257	145,036
Trailer Division	**45,340**	33,776	20,961
Industrial Supplies Division	**4,899**	5,125	4,902
General corporate assets	**93,559**	98,907	89,325
Total assets	**285,134**	266,065	260,224
Capital Expenditures:			
Machinery Division	**9,349**	4,836	21,828
Trailer Division	**926**	109	413
Industrial Supplies Division	**40**	49	37
General corporate	**2,314**	106	3,981
Total capital expenditures	**12,629**	5,100	26,259
Depreciation:			
Machinery Division	**7,604**	7,392	6,634
Trailer Division	**462**	420	494
Industrial Supplies Division	**113**	116	108
General corporate	**699**	644	500
Total depreciation	**8,878**	8,572	7,736
Net sales by geographic region:			
United States	**213,058**	138,774	233,275
Canada	**22,339**	15,132	12,216
Latin America	**13,037**	6,301	45,592
Other regions	**9,572**	10,199	18,581
Total net sales	**$258,006**	$170,406	$309,664

Management's Analysis of Operating Results and Financial Condition

Operating Results

The downward trend in net sales and earnings which began during 1982 was reversed in 1984. Net sales increased 51% from $170.4 million in 1983 to $258.0 million in 1984. This followed a 45% decrease in 1983. Net earnings increased 109% from $19.6 million in 1983 to $41.0 million in 1984. This followed a 58% decrease in 1983. The increase in sales was primarily in the Machinery Division's pumping unit products and the Trailer Division's products.

Both of the Machinery Division's product lines reported improved sales in 1984. Pumping unit product sales increased 55% to $168.1 million. Gear sales increased 16% in 1984, but were still significantly depressed from 1982 levels. The improvement of oilfield pumping unit sales are attributable not only to a modest improvement in the number of wells drilled during 1984, but also to the liquidation of pumping unit inventories in the market place requiring the Company's customers to begin buying units as wells were completed.

Due to the uncertainty of oil prices and the supply/demand imbalance of oil, the Company is unsure of prospects for 1985 and beyond. Although the Company saw a significant improvement in pumping unit sales in 1984, continued improvement in drilling activity and the Company's sale of pumping units are dependent on continued recovery in demand for oil and stable oil prices.

The Trailer Division's sales increased 69% from $36.6 million in 1983 to $61.7 million in 1984. Sales had increased 61% in 1983 over 1982. This increase in demand of trailers during 1983 and 1984 resulted primarily from improved economic conditions of the customers served as well as new regulations allowing larger trailers on Federal highways.

The Trailer Division had an operating loss during 1982 as a result of the decrease in demand and also because of the loss of the fabrication and assembly work on pumping units for the Machinery Division. In 1981, it had fabricated structural parts and assembled some 2,100 pumping units.

Orders began to increase significantly for trailers in the last half of 1983 and a backlog of approximately six months in most trailer models existed at the beginning of 1985. The Company feels that trailer sales will continue to be strong throughout 1985.

While sales increased 51% in 1984, net earnings also increased 109% after a 58% decrease in 1983. Part of the increase in 1984 earnings is attributable to a credit of $8,397,000 to tax expense as a result of a change in the tax law (The Tax Reform Act of 1984), which treats the undistributed earnings of the Company's DISC subsidiary as previously taxed income and therefore, they escape tax permanently. Net earnings as a percent of net sales increased to 15.9% in 1984 as compared to 11.5% in 1983 and 15.2% in 1982. This increase was primarily attributable to the change in the tax law and improved margins in the Trailer Division.

The operating income of both the Machinery and Trailer Divisions increased in 1984. Operating income in the Machinery Division increased 66% in 1984 after decreasing 66% in 1983. The Trailer Division's operating income increased to $4.8 million in 1984 from $.3 million in 1983 and an operating loss in 1982. Operating income as a percent of net sales increased in both the Machinery and Trailer Divisions in 1984.

Liquidity and Capital Resources

At December 31, 1984, the Company had working capital of $114,774,000 as compared to $94,745,000 at December 31, 1983 and $108,730,000 at December 31, 1982. The Company believes that existing working capital is sufficient to satisfy its 1985 requirements. In recent years, the expansion of the Company's facilities has been financed with internally generated funds and the Company plans financing any expansion and improvements of its facilities in this manner.

The impact of inflation on the Company is discussed in Note 8 of the Notes to Consolidated Financial Statements.

Consolidated Balance Sheet

December 31, 1984 and 1983
(Thousands of dollars)

Assets	1984	1983
Current assets:		
Cash	$ 3,808	$ 3,469
Temporary investments	38,456	43,016
Accounts receivable	43,681	30,220
Installment notes and contracts receivable	24,175	16,449
Inventories	27,177	26,083
Total current assets	137,297	119,237
Property, plant and equipment:		
Land	7,483	7,384
Buildings	47,344	45,847
Machinery and equipment	107,596	97,804
	162,423	151,035
Less accumulated depreciation	56,683	49,046
Net property, plant and equipment	105,740	101,989
Investments in marketable securities	41,883	44,514
Other assets	214	325
	$285,134	266,065

See notes to consolidated financial statements.

Liabilities and Stockholders' Equity	1984	1983
Current liabilities:		
Current portion of long-term debt	$ 500	$ 500
Accounts payable	10,036	6,287
Accrued liabilities:		
Payrolls	1,395	1,011
Contributions to pension plans	4,613	5,547
Taxes	1,681	7,709
Dividends declared	4,298	3,438
Total current liabilities	22,523	24,492
Long-term debt, net of current portion	1,500	2,000
Deferred income taxes	16,622	18,865
Stockholders' equity:		
Common stock, par $1 per share, 2,000,000 shares authorized	1,719	1,719
Capital in excess of par	15,555	15,555
Retained earnings	227,215	203,434
Total stockholders' equity	244,489	220,708
	$285,134	$266,065

Consolidated Statement of Earnings

Years ended December 31, 1984, 1983 and 1982
(Thousands of dollars)

	1984	1983	1982
Net sales	**$ 258,006**	$170,406	$309,664
Cost and expenses:			
Cost of sales	**192,885**	127,752	216,316
Selling, general and administrative expenses	**18,078**	16,629	18,151
Interest income	**(11,275)**	(9,714)	(8,263)
Interest expense	**267**	187	283
Other, net	**16**	224	(280)
	199,971	135,078	226,207
Earnings before income taxes	**58,035**	35,328	83,457
Income taxes	**17,062**	15,755	36,500
Net earnings	**$ 40,973**	$ 19,573	$ 46,957
Earnings per share	**$ 23.83**	$ 11.38	$ 27.12

Consolidated Statement of Stockholders' Equity

Years ended December 31, 1984, 1983, and 1982
(Thousands of dollars)

	Common Stock		Capital In Excess	Retained
	Shares	Amount	of Par	Earnings
Balance December 31, 1981	1,740,730	$1,741	$15,750	$173,786
Net earnings				46,957
Cash dividends, $10.00 per share				(17,321)
Purchase of treasury stock	(21,520)	(22)	(195)	(4,088)
Balance December 31, 1982	1,719,210	1,719	15,555	199,334
Net earnings				19,573
Cash dividends, $9.00 per share				(15,473)
Balance December 31, 1983	1,719,210	1,719	15,555	203,434
Net earnings				40,973
Cash dividends, $10.00 per share				(17,192)
Balance December 31, 1984	1,719,210	$1,719	$15,555	$227,215

See notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

Years ended December 31, 1984, 1983 and 1982
(Thousands of dollars)

	1984	1983	1982
Source of funds:			
From operations:			
Net earnings	**$ 40,973**	$ 19,573	$ 46,957
Expenses not currently requiring outlay of working capital			
Depreciation	**8,878**	8,572	7,736
Deferred income taxes	**(2,243)**	5,062	4,435
Funds generated from operations	**47,608**	33,207	59,128
Decrease in marketable securities and other assets	**2,742**	—	3,994
Total funds provided	**50,350**	33,207	63,122
Use of funds:			
Net additions to property, plant and equipment	**12,629**	5,100	26,259
Dividends	**17,192**	15,473	17,321
Reduction in long-term debt	**500**	500	500
Increase in marketable securities and other assets	**—**	26,119	—
Purchase of treasury stock	**—**	—	4,305
Total funds used	**30,321**	47,192	48,385
Increase (decrease) in working capital	**$20,029**	$ (13,985)	$ 14,737

	1984	1983	1982
Working capital increase (decrease) resulted from changes in:			
Cash	**339**	$ 692	$ 61
Temporary investments	**(4,560)**	(16,692)	35,923
Accounts receivable	**13,461**	(2,570)	(21,536)
Installment notes and contracts receivable	**7,726**	6,196	(107)
Inventories	**1,094**	(4,432)	(16,124)
Accounts payable	**(3,749)**	(1,717)	8,431
Accrued liabilities	**5,718**	4,538	8,089
Increase (decrease) in working capital	**$20,029**	$ (13,985)	$ 14,737

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of major accounting policies

Principles of consolidation: The consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of all significant intercompany accounts and transactions.

Temporary investments and investments in marketable securities: In the accompanying balance sheet, temporary investments are carried at cost, which approximates market. The investment in marketable securities consisting of corporate bonds, government securities and common and preferred stock is carried at cost and had a market value of $40,539,000 and $43,109,000 at December 31, 1984 and 1983, respectively. In management's opinion, there is no permanent impairment in value and there is no present intention to liquidate these securities at less than cost.

Installment notes and contracts receivable: A portion of the Company's sales is made on notes and conditional sales contracts which are payable on an installment basis over a period generally from three to five years. The profit from such sales is included in income at the time of sale for financial reporting purposes; however, for tax purposes such profit is recognized as installments are collected. The amounts due after one year ($21,184,000 at December 31, 1984 and $14,497,000 at December 31, 1983) are included in current assets in accordance with trade practice.

Inventories: The Company uses the last-in, first-out (LIFO) method of determining inventory cost, which does not exceed market, for substantially all inventories. Inventory costs include material, labor and factory overhead.

Property, plant and equipment: The Company records investments in these assets at cost. Improvements are capitalized, while repair and maintenance costs are charged to operations as incurred. Gains or losses realized on the sale or retirement of these assets are reflected in income.

The Company uses the straight-line depreciation method for financial reporting and accelerated methods for tax purposes.

Income taxes: The Company provides for United States taxes that may ultimately be payable on all undistributed foreign earnings. Provision is also made in the financial statements for the deferred taxes applicable to depreciation, income on installment notes and contracts receivable and other timing differences between financial and tax reporting methods. Current recognition is given in the statement of earnings to tax benefits resulting from the utilization of investment tax credits.

Earnings per share: Earnings per share amounts are based on the weighted average number of shares of common stock outstanding during the period.

(2) Long-term debt

The long-term debt at December 31, 1984 is payable $250,000 semi-annually thru 1987 and bears interest at 6.7 percent. The Company is in compliance with the covenants of its debt agreements and does not believe that the covenants will have any adverse effect on future operations.

(3) Retirement Plans

The Company and its subsidiaries have retirement plans covering substantially all employees. The total unfunded prior service costs at January 1, 1984, the date of the latest actuarial valuation, was estimated to be $7,629,000. The total pension expense was $4,613,000 in 1984, $5,541,000 in 1983, and $5,018,000 in 1982, including amortization of prior service costs principally over a 10-year period. The amount provided each year for pension expense is paid into pension trust funds.

A comparison of accumulated plan benefits, calculated using an estimated rate of return of 4.5%, and net assets for the plans are as follows:

	(In thousands) January 1	
	1984	1983
Actuarial present value of accumulated plan benefits		
Vested	**$38,814**	$34,448
Nonvested	**3,089**	3,345
	$41,903	$37,793
Net assets available for benefits	**$54,383**	$45,100

(4) Income taxes

The income tax provision for 1984, 1983 and 1982 consisted of the following:

	(Thousands of dollars)		
	1984	1983	1982
Amounts currently payable	**$19,305**	$10,693	$32,065
Amounts deferred	**(2,243)**	5,062	4,435
	$17,062	$15,755	$36,500

A reconciliation of the provision for income taxes to the United States tax rate of 46% of earnings before income taxes is as follows:

	(Thousands of dollars)		
	1984	1983	1982
Taxes computed at statutory rate	**$26,696**	$16,250	$38,390
Investment tax credits	**(483)**	(234)	(1,908)
Taxes previously provided on DISC*	**(8,397)**	—	—
Other net	**(754)**	(261)	18
Actual provision	**$17,062**	$15,755	$36,500

The Company provides deferred taxes for timing differences between financial and taxable income as follows:

	(Thousands of dollars)		
	1984	1983	1982
Excess of tax depreciation over book depreciation	**$3,207**	$3,156	$2,658
DISC earnings not currently subject to tax	**(6,087)**	1,969	1,989
Income on installment notes	**637**	(63)	(212)
	($2,243)	$5,062	$4,435

*In prior years, the Company provided deferred taxes on the undistributed earnings of its DISC subsidiary. The Tax Reform Act of 1984 treats these undistributed earnings as previously taxed income, and therefore, they escape tax permanently.

(5) Inventories

Inventories used in determining cost of sales were as follows:

	(Thousands of dollars)			
	1984	1983	1982	1981
Finished goods	**$ 5,670**	$ 5,054	$ 5,906	$ 5,494
Work in process	**11,597**	10,391	11,218	18,979
Raw material	**9,910**	10,638	13,391	22,166
	$27,177	$26,083	$30,515	$46,639

Had the FIFO method been used in determining inventory values, inventories would have been $30,936,000, $29,693,000, $36,996,000, and $43,904,000 higher at December 31, 1984, 1983, 1982 and 1981, respectively.

During 1983, inventory quantities were reduced. This reduction resulted in a liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years as compared with the cost of 1983 purchases. The effect of this liquidation increased net earnings by approximately $4,350,000 or $2.53 per share.

(6) Supplementary income statement information

The following costs and expenses were charged to income during 1984, 1983, and 1982:

	(Thousands of dollars)		
	1984	1983	1982
Maintenance and repairs	**$5,047**	$5,311	$11,495
Depreciation	**8,878**	8,572	7,736

(7) Business segment information

Information concerning the company's various business segments is included on Page 18 of this report.

(8) Supplemental information on the effects of inflation (Unaudited)

The following supplementary financial information discloses certain effects of inflation on the Company's historical cost financial statements. Current cost calculations involve a number of judgments as well as use of various estimating techniques and, therefore, may not accurately reflect the impact of inflation on the Company's business.

The constant dollar data presents historical cost financial information stated in dollars having equivalent purchasing power as measured by the consumer price index. The current cost data presents financial information adjusted to reflect the changes in prices of certain resources used in the operations of the Company. These adjustments involved the use of current cost amounts for inventories and appropriate indices for current costs of property, plant and equipment. Current cost depreciation is based on the average current cost of properties held during the year. The depreciation methods and useful lives are the same as those used in preparing the primary financial statements.

Consolidated Statement of Earnings Adjusted for Changing Prices for the Year Ended December 31, 1984

(Thousands of dollars)	As Reported in Financial Statements	Adjusted for General Inflation (Constant dollars)	Adjusted for Changes in Specific Prices (Current costs)
Net sales	$258,006	$258,006	$258,006
Cost of sales excluding depreciation	185,494	183,996	182,134
Depreciation	8,878	11,808	13,560
Other expenses excluding depreciation	5,599	5,599	5,599
Income taxes	17,062	17,062	17,062
Net earnings	40,973	39,541	39,651
Loss from decline in purchasing power due to increase in net monetary assets		3,865	3,865
Increase in specific prices of inventories and propery and equipment, net*			8,724
Effect of increase in general price level			4,916
Excess of increase in specific prices over increase in general price level			3,808

*At December 31, 1984, the current cost of inventory was $53,987,000 and the current cost of net property and equipment was $160,779,000.

Five Year Comparison of Selected Supplementary Financial Data Adjusted for Effects of Changing Prices in Average 1984 Dollars

(Thousand of dollars, except per share amounts)	Years Ended December 31 1984	1983	1982	1981	1980
Net sales	**$258,006**	$170,406	$309,664	$364,443	$273,936
Historical cost information adjusted for general inflation:					
Net income	**39,541**	15,427	45,810		
Earnings per share	**23.00**	8.97	26.46		
Net assets at year-end	**304,016**	278,243	262,588		
Current cost information:					
Net income	**39,651**	8,577	38,139		
Increase (decrease) in specific prices of inventories and property and equipment, net of inflation	**8,724**	(9,816)	6,393		
Earnings per share	**23.06**	4.99	22.03		
Net assets at year-end	**326,338**	298,724	302,065		
Other information:					
Purchasing power loss of net monetary items	**(3,865)**	(3,198)	(2,458)		
Dividends per share	**10.00**	9.00	10.00	9.00	6.50
Average Consumer Price Index (1967 = 100)	**311.1**	298.4	289.1	272.3	246.8

Report of Independent Public Accountants

To the Stockholders of Lufkin Industries, Inc.

We have examined the consolidated balance sheet of Lufkin Industries, Inc. (a Texas corporation), and subsidiaries as of December 31, 1984 and 1983 and the related consolidated statements of earnings, stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 1984. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of Lufkin Industries, Inc., and subsidiaries as of December 31, 1984 and 1983, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1984, in conformity with generally accepted accounting principles applied on a consistent basis.

ARTHUR ANDERSEN & CO.

Houston, Texas
February 15, 1985

Directors and Officers

Board of Directors

*S.W. Henderson, Jr.
S.W. Henderson, III
J.G. Kurth
*M.E. Kurth, Jr.
*L.A. Little
W.T. Little
*R.L. Poland
*F.B. Stevenson
H.J. Trout, Jr.
*W.W. Trout, Jr.
*J.L. Wiener
J.L. Wiener, Jr.
Samson Wiener

*Member Executive Committee

Officers

R.L. Poland
Chairman, Chief Executive Officer

F.B. Stevenson
President, Chief Operating Officer

F.D. Griffin
Vice President

J.C. McKay
Vice President

M.A. Penn
Vice President

W.T. Pennington
Vice President

E.G. Pittman
Vice President

B.M. Queen
Vice President

W.W. Trout, Jr.
Vice President

C.J. Haley, Jr.
Secretary-Treasurer

R.E. Myers, Jr.
Assistant Secretary

J.T. Floyd
Assistant Secretary

J.B. Massingill
Assistant Treasurer

Board of Directors; Seated, from left, J.L. Wiener, Samson Wiener, S.W. Henderson, Jr., L.A. Little. Standing, from left, S.W. Henderson, III, W.W. Trout, Jr., H.J. Trout, Jr., W.T. Little, F.B. Stevenson, R.L. Poland, J.L. Wiener, Jr., M.E. Kurth, Jr., J.G. Kurth.

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