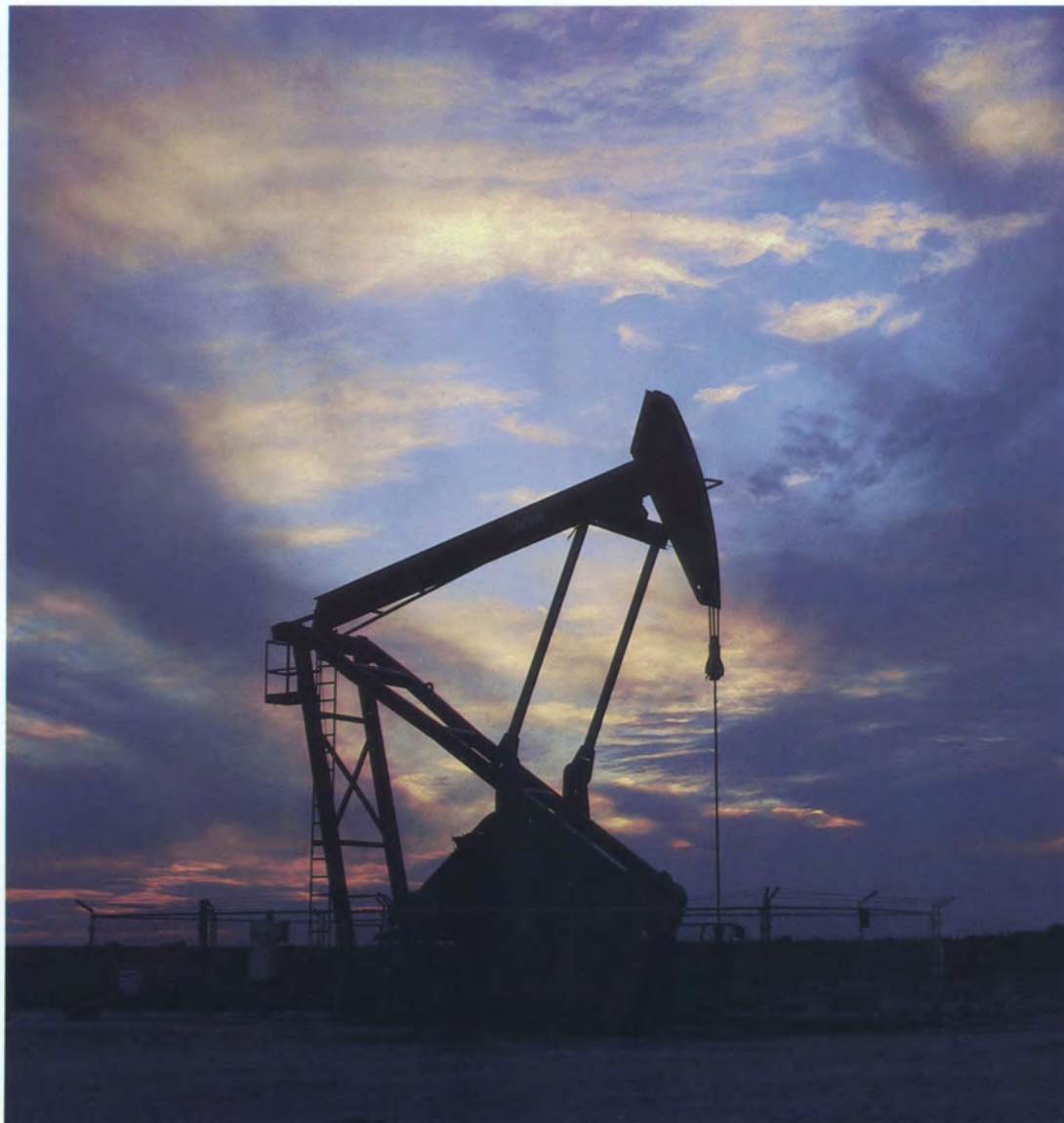


LUFKIN



1990 ANNUAL REPORT

C O R P O R A T E P R O F I L E



L

ufkin Industries, Inc. sells its product lines through three separate divisions: the Machinery Division, the Trailer Division, and the Industrial Supplies Division.

The Machinery Division designs, manufactures, and markets oil field pumping units, power transmission equipment, and commercial products including castings and fabrications. These product groups share common manufacturing facilities: gray and ductile iron foundries, machining operations, and steel fabrication facilities.

The Trailer Division designs, manufactures, and markets flatbed, van, and dump trailers as well as specialty trailers.

The Industrial Supplies Division wholesales a number of lines of industrial supplies.

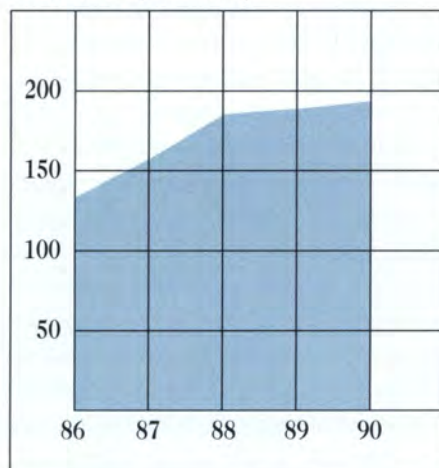
Lufkin Industries stock is traded on the NASDAQ as LUFK.

FINANCIAL HIGHLIGHTS

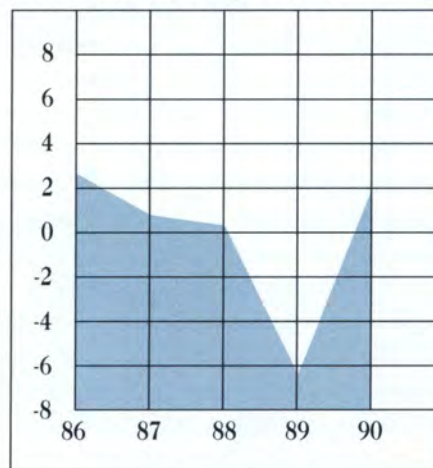
(Thousands of dollars, except per share data)	1990	1989	1988	1987	1986
Net sales	\$194,748	\$182,000	\$181,158	\$158,077	\$130,442
Net earnings (loss)					
Earnings (loss) before the cumulative effect of the change in accounting for income taxes	2,025	(6,418)	766	1,066	2,807
Cumulative effect of the change in accounting for income taxes	—	—	5,170	—	—
Net earnings (loss)	2,025	(6,418)	5,936	1,066	2,807
Earnings (loss) per share*					
Earnings (loss) before the cumulative effect of the change in accounting for income taxes	.30	(.95)	.11	.16	.41
Cumulative effect of the change in accounting for income taxes	—	—	.76	—	—
Net earnings (loss) per share*	.30	(.95)	.87	.16	.41
Cash flows from operating activities	11,019	11,109	(7,847)	3,463	22,884
Total assets	222,469	227,248	246,171	264,483	272,611
Cash dividends per share*	1.53	1.50	1.76	2.01	2.52
Book value per share*	28.52	29.75	32.20	33.29	35.15

*Adjusted for 3 for 1 stock dividend distributed on December 3, 1990.

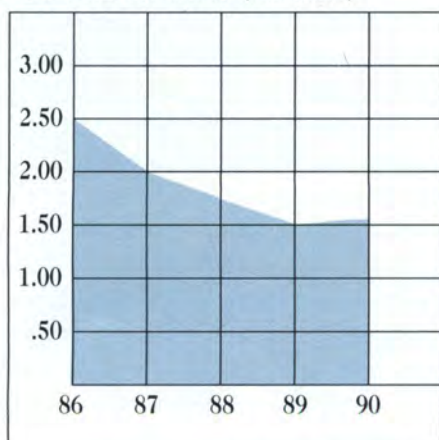
SALES (\$ Millions)



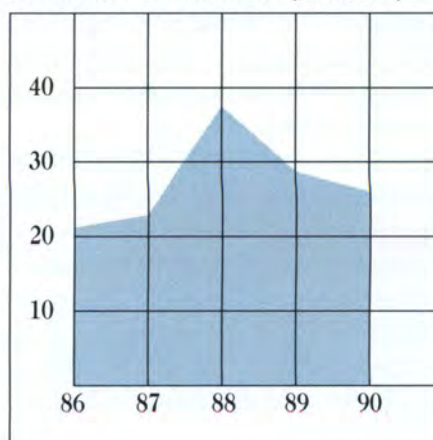
EARNINGS (\$ Millions)**



DIVIDENDS (Per Share)



INVENTORIES (\$ Millions)



**Before the cumulative effect of the change in accounting for income taxes.

LETTER TO SHAREHOLDERS



In 1990, the Company achieved significant improvements in financial results, market share, and product diversification. Sales increased from \$182.0 million in 1989 to \$194.7 million. Earnings before income taxes improved from a loss of \$10.3 million in 1989 to earnings of \$2.9 million, and net earnings were up from a loss of \$6.4 million in 1989 to earnings of \$2.0 million in 1990.

We improved our market share in pumping units and power transmission, but the continuing slump in the trucking industry adversely affected our trailer business. Commercial castings and fabrications continued to show strong growth and the introduction of a winch product line in late 1990 opened promising new market opportunities.

Significant events affecting our business units include:

- **Oil Field Equipment** — The turnaround achieved in oil field business was successful due to determination, persistence, aggressive strategy, and hard work. To increase our market penetration around the world we now produce pumping units in five countries outside of the U.S., adding in 1990 operations in Indonesia and Turkey. We have identified promising opportunities in other parts of the world and plan to actively pursue them.

- **Power Transmission** — We achieved a growth rate of approximately 34% and ended the year with a strong backlog. We have moved most aggressively in high speed gearing and will continue to expand our capacity to produce high performance, high speed, high horsepower units. We intend to add case hardening capability in 1991 which will allow us to further accelerate our growth in this market.

- **Commercial Products - Castings** — We had a dramatic growth of nearly 60% in sales for the year. Our manufacturing capacity increased by 30% to 5,000 tons per month and we continue to see an opportunity for growth in this market. **Fabrications** — We experienced record growth of over 260% in this market, and we expect to substantially increase this business again in 1991.

- **Trailer Division** — Our continuing strategy is to seek higher margin businesses for this facility. Faced with a severely depressed transportation industry and seeing no substantial improvement in new trailer sales for 1991, our corrective action was to place other products into the trailer manufacturing area. Our trailer plant has a \$10 million backlog of business other than highway trailers.

- **Industrial Supply Division** — The Industrial Supply Division experienced another year of steady growth and improved profitability. This division fulfills a vital link in our operation by providing various industrial supplies for our plant operations, as well as serving a growing industrial market in the East Texas area.

Acquisition — In January 1991 the Company completed the purchase of the assets of GEO Churchill. The Churchill pumping unit will broaden our line and strengthen our market share. The well-equipped, well maintained, facility was built in the early 1980's and has many modern machine tools which will increase our capacity to produce smaller products such as our winch line and some of our smaller industrial gears. The product is a positive addition, but most importantly, we gained a group of highly skilled, energetic, and enthusiastic people at the Churchill operation.



Fourth Quarter

Results — Although sales posted an impressive 26% gain over the previous quarter, we ended the fourth quarter with a slight loss. The major cause for this loss was an unexpected increase in fourth quarter inventories and the related LIFO effect.

Through September 30, 1990 the Company had achieved a steady decline in inventories and anticipated that this would continue through the end of 1990 and that the expected liquidation of LIFO inventory quantities, which were carried at lower costs prevailing in prior years, would substantially benefit the 1990 statement of income. However, a large adjustment to cost of sales in the fourth quarter resulted because of a sizable build up of inventory which was necessitated by an unusually large backlog of export orders. These orders should be completed and shipped in the first quarter of 1991. We were not able to anticipate this year-end surge in orders and the LIFO benefits we had anticipated were not realized.

The LIFO inventory method also directly increased our fourth quarter cost of sales because the abnormal production cost incurred to meet this welcome but unexpected customer demand was charged off against our 1990 revenues. For example, customer commitments for our large level of export business demanded that we work a considerable amount of overtime in the fourth quarter. Though the goods could not be shipped until early 1991, sizable overtime premium costs and other increases in expenses were charged to our fourth quarter operating results in accordance with the LIFO method of accounting.

Because we use the LIFO method of accounting our ending

inventory and net income are reported on a very conservative basis. As discussed in note 4 to the financial statements, our LIFO inventories are recorded in our balance sheet at less than one half of their current replacement costs. If we are successful in reducing our overall level of inventories during 1991 we should report significant increases in gross margins as we liquidate our lower cost LIFO inventories.

Outlook — The Company entered 1991 with a backlog of \$70.9 million, its strongest in several years. The largest portion is scheduled for shipment during the first quarter. This increased volume, along with the improved pricing for most of the Machinery Division products instituted in the fourth quarter of 1990 should result in a very strong first quarter for 1991.

We believe that recent initiatives to develop additional business opportunities will aid us in improving operating results and will be extremely important to the growth of the company in the coming years. We have a strong foundation of engineering, manufacturing, and sales on which to build. There are numerous opportunities for us to continue our growth and diversification through the expansion of existing and addition of new product lines and markets.

The quality of our products, the commitment of our people, and the financial and technological strength of the company will continue to be the driving force as we continue our growth into the 1990's.

Frank B. Stevenson

O I L F I E L D E Q U I P M E N T



P

umping units have traditionally been Lufkin Industries' strongest product in the global marketplace. In 1990, however, oil field markets remained weak at home and abroad until the fourth quarter when the Persian Gulf crisis drove up oil prices.

Throughout its history, the Company has maintained its ability to react quickly to oil field surges and opportunities. During the fourth quarter, pumping unit shipments increased significantly, surpassing average shipments for the first three quarters by more than 98 percent. Even though the oil field market demand increased in the last half of 1990, strong pricing pressures from North American and foreign manufacturers never diminished.

Lufkin Industries strengthened its international position in 1990 by establishing manufacturing capabilities in Indonesia and Turkey. A new LUFKIN office was established in Singapore to serve the Far East. The Company also developed new pumping unit markets in the Soviet Union, Europe, Africa, and Japan. In the United States, LUFKIN sales and engineering staffs responded vigorously to opportunities for innovative equipment applications such as coal bed methane gas and horizontal drilling.

In the first quarter of 1991, the Company acquired a manufacturer of small to mid-sized pumping units in Chanute, Kansas. In addition to manufacturing Churchill pumping units in the Chanute plant, Lufkin Industries will produce LUFKIN power transmission products at the new facility.

Industry-wide, inventories of surplus as well as used pumping units (a result of low oil prices in the 1980s) were reduced in 1990 when rising oil prices stimulated oil field activity.

The Company's commitment to sell and produce every possible pumping unit from its complete line of oil field sucker rod pumping units has never changed. In 1990, conventional crank-balanced units accounted for nearly 50 percent of the Company's oil field business. Mark II and RM units contributed approximately 36 percent,

and air-balanced, beam-balanced, slant hole, and trailer-mounted units added another 14 percent to sales.

LUFKIN's ultra large units continued to demonstrate outstanding performance for major oil companies as reliable cost-effective alternatives to downhole electric submersible pumps. However, independent oil producers with specialized needs were still a major portion of LUFKIN'S pumping unit customer base.

A special line of pumping units built around high quality non-Lufkin gear reducers made it possible for the Company to compete in extremely price-conscious markets for both new and used equipment.

In addition to U.S. operations, and the new manufacturing capability now available to customers in Indonesia and Turkey, the oil field division manufactures pumping units in Canada and Venezuela to meet domestic content requirements for pumping equipment purchased in these countries.



P O W E R T R A N S M I S S I O N



L

ufkin Industries' largest growth area in 1990 was in power transmission equipment. Our industrial gear marketing group targeted both national and international markets for its diversified industrial gear product mix.

This product line includes units weighing from approximately 300 pounds up to 250 tons and gears varying in size from one inch to 168 inches in diameter. The Company markets gear units and loose gears to petrochemical, rubber, sugar, marine propulsion, plastics, electrical and gas utilities, food processing, coal processing and other industries requiring heavy duty gears and gear drives.

New gear designs plus expanded service and repair work broadened the scope of the Company's power transmission business. Bookings for 1990 totaled \$45 million with an end-of-the-year backlog of \$24 million.

The Company is continuing its efforts to develop markets in standard and open gearing lines where higher volume sales and production rates are possible. More compact, less costly gear drives utilizing more sophisticated materials were the result of extensive redesign of our standard gear lines.

The after-market parts, repair, and service business approached 33 percent of the total power transmission equipment sales. Competition for this business requires diverse facilities and quick response to customers' needs.

G R E A T E R P R E C I S I O N

H

igher performance gear drives were the largest segment of the gear business in 1990 and accounted for approximately 33 percent of total gear revenue. To date, the Company has built several units transmitting 80,000 horsepower and is completing three 60,000 horsepower drives, which will be full load tested prior to shipment to the customer early in 1991.

Staying at the leading edge in high precision gear manufacturing means continuously reevaluating every process. In addition to ultra-precision machinery and skill of experienced craftsmen, large precision gears require exacting



temperature control during the critical stages of gear grinding. By enclosing these operations in an environmentally controlled room where temperatures are controlled within 1° Fahrenheit, LUFKIN is able to insure that dimensional errors caused by thermal expansion are eliminated.

In 1990 the machine shop expanded its gear grinding and hobbing capabilities to meet demands for greater precision. To insure we retain our state-of-the-art position, LUFKIN purchased 15 major machine tools and updated a significant number of existing tools. Carburizing heat treatment equipment to produce case hardened and ground gear products was purchased and will be installed in 1991.

ENGINEERING CAPABILITIES

T*he Company continued to invest in CAD/CAM systems in its engineering and manufacturing areas. This computer integration will enhance communication between engineering disciplines and expedited the flow of information from the product manufacturing designer to the shop floor users. These more efficient design and production functions are expected to improve our competitive edge and market share.*

WINCHES

L*UFKIN's new line of winches, introduced in 1991, will include applications in forestry, oil field, construction, utility and military machinery.*

Essentially a slow-speed gearbox containing a drum and clutches, the winch design is well suited to our manufacturing and engineering capabilities and takes advantage of the Machinery Division's vertical integration.

T R A I L E R S



I

ndustry-wide, trailer shipments in 1990 were the lowest since 1983. Higher fuel costs and uncertainty about the Persian Gulf crisis caused increased instability in the trucking industry. LUFKIN trailer sales followed the national trend and fell 28 percent from record sales of \$81.5 million in 1989. However, the Trailer Division took positive steps to deal with the anticipated future nationwide market decline.

New products with an emphasis on specialized equipment and higher profit margins were offered. Traditional LUFKIN van, flatbed, and dump lines were redesigned and simplified to reduce production time. More efficient manufacturing procedures were established to increase production and reduce manufacturing costs.

8

S T R A T E G Y F O R I M P R O V E M E N T

C

ommercial and government fabrication work at the Trailer Division was an integral part of the transitional philosophy to change the plant's product mix for improved profitability. The Company has taken steps to broaden our range of products which should make the trailer plant less susceptible to periodic economic slumps in the transportation industry.

A government contract provided the Trailer Division an opportunity to diversify its product line and to offset the decline in the trucking industry. Late in 1990 production started on the first of 517 military dump beds for 2.5 ton U.S. Armed Forces trucks.

Trailer business has always been highly competitive, and the recent economic downturn has required an even more streamlined, leaner operation. A total team effort of implementing cost-cutting programs, redesigning manufacturing systems, and continuously improving equipment to reduce production time, limit inventory, or bolster sales has involved every trailer department.

Trailer engineering completed American Association of Railroads certification of the intermodal van, introduced three new extendible designs, and redesigned the Ultralight dump trailer. Trailer manufacturing also installed a steel decoiler system to reduce raw steel costs.



C O M M E R C I A L P R O D U C T S



10

The company continued to strengthen its commitment to increased diversification in 1990. Two new businesses introduced in recent years, Commercial Castings and Commercial Fabrications, won a diversity of contracts ranging from major structural components for satellite earth stations to research and development projects for the U.S. Navy.

C O M M E R C I A L C A S T I N G S

Since 1987, our Commercial Castings business has grown rapidly. The Company shipped commercial castings worth approximately \$10.5 million in 1990; up from \$4.0 million in 1989. Forklift, pump, compressor, construction, and mining castings headlined these markets. Commercial products represented more than 40 percent of the foundry's tonnage in 1990.

In 1990, the Company acquired government contracts to research, document, and develop the use of austempered ductile iron to replace steel forgings in Navy projectiles. Another research project, still in the developmental stage, tested ductile iron for Navy FOG-S missiles.

Lufkin Industries entered a developmental contract with the Air Force to research software packages for casting analysis. The addition of a radiosopic X-ray unit placed on order in 1990 will allow the Company to meet stringent specification requirements, especially for military work.

NEW FOUNDRY CAPACITY

Our no-bake, large castings foundry, built in 1982, had remained an incomplete facility and was used for pattern storage until late 1990 when state-of-the-art production equipment was installed. Our large castings foundry started operating at the end of the year and has added 30 percent to the foundry's capacity to produce cranks, counterweights, and other large LUFKIN or commercial castings.



11

COMMERCIAL FABRICATIONS

The fabrication department developed a commercial fabrication business in response to a recognized need for specialty fabricated products. Fabrications for telecommunications, military, forest products, industrial motor, and sawmill applications are high-growth businesses that fit well into the Company's diversification philosophy. During 1990, the Company's fabrication facilities were reorganized to improve manufacturing flow and efficiency and to provide capacity for additional growth in the commercial fabrication business. Commercial Fabrication sales quadrupled from \$1 million in 1989 to \$4 million sales in 1990.

INDUSTRIAL SUPPLIES



12

Industrial Supplies exceeded its sales goals in 1990. Total sales for 1990 were \$14.0 million compared to \$12.4 million in 1989. Internal sales to Lufkin Industries, Industrial Supplies' major customer, increased from \$4.4 million in 1989 to \$5.4 million in 1990. Outside sales rose from \$8.0 million to \$8.6 million.

Industrial Supplies expanded its power transmission, welding supplies and equipment, general industrial supplies, and poleline hardware lines to meet the needs of its major outside customers. A plumbing fixtures and supplies product line serves contractors and homeowners.

To serve Lufkin Industries and outside customers, Industrial Supplies operated a fleet of delivery trucks which extend approximately 150 miles from Lufkin.

During 1990, Industrial Supplies secured a multi-year sprocket, sheaves, and V-belts contract and subscribed to an Eletronic Data Interchange network to facilitate communications with its customers. Industrial Supplies worked to acquire and maintain single source status with other major outside customers. This single source status or "partnering" has become a new theme and long-term goal of Industrial Supplies. Through "partnering" the division provides superior value through ongoing relationships with its customers and vendors.

FINANCIAL REVIEW & FINANCIAL STATEMENTS

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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 types of oilfield pumping units, power transmission products and commercial castings and fabrications. 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 power transmission products (speed increasers and reducers) are designed, manufactured, and sold primarily for use in industrial applications such as petrochemical, refining, rubber, plastics and steel and for use in marine propulsion applications. The Company produces numerous sizes and combinations of gears. The Company's commercial castings and fabrications are primarily customer designed components manufactured by Lufkin for use in customer products.

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 primarily by the division's own employees.

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 1990,

foreign sales accounted for approximately 13 percent of the Company's total net sales.

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 has a large market share in the power transmission, castings or fabrication markets.

Trailer Division

The Company designs, manufactures, sells and services a variety of van, flatbed and dump trailers, ranging in length from 24 to 53 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 uses a sales force of approximately 28 employees to distribute its trailers, primarily in the South. The Company also markets trailers through dealers. The Company's 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 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 and through six salesmen. Sales are primarily in the East Texas area and the division is not a substantial factor in the markets in which it competes.

F I N A N C I A L R E V I E W

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 consist 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 located in Lufkin containing approximately 120,000 square feet. A portion of this space is used for administrative operations.

Employees. The Company employs approximately 2,300 people, of whom approximately 1,600 are hourly paid. The Company has an open shop contract with three labor unions, all members of the AFL-CIO, which runs to October 3, 1993. The Company considers employee relations to be satisfactory.

Information on Voting Stock

On November 6, 1990, trading began on the Company's common stock on NASDAQ National Market System. From November 6, 1990 thru December 31, 1990 the stock traded from a high market price of \$33.75 per share to a low market price of \$26.25 per share.

As of February, 1991, the Company had approximately 1,025 record holders of its common stock.

Lufkin has paid cash dividends for 51 consecutive years. Total dividend payments were \$10,357,000 in 1990 and \$10,188,000 in 1989.

Quarterly Financial Data

In millions, except per share data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
---------------------------------------	------------------	-------------------	------------------	-------------------

1990

Net sales	\$45.4	\$43.9	\$46.7	\$58.7
Gross margin	5.2	5.1	4.7	5.1
Net earnings (loss)	1.0	.7	.5	(.2)*
Earnings (loss) per share	.14	.10	.08	(.02)
Dividends per share	.375	.375	.375	.400

1989

Net sales	\$41.6	\$48.5	\$42.4	\$49.5
Gross margin (loss)	1.8	4.0	.7	(.9)
Net earnings (loss)	(2.3)	.7	(2.1)	(2.7)
Earnings (loss) per share	(.34)	.10	(.31)	(.40)
Dividends per share	.375	.375	.375	.375

* See Letter to Stockholders on page 2.

Additional Financial Information

Stockholders may obtain additional financial information for the year ended December 31, 1990 from the Company's Form 10-K Report filed with the Securities and Exchange Commission. A copy of such report may be obtained without charge 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.

B U S I N E S S S E G M E N T I N F O R M A T I O N

(Thousands of dollars)	1990	1989	1988
Net sales:			
Machinery Division			
Pumping units	\$ 66,868	\$ 50,324	\$ 68,817
Power transmission products	45,003	33,629	26,386
Commercial products	15,452	8,586	4,525
Trailer Division	58,853	81,494	73,489
Industrial Supplies Division	14,003	12,366	11,828
Less: Elimination of interdivision sales	(5,431)	(4,399)	(3,887)
Total net sales	194,748	182,000	181,158
Operating income (loss):			
Machinery Division	(3)	(14,185)	(3,740)
Trailer Division	(2,651)	(1,474)	(2,258)
Industrial Supplies Division	688	105	(201)
Less: Elimination of interdivision profit	(1,086)	(1,123)	(1,184)
Total operating income (loss)	(3,052)	(16,677)	(7,383)
Assets:			
Machinery Division	106,692	99,062	113,107
Trailer Division	31,398	34,531	33,520
Industrial Supplies Division	5,896	5,160	5,485
General corporate	78,483	88,495	94,059
Total assets	222,469	227,248	246,171
Capital expenditures:			
Machinery Division	7,804	3,012	3,738
Trailer Division	1,169	1,715	3,318
Industrial Supplies Division	82	267	244
General corporate	90	172	274
Total capital expenditures	9,145	5,166	7,574
Depreciation:			
Machinery Division	8,983	8,938	9,025
Trailer Division	1,052	1,069	1,008
Industrial Supplies Division	196	214	196
General corporate	990	994	999
Total depreciation	11,221	11,215	11,228
Net sales by geographic region:			
United States	168,824	162,824	152,498
Canada	7,131	6,281	11,030
Latin America	5,969	6,797	10,692
Other regions	12,824	6,098	6,938
Total net sales	\$194,748	\$182,000	\$181,158

MANAGEMENT'S ANALYSIS OF OPERATING RESULTS AND FINANCIAL CONDITION

Results of Operations

Net sales for 1990 were \$194.7 million as compared to \$182.0 million in 1989. Sales for 1989 had increased only slightly from 1988 when sales totaled \$181.2 million. The Company reported earnings before income taxes of \$2.9 million in 1990 as compared to losses before income taxes of \$10.3 million in 1989 and \$.7 million in 1988. Net earnings of \$2.0 were generated in 1990 compared to a net loss of \$6.4 million in 1989 and net earnings of \$5.9 million in 1988. The earnings in 1988 were due primarily to the adoption in 1988 of the Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes". The cumulative effect of this change amounted to \$5.2 million in 1988.

The annual percentage increases (decreases) in net sales of the Company's product groups for the three years ended December 31, 1990, were as follows.

	Annual Increase (Decrease)		
	1990	1989	1988
Machinery Division			
Pumping units	33%	(27%)	17%
Power transmission products	34	27	19
Commercial products	80	90	—
Trailer Division	(28)	11	10
Industrial Supplies Division	13	5	15

The Company's pumping unit sales were positively affected in 1990 by the improved market price of oil and the resulting increase in drilling activity. Domestic drilling activity in 1989 was at its lowest level of activity in over forty years. The number of pumping units shipped during 1990 increased 56% after decreasing 19% in 1989. The average unit size decreased 3% in 1990 and 15% in 1989. In addition to the significant increase in volume of units sold during 1990, the Company was able to implement some price increases in 1990, 1989 and 1988. The Machinery Division's power transmission products sales increased in 1990 and 1989 as a result of higher volumes as well as price increases during both years.

In a diversification effort, the Company introduced two new products. In the foundry a commercial castings business was introduced. This business grew from \$6.7 million in 1989 to \$10.7 million in 1990. Likewise, a commercial fabrications business was begun and this business expanded from \$1.2 million in 1989 to \$4.5 million in 1990. The Company anticipates that these businesses will continue to grow in 1991.

The Machinery Division reported a break even at the operating level in 1990 compared to operating losses of \$14.2 million in 1989 and \$3.7 million in 1988. The significant improvement in operating profits for 1990 was primarily the result of the large increase in pumping unit sales and the growth of power transmission and commercial castings and fabrications businesses. The large operating loss in 1989 was the result of the major decline of pumping units sold in that year.

The Machinery Division's backlog at December 31,

1990 was approximately \$60.5 million as compared to \$30.2 million at December 31, 1989. Continued improvement in the Company's sales of pumping units is dependent on future drilling activity which will be directly affected by the demand for and price of oil. Due to the uncertainty of oil prices, the supply/demand imbalance of oil, and the conflict in the Persian Gulf, the Company is uncertain about the prospects for the Machinery Division for 1991 and beyond.

Trailer Division sales were \$58.9 million in 1990 after a record year of \$81.5 million in 1989. This was a decrease of 28% after an 11% increase in 1989 over 1988 sales of \$73.5 million. The general decline in demand for trailers over the past few years was felt by the Company for the first time in 1990. In addition, the lower demand continued to depress selling prices. After allocation of corporate expenses, the Trailer Division reported an operating loss of \$2.7 million in 1990, compared to operating losses of \$1.5 million in 1989 and \$2.3 million in 1988. These operating losses were caused by the continuing competitive conditions in the trailer industry.

The Trailer Division had a backlog of approximately \$10.4 million in sales orders at December 31, 1990 as compared to \$12.8 million at December 31, 1989. The Company believes that the depressed condition of the trucking industry will cause its trailer sales to be even lower in 1991. To offset this reduced level of trailer sales, the Company has started a program to place other fabricated products in the trailer facility. These additional products should help absorb some of the significant fixed costs associated with this Division's manufacturing facilities.

Interest income decreased 7% in 1990 due to the reduced level of temporary investments and investments in marketable securities held during the year. See Footnote 3 for information relating to the Company's income tax provisions and benefits.

With the relatively low level of the annual inflation rate in the last several years, the Company believes that the impact of inflation on revenues, costs and expenses has been modest.

The Company has not yet implemented the new accounting standard for post-retirement benefits other than pensions and has not yet determined the effect that this change which will be made in 1993 will have on its consolidated financial position and results of operation.

Liquidity and Capital Resources

At December 31, 1990, the Company had working capital of \$98.4 million as compared to \$105.2 million at December 31, 1989, and \$109.2 million at December 31, 1988.

The Company believes that existing working capital is sufficient to satisfy its 1991 requirements. In recent years, the expansion of the Company's facilities has been financed with internally generated funds and the Company plans to finance future expansion and improvement of its facilities in this manner. No significant commitments exist for future capital expenditures.

C O N S O L I D A T E D B A L A N C E S H E E T

December 31, 1990 and 1989
(Thousands of dollars)

Assets	1990	1989
Current assets:		
Cash	\$ 1,498	\$ 310
Temporary investments	16,138	27,257
Accounts receivable, less allowance of \$225	32,533	23,313
Installment notes and contracts receivable, less allowance of \$650	36,575	37,205
Inventories	26,616	29,426
Total current assets	113,360	117,511
Property, plant and equipment:		
Land and improvements	9,381	9,345
Buildings	51,788	51,446
Machinery and equipment	144,848	137,500
	206,017	198,291
Less accumulated depreciation	115,353	105,551
Net property, plant and equipment	90,664	92,740
Investments in marketable securities	11,231	12,661
Other assets	7,214	4,336
	\$222,469	\$227,248

Liabilities and Stockholders' Equity

Current liabilities:		
Accounts payable	\$10,368	\$8,062
Accrued liabilities		
Payrolls	1,863	1,214
Taxes and other	2,744	3,026
Total current liabilities	14,975	12,302
Deferred income taxes	13,755	12,875
Stockholders' equity:		
Common stock, par \$1 per share; 20,000,000 shares authorized; 6,792,096 shares issued in 1990	6,792	1,698
Capital in excess of par	15,364	15,364
Retained earnings	171,583	185,009
Total stockholders' equity	193,739	202,071
	\$222,469	\$227,248

See notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF EARNINGS

Years ended December 31, 1990, 1989 and 1988
(Thousands of dollars, except per share data)

	1990	1989	1988
Revenues:			
Net sales	\$194,748	\$182,000	\$181,158
Interest income	5,957	6,418	6,666
	200,705	188,418	187,824
Expenses:			
Cost of sales	174,689	176,416	166,728
Selling, general and administrative expenses	23,111	22,261	21,813
	197,800	198,677	188,541
Earnings (loss) before income taxes and the cumulative effect of the change in accounting for income taxes	2,905	(10,259)	(717)
Income taxes (benefits)	880	(3,841)	(1,483)
Earnings (loss) before the cumulative effect of the change in accounting for income taxes	2,025	(6,418)	766
Cumulative effect of the change in accounting for income taxes	—	—	5,170
Net earnings (loss)	\$ 2,025	\$ (6,418)	\$ 5,936
Earnings (loss) per share			
Earnings (loss) before the cumulative effect of the change in accounting for income taxes	\$.30	\$ (.95)	\$.11
Cumulative effect of the change in accounting for income taxes	—	—	.76
Net earnings (loss) per share	\$.30	\$ (.95)	\$.87

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Years ended December 31, 1990, 1989 and 1988
(Thousands of dollars, except per share data)

	Common Stock		Capital	Retained
	Shares	Amount	In Excess of Par	Earnings
Balance December 31, 1987	1,708,024	\$1,708	\$15,454	\$208,970
Net earnings				5,936
Cash dividends, \$1.76 per share				(11,941)
Stock purchased and retired	(10,000)	(10)	(90)	(1,350)
Balance December 31, 1988	1,698,024	1,698	15,364	201,615
Net loss				(6,418)
Cash dividends, \$1.50 per share				(10,188)
Balance December 31, 1989	1,698,024	1,698	15,364	185,009
Net earnings				2,025
Cash dividends, \$1.53 per share				(10,357)
Stock split in the form of a 3 for 1 stock dividend	5,094,072	5,094		(5,094)
Balance December 31, 1990	6,792,096	\$6,792	\$15,364	\$171,583

See notes to consolidated financial statements.

C O N S O L I D A T E D S T A T E M E N T O F C A S H F L O W S

Years ended December 31, 1990, 1989 and 1988
(Thousands of dollars)

	1990	1989	1988
Cash flows from operating activities:			
Earnings (loss) before the cumulative effect of the change in accounting for income taxes	\$ 2,025	\$ (6,418)	\$ 766
Adjustments to reconcile earnings (loss) to net cash provided (used) by operating activities:			
Depreciation	11,221	11,215	11,228
Deferred income tax provision (benefit)	880	(3,841)	(398)
Changes in assets and liabilities:			
Accounts receivable	(9,220)	29	2,176
Refundable income taxes	—	2,508	1,013
Installment notes and contracts receivable	630	(2,011)	(3,212)
Inventories	2,810	8,103	(14,131)
Accounts payable	2,306	(422)	(841)
Accrued liabilities	367	1,946	(4,448)
Net cash provided (used) by operating activities	11,019	11,109	(7,847)
Cash flows from investing activities:			
Net additions to property, plant and equipment	(9,145)	(5,166)	(7,574)
(Increase) decrease in investments in marketable securities and other assets	(1,448)	10,372	6,186
Net cash provided (used) by investing activities	(10,593)	5,206	(1,388)
Cash flows from financing activities:			
Dividends paid	(10,357)	(10,188)	(11,941)
Stock purchased and retired	—	—	(1,450)
Net cash used by financing activities	(10,357)	(10,188)	(13,391)
Net increase (decrease) in cash and temporary investments	(9,931)	6,127	(22,626)
Cash and temporary investments, at beginning of year	27,567	21,440	44,066
Cash and temporary investments, at end of year	\$17,636	\$27,567	\$21,440

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 the lower of cost or market. Temporary investments are included with cash for purposes of reporting cash flows.

The investment in marketable securities consisting of corporate and tax exempt bonds, government securities, common and preferred stock and guaranteed investment contracts is carried at cost and had a market value of \$9,384,000 and \$11,377,000 at December 31, 1990 and 1989, respectively.

Installment notes and contracts receivable: A portion of the Company's trailer 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 company retains a secured interest in trailers sold on installment notes. The amounts due after one year (\$23,115,000 at December 31, 1990 and \$24,724,000 at December 31, 1989) are included in current assets.

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. Depreciation for financial reporting purposes is provided on a straight-line method based upon the estimated useful lives of the assets.

Expenditures for maintenance and repairs were \$6,011,000 in 1990, \$4,635,000 in 1989, and \$5,019,000 in 1988.

Income taxes: A provision (benefit) is made in the financial statements for the deferred taxes applicable to depreciation and other temporary differences between financial and tax reporting methods.

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

Other: Certain items have been reclassified in the 1989 and 1988 consolidated financial statements to conform with 1990 classifications.

(2) Business segment information

Information concerning the Company's various business segments is included on Page 16 of this report.

Sales to a customer of the Company's trailer products, accounted for 12% of net sales in 1988, 10% of net sales in 1989 and less than 10% in 1990.

(3) Income taxes

The income tax provision (benefit) for 1990, 1989 and 1988 consisted of the following:

(Thousands of dollars)	1990	1989	1988
Amounts currently refundable	\$ —	\$ —	\$(1,085)
Provision (benefit) of deferred taxes	880	(3,841)	(398)
Total	\$880	\$(3,841)	\$(1,483)

A reconciliation of the benefit for income taxes to the statutory United States tax rate is as follows:

(Thousands of dollars)	1990	1989	1988
Taxes computed at statutory rate	\$988	\$(3,488)	\$ (244)
Tax-exempt interest	(21)	(206)	(694)
Dividend income exclusion	(122)	(145)	(177)
Rate differential on NOL carryback to 1985	—	—	(332)
Other, net	35	(2)	(36)
Actual provision (benefit)	\$880	\$(3,841)	\$(1,483)

For income tax reporting purposes, the Company has net operating losses from previous years. The utilization of these tax operating loss carryforwards in the current year resulted in the reinstatement of previously deferred income taxes. At December 31, 1990 the Company had tax operating loss carryforwards of approximately \$3.7 million which are available to reduce future taxable income.

Effective January 1, 1988, the Company adopted the Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes." The cumulative effect of the change in accounting for income taxes at that date amounted to \$5,170,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(4) Inventories

Inventories used in determining cost of sales were as follows:

(Thousands of dollars)	1990	1989	1988	1987
Finished goods	\$13,297	\$12,470	\$11,087	\$ 7,091
Work in process	6,983	7,330	11,528	7,720
Raw materials	6,336	9,626	14,914	8,587
Total	\$26,616	\$29,426	\$37,529	\$23,398

Had the first-in, first-out method been used in determining inventory values, inventories would have been \$25,653,000, \$27,825,000, \$27,809,000 and \$23,353,000 higher at December 31, 1990, 1989, 1988 and 1987, respectively.

During 1990 and 1989 inventory quantities were reduced. These reductions resulted in a liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years. The effect of these liquidations increased net earnings in 1990 by \$297,000 or \$.04 per share and decreased the net loss in 1989 by approximately \$79,000 or \$.01 per share.

(5) Retirement benefits

The Company has noncontributory pension plans covering substantially all employees. The benefits provided by these plans are measured by length of service, compensation and other factors, and are currently funded by trusts established under the plans. Funding of retirement costs for these plans complies with the minimum funding requirements specified by the Employee Retirement Income Security Act.

Plan investment assets are invested primarily in equity securities, groups annuity contracts, corporate and United States debt securities and cash equivalents.

The following tables detail the components of pension income and expense, the funded status of the plans and amounts of prepaid pension cost recognized in the Company's consolidated balance sheet, and major assumptions used to determine these amounts.

(Thousands of dollars)	1990	1989	1988
Components of pension (credit) expense			
Service cost	\$2,338	\$ 2,246	\$ 2,141
Interest cost	4,977	4,640	4,638
Actual return on plan assets	(5,305)	(14,448)	(6,850)
Net amortization and deferral	(3,588)	6,453	(923)
Net pension credit	\$(1,578)	\$ (1,109)	\$ (994)
Plan assets at fair value	\$92,165	\$ 90,868	\$ 80,694
Actuarial present value of projected benefit obligations			
Accumulated benefit obligations			
Vested	(46,789)	(42,213)	(42,506)
Nonvested	(5,274)	(5,870)	(5,659)
Provision for future salary increases	(15,662)	(14,628)	(14,359)
Plan assets over projected benefit obligations	24,440	28,157	18,170
Unrecognized transition gain	(16,389)	(17,315)	(18,242)
Unrecognized (gain) loss	(3,183)	(7,224)	2,578
Unrecognized prior service cost	387	60	63
Net prepaid pension cost	\$5,255	\$ 3,678	\$ 2,569
Major assumptions at year-end			
Discount rate	8%	8%	8%
Rate of increase in compensation levels	6%	6%	6%
Expected long-term rate of return on plan assets	9%	9%	9%

The Company also has a defined contribution retirement plan covering substantially all of its salaried employees. The Company makes contributions of 75% of employee contributions during the year. All obligations of the Company were funded currently through December 31, 1990. Pension expense for these plans totaled \$677,000, \$628,000 and \$577,000 in 1990, 1989 and 1988, respectively.

In December 1990, the Financial Accounting Standards Board released Statement of Financial Accounting Standards No. 106, "Accounting for Post-Retirement Benefits Other Than Pensions", which significantly alters the accounting and reporting of unfunded liabilities relating to post-retirement benefits by requiring accrual during the years that the employee renders service. The Company is currently required to adopt the new accounting and disclosure rules no later than its year ending December 31, 1993. The Company has not yet implemented the new accounting standard and has not yet determined the effect that the change will have on the consolidated financial position and results of operation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(6) Employee Stock Option Plan

The Company's 1990 Stock Option Plan provides for the granting of options to key employees to purchase an aggregate of 400,000 shares of the Company's stock at fair market value on the date of grant. One fourth of granted options become exercisable after one year and each year thereafter. The options may not be exercised after ten years from the date of grant. Outstanding options may be cancelled and reissued under terms specified in the plan. At December 31, 1990, a total of 73,200 options had been awarded at an option price of \$30 per share. None of these options were exercisable at December 31, 1990.

(7) Common Stock

On December 3, 1990, the Company distributed a stock split in the form of a three-for-one stock dividend to stockholders of record on November 12, 1990. References to number of common shares and to per share information in the consolidated financial statements have been adjusted to reflect the stock dividend on a retroactive basis.

In May 1987, the Board of Directors adopted a "Shareholder Rights Plan" designed to protect against unsolicited attempts to acquire control of the Company that the Board believes are not in the best interest of the shareholders. The Plan provides for the possible issuance of a dividend of one common stock purchase right for each outstanding share of common stock. Under certain conditions, each right may be exercised to purchase one share of common stock at an exercise price of \$100, subject to adjustment. Under certain circumstances, the rights entitle holders to purchase the common stock of the Company or an acquiring company having a value of twice the exercise price of the rights. The rights would become exercisable, or transferable apart from the common stock, ten days after a person or group acquired 20% or more, or announced or made a tender offer for 30% or more, of the outstanding common stock. Under certain circumstances, all rights owned by an acquiring person would be null and void. The rights expire on May 31, 1996 and may be redeemed by the Company at any time prior to the occurrence of certain events at \$.05 per right.

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Stockholders of Lufkin Industries, Inc.:

We have audited the accompanying consolidated balance sheets of Lufkin Industries, Inc. (a Texas corporation) and subsidiaries as of December 31, 1990 and 1989, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1990. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lufkin Industries, Inc., and subsidiaries as of December 31, 1990 and 1989, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1990, in conformity with generally accepted accounting principles.

As discussed in Note 3 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 96 "Accounting for Income Taxes" in 1988.

ARTHUR ANDERSEN & CO.

Houston, Texas
February 18, 1991

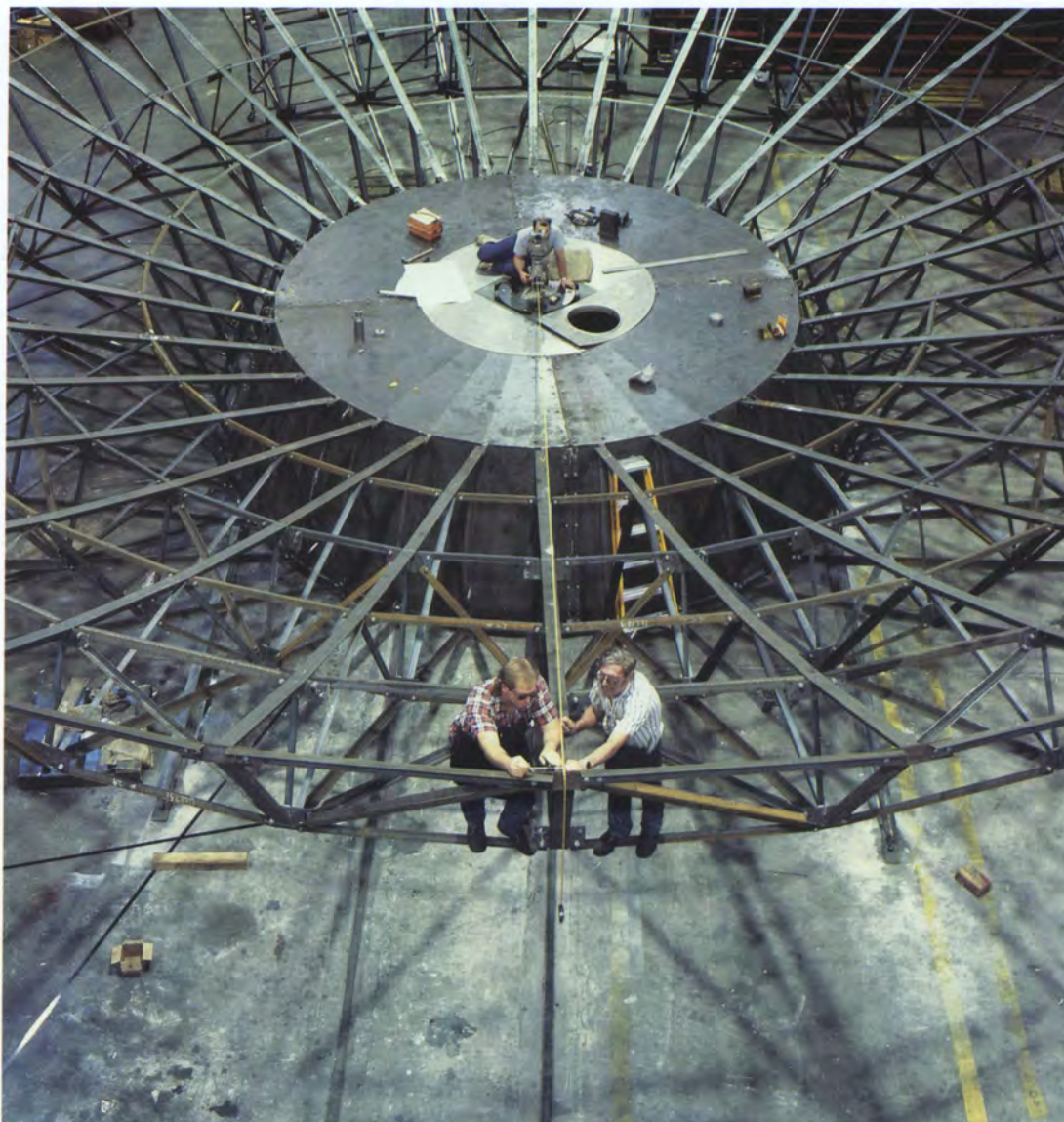
BOARD OF DIRECTORS

- H. J. Green, *Executive Vice President*
- S. W. Henderson, III, *Chairman of the Board and Chief Executive Officer of Lufkin Federal Savings and Loan*
 - L. R. Jalenak, Jr., *Chairman of the Board, Cleo Inc.*
 - H. H. King, *President, Henry H. King & Associates*
 - M. E. Kurth, Jr., *Manager of his own investments*
 - W. T. Little, *Management consultant*
 - R. L. Poland, *Retired Chairman of the Board and Chief Executive Officer*
 - F. B. Stevenson, *President and Chief Executive Officer*
 - H. J. Trout, Jr., *District Sales, Manager, Lufkin Industries, Inc.*
 - W. W. Trout, Jr., *Retired Vice President*
 - T. E. Wiener, *Principal, Franklin, Margulies (law firm)*

- Member of Executive Committee

OFFICERS

- F. B. Stevenson, *President, Chief Executive Officer*
- H. J. Green, *Executive Vice President*
- J. R. Partridge, *Vice President*
- M. A. Penn, *Vice President*
- E. G. Pittman, *Vice President*
- J. E. Riggs, *Vice President*
- E. L. Watts, *Vice President*
- C. J. Haley, Jr., *Secretary-Treasurer*
- R. E. Myers, Jr., *Assistant Secretary*
- J. B. Massingill, *Assistant Treasurer*



INSIDE FRONT COVER: The sun sets on a Mark II unit near Odessa, Texas.

3 A technician checks shaft end play on a large CVC-804L gearbox.

4 (1) A LUFKIN Air Balance unit operating in the foothills of Hot Springs County, Wyoming.
(2) A LUFKIN Mark II unit pumps oil from beneath Black Lake, near Hackberry, Louisiana.
(3) A LUFKIN RM unit works dewatering a coal bed methane gas well in the Black Warrior Basin of Alabama.
(4) A LUFKIN Roadrunner keeps a well site producing as its pumping unit is serviced in an oilfield near Kilgore, Texas.

5 A LUFKIN Mark II pumps oil in the early morning light of Campbell County, Wyoming.

6 (1) A LUFKIN high speed gear is about to begin the final tooth finishing.
(2) A team of LUFKIN technicians assemble five small high speed gearboxes.
(3) A 31,500 horsepower speed reducer is being tested.

7 A large low speed LUFKIN gear.

8 (1) The first production model of the military dump and hoist assembly is being fabricated.
(2) A LUFKIN "Thin Wall" van.
(3) A LUFKIN Ultralight dump on site at a concrete plant.

9 A LUFKIN extendable float extended to 65 ft.

10 A row of molds in LUFKIN's small casting facility.

11 The Fabrication Department puts the finishing welds on a gearbox housing weighing 79,500 lbs.

12 (1) A fork truck driver receiving his orders straight from the terminal operator.
(2) In a section of the warehouse dedicated to papermill supply, a large gear is billed for shipment.

13 Senior managers refine details of Lufkin's global strategy.

INSIDE BACK COVER: The steel framework of a 20.1 meter satellite antenna earth station is being assembled to assure correct fit before shipping.



LUFKIN INDUSTRIES, INC.
P.O. Box 849
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