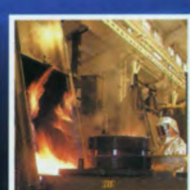
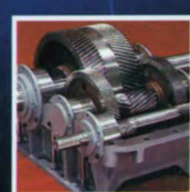
LUFKIN


1991 ANNUAL REPORT

CORPORATE PROFILE

Lufkin Industries, Inc., sells oilfield pumping units, power transmission equipment, commercial products (castings and fabrications) and related industrial supplies throughout the world.

The Company has vertically integrated all vital technologies required to design, manufacture and market its products. Its facilities include engineering, gray and ductile iron foundries, machining operations and steel fabrication.

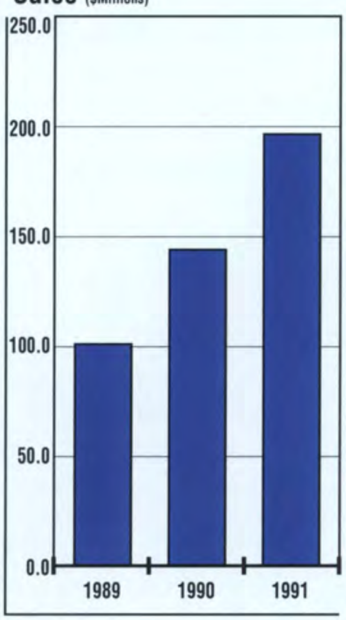
Lufkin Industries stock is traded on the NASDAQ as LUFK.

FINANCIAL HIGHLIGHTS

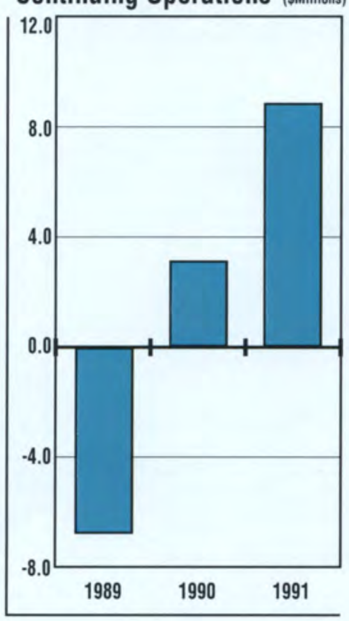
(Thousands of dollars, except per share amounts)

	December 31		
	1991	1990	% Change
Sales	**$193,585**	$135,895	42%
Earnings from continuing operations	**8,969**	2,575	248%
Net earnings	**6,867**	2,025	239%
Earnings (loss) per share			
Continuing operations	**1.32**	.38	248%
Discontinued operations	**(.31)**	(.08)	288%
	1.01	.30	239%
Working capital	**83,114**	83,070	—
Total assets	**215,969**	218,520	-1%

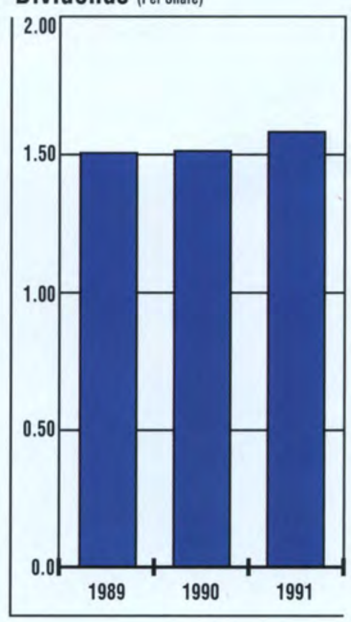
Sales ($Millions)



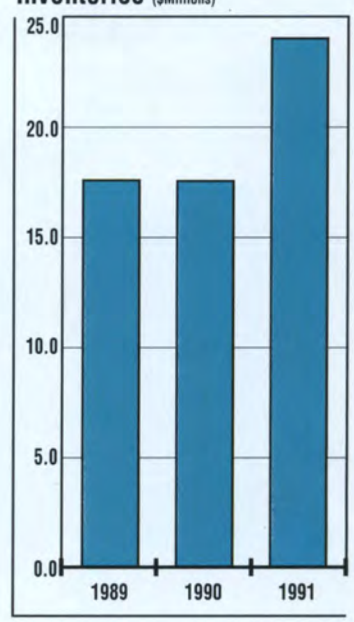
Earnings from Continuing Operations ($Millions)



Dividends (Per Share)



Inventories ($Millions)



Frank B. Stevenson
Chairman,
Chief Executive Officer

Herbert J. Green
President,
Chief Operating Officer

A LUFKIN pumping unit, specially designed with a pivotal horse head, undergoes evaluation at the test well before being shipped to Russia.

LETTER TO THE SHAREHOLDERS

The year 1991 was an eventful one for Lufkin Industries, Inc. It began with the development of a significant new market in Russia for oilfield pumping units, and ended with the decision to exit the trailer business. Sales and earnings improved substantially in 1991. Sales climbed from $135.9 million in 1990 to $193.6 million in 1991, an increase of 42%. Earnings from continuing operations increased to $9.0 million in 1991 from $2.6 million in 1990 and net earnings increased 239% to $6.9 million.

Perhaps the most notable achievement of the year was the explosive expansion of the Company's international markets for its oilfield pumping units. Sales to Russia reached approximately $39.0 million, representing 20% of the Company's sales. Sales in Latin America increased almost five fold over 1990. In fact, over two thirds of our pumping unit shipments were sent to locations outside the United States in 1991.

In November 1991, a strategic decision was made to exit the trailer business. This was brought about by the severely depressed transportation industry and the resulting contraction of our customer base. The divestiture of this business will allow us to focus on our core business and to concentrate our energies on the remaining profitable product lines.

Oilfield equipment sales increased 86% in 1991, primarily the result of greater demand for our products in international markets. Although U.S. drilling activity is at an all-time low, the opportunity for growth in the international arena remains strong. We will continue to pursue the promising markets of Russia and Latin America in 1991, as well as every other available market around the globe.

Power transmission sales continued to grow at a somewhat slower pace than 1990. During the year, we made large capital expenditures in manufacturing equipment for this product line that will allow this business to grow more rapidly in the future. Our case hardening facility became operational in the fourth quarter, and will greatly enhance our ability to provide high horsepower units. During the year we acquired additional gear grinding capability, enabling us to improve the accuracy of our product and to strengthen our total product line. A new gear service and repair center opened at year end, which allows us to provide improved response to customer needs for repairs and service parts.

Commercial products' sales including castings, fabrications and winches were affected by the recession and our shipments were below projected levels. However, several new customers were attracted and our casting research project for the Department of the Navy is well underway. Because of this broadened activity, we expect improved results from this product line in 1992.

Quality, dependability, and real value have built the reputation LUFKIN has prized for ninety years. In 1991, we rededicated our efforts and developed a new quality initiative that will flow through the entire Company. *The Lufkin Quality Process,* a process devoted to continuous improvement and doing things right the first time, will involve every member of the LUFKIN Team and will be the platform for even greater dedication to customer service.

The commitment of our people, the quality of our products, unequaled service to the customer, and the financial and technological strengths of the Company will continue to be the driving forces of Lufkin Industries, Inc.

F B Stevenson

Frank B. Stevenson
Chairman, Chief Executive Officer

Herbert J. Green

Herbert J. Green
President, Chief Operating Officer

1991 FINANCIALS

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FINANCIAL REVIEW

Common Stock Information

	1991			1990		
	Stock Price			Stock Price		
Quarter	High	Low	Dividend	High	Low	Dividend
First	$31.00	$26.00	$.40	$ *	$ *	$.375
Second	33.00	28.00	.40	*	*	.375
Third	36.00	29.75	.40	*	*	.375
Fourth	35.00	24.50	.40	33.75	26.25	.40

* On November 6, 1990, trading began on the Company's common stock on NASDAQ National Market system (Symbol LUFK).

As of February, 1992, the Company has approximately 1,025 record holders of its common stock.

The Company has paid cash dividends for 52 consecutive years. Total dividend payments were $10,868,000 in 1991 and $10,357,000 in 1990.

Quarterly Financial Data

In millions, except per share data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1991				
Net sales	$52.6	$41.6	$50.6	$48.8
Gross margin	10.4	8.3	9.0	8.7
Net earnings (loss):				
Continuing operations	3.5	2.4	1.6	1.5
Discontinued operations	(.7)	(.2)	(.4)	(.8)
	$ 2.8	$ 2.2	$ 1.2	$ .7
Earnings (loss) per share:				
Continuing operations	$ .51	$ .35	$ .24	$ .22
Discontinued operations	(.10)	(.03)	(.06)	(.12)
	$ .41	$ .32	$ .18	$ .10
1990				
Net sales	$30.4	$28.8	$32.7	$44.0
Gross margin	4.5	4.0	3.7	4.6
Net earnings (loss):				
Continuing operations	1.1	.6	.5	.4
Discontinued operations	(.1)	.1	.0	(.6)
	$ 1.0	$ .7	$ .5	$ (.2)
Earnings (loss) per share:				
Continuing operations	$ .16	$ .09	$ .08	$ .06
Discontinued operations	(.01)	.01	.00	(.09)
	$ .15	$ .10	$ .08	$ (.03)

Additional Financial Information

Stockholders may obtain additional financial information for the year ended December 31, 1991 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.

Results of Operations

Sales from continuing operations for 1991 were $193.6 million and $135.9 million for 1990. Sales in 1990 had also increased significantly from $100.5 million in 1989. The Company reported earnings from continuing operations of $9.0 million in 1991 as compared to $2.6 million in 1990 and a loss of $6.5 million in 1989. Net earnings increased significantly to $6.9 million in 1991 from $2.0 million in 1990. The Company reported a net loss of $6.4 in 1989.

In November 1991, the Company announced its decision to exit the trailer business and is currently seeking a buyer for this operation. These operations, including the direct administrative expenses related thereto and the applicable provision or benefit for income taxes, have been reported as the results of discontinued operations in the restated consolidated statement of earnings. Losses of $2.1 million and $.6 million were reported in 1991 and 1990 while a small income of $.1 million was earned in 1989.

The annual percentage increases (decreases) in sales of the Company's product groups for the three years ended December 31, 1991 were as follows:

	Annual Increase (Decrease)		
	1991	1990	1989
Oilfield pumping units	86 %	33%	(27)%
Power transmission	4 %	34%	27 %
Commercial products	—	80%	90 %
Industrial supplies	(12)%	8%	—

The dramatic 86% increase in the Company's oilfield pumping unit sales in 1991 resulted from significant increased demand for these products in the international market. Although the U. S. drilling activity is at an all-time low and the domestic demand for the Company's oilfield products is likewise significantly reduced, the international demand has more than offset this domestic decline. In 1991, more than two-thirds of oilfield pumping unit shipments were shipped to locations outside the United States. During 1991, a significant market was developed in Russia with more than $39.0 million of sales. In addition, sales to Venezuela and other Latin American customers increased almost five times over the 1990 level of sales to these areas.

The backlog for pumping unit products at December 31, 1991 was approximately $27.1 million as compared to $33.2 million at December 31, 1990. Continued improvement in the Company's sales of oilfield pumping units is dependent on the stability of our international markets as well as future domestic drilling activity which will be directly affected by the demand for and price of oil. Due to the many uncertainties faced by the worldwide energy industry, the Company is unsure about our prospects for these products in 1992 and beyond and the resulting impact on its level of sales and net earnings.

Power transmission sales increased 4% in 1991, compared to increases of 34% in 1990 and 27% in 1989. During 1991 and continuing into 1992, the Company has made significant capital expenditures in its manufacturing capabilities for this product line which should enable sales to continue to increase in future years as demand for its products increases. The backlog for power transmission products at December 31, 1991 was $22.3 million as compared to $23.9 at December 31, 1990.

Sales of commercial products were $15.3 million in 1991 compared to $15.5 in 1990 and $8.6 million in 1989. The market for these products has also been adversely affected by the current economic recession. The backlog of commercial products was $2.4 million at December 31, 1991 as compared to $2.7 million at December 31, 1990. The recession also adversely impacted the net sales of the industrial supplies product line which declined 12% in 1991. Expected improvement in the United States economic condition should increase sales for both of these product lines.

Gross profit for the Company increased 117% in 1991 from $16.8 million in 1990 to $36.4 million in 1990. As a percentage of sales, gross margin was 18.8% in 1991, 12.3% in 1990 and 1.5% in 1989. While a portion of these increases was generated by increased selling prices, the major portion of the increases came from the significant volume increases primarily of the Company's oilfield pumping unit products. During 1991, the number of pumping units sold increased 86% after increasing 56% in 1990. Along with the volume increase, the average size of pumping units sold in 1991 increased 13% after decreasing 3% in 1990 and 15% in 1989. The increased volume in 1991 resulted in reduced unit manufacturing costs for this product line resulting in the significant gross margin improvements.

Selling, general and administrative costs increased from $18.0 million in 1989 to $19.0 million in 1990 to $27.5 million in 1991. As a percentage of sales, these expenses were 14.2% in 1991, 14.0% in 1990 and 17.8% in 1989. The major cause for the large dollar increase in 1991 was the significantly higher costs associated with doing business in international markets. Commissions were paid on a large portion of the international sales which are greater than the selling costs related to domestic sales.

Investment income decreased 2% in 1991 due to reduced level of temporary and other investments held during the year, offset by gains on the sale of investments. Other expense (net) increased to $1.5 million from $.1 million primarily as a result of installment notes receivable written off during 1991. These installment notes were derived from the sale of products manufactured by the Company's discontinued trailer operations. Because of the very depressed condition of the trucking industry, a large number of bankruptcies of the trailer customers caused this significant charge.

See Footnote 3 for information relating to the Company's income tax provisions and benefits and Footnote 5 for an explanation of its treatment of discontinued operations.

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

The Company has not yet implemented the new accounting standard for post-retirement benefits other than pensions but does not believe that the impact of its implementation in 1993 will have a material impact on its consolidated financial position or results of operations.

Liquidity and Capital Resources

At December 31, 1991, and December 31, 1990 the Company's working capital was $83.1 million. The Company believes that existing working capital is sufficient to satisfy its 1992 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 were outstanding for future capital expenditures at December 31, 1991.

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, 1991 and 1990, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1991. 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, 1991 and 1990, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1991, in conformity with generally accepted accounting principles.

ARTHUR ANDERSEN & CO.

Houston, Texas
February 19, 1992

CONSOLIDATED BALANCE SHEET

December 31, 1991 and 1990
(Thousands of dollars)

Assets	**1991**	1990
Current assets:		
Cash	**$ 170**	$ 1,498
Temporary investments	**5,367**	16,138
Accounts receivable, less allowances of $225	**36,975**	22,732
Installment notes, less allowances of $650	**26,462**	36,575
Inventories	**23,680**	17,153
Total current assets	**92,654**	94,096
Property, plant and equipment:		
Land and improvements	**7,315**	6,854
Buildings	**45,401**	44,145
Machinery and equipment	**146,885**	131,733
	199,601	182,732
Less accumulated depreciation	**113,952**	104,202
	85,649	78,530
Other investments	**5,074**	11,231
Other assets	**8,966**	7,214
Net assets of discontinued operations	**23,626**	27,449
	$215,969	$218,520

Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	**$ 6,547**	$ 7,237
Accrued liabilities:		
Payrolls	**2,102**	1,597
Commissions	**603**	—
Taxes and other	**288**	2,192
Total current liabilities	**9,540**	11,026
Deferred income taxes	**16,683**	13,755
Stockholders' equity:		
Common stock, par $1 per share; 20,000,000 shares authorized; 6,792,381 and 6,792,096 shares issued	**6,792**	6,792
Capital in excess of par	**15,372**	15,364
Retained earnings	**167,582**	171,583
Total stockholders' equity	**189,746**	193,739
	$215,969	$218,520

See notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF EARNINGS

Years ended December 31, 1991, 1990 and 1989
(Thousands of dollars, except per share data)

	1991	1990	1989
Sales	**$193,585**	$135,895	$100,507
Cost of sales	**157,190**	119,118	99,029
Gross profit	**36,395**	16,777	1,478
Selling, general and administrative expenses	**27,508**	18,996	17,981
Investment income	**(5,866)**	(6,015)	(6,417)
Other expense (net)	**1,510**	58	329
Earnings (loss) from continuing operations before income taxes	**13,243**	3,738	(10,415)
Income taxes (benefits)	**4,274**	1,163	(3,894)
Earnings (loss) from continuing operations	**8,969**	2,575	(6,521)
Income (loss) from discontinued operations, including applicable income tax (provisions) benefits of $1,083, $283 and $(53)	**(2,102)**	(550)	103
Net earnings (loss)	**$ 6,867**	$ 2,025	$ (6,418)
Earnings (loss) per share:			
Continuing operations	**$ 1.32**	$ .38	$ (.96)
Discontinued operations	**(.31)**	(.08)	.01
Net earnings (loss) per share	**$ 1.01**	$ .30	$ (.95)

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Years ended December 31, 1991, 1990 and 1989
(Thousands of dollars, except per share data)

	Common Stock		Capital In Excess	Retained
	Shares	Amount	of Par	Earnings
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
Net earnings				6,867
Cash dividends, $1.60 per share				(10,868)
Issuance of common stock upon exercise of stock options	285		8	—
Balance December 31, 1991	6,792,381	$6,792	$15,372	$167,582

See notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

Years ended December 31, 1991, 1990 and 1989
(Thousands of dollars)

	1991	1990	1989
Cash flow from operating activities:			
Net earnings (loss)	**$ 6,867**	$ 2,025	$ (6,418)
Adjustments to reconcile earnings (loss) to net cash provided by operating activities:			
Depreciation	**11,552**	11,221	11,215
Deferred income tax provision (benefit)	**2,928**	880	(3,841)
Changes in assets and liabilities:			
Accounts receivable	**(14,315)**	(9,220)	29
Refundable income taxes	**—**	—	2,508
Installment notes	**10,113**	630	(2,011)
Inventories	**(3,501)**	2,810	8,103
Accounts payable	**(2,065)**	2,306	(422)
Accrued liabilities	**(376)**	367	1,946
Net cash provided by operating activities	**11,203**	11,019	11,109
Cash flows from investing activities:			
Additions to property, plant and equipment	**(18,428)**	(9,477)	(5,876)
Retirement of property, plant and equipment	**1,582**	332	710
(Increase) decrease in other investments and other assets	**4,404**	(1,448)	10,372
Net cash provided (used) by investing activities	**(12,442)**	(10,593)	5,206
Cash flows from financing activities:			
Dividends paid	**(10,868)**	(10,357)	(10,188)
Proceeds from exercise of stock options	**8**	—	—
Net cash used by financing activities	**(10,860)**	(10,357)	(10,188)
Net increase (decrease) in cash and temporary investments	**(12,099)**	(9,931)	6,127
Cash and temporary investments, at beginning of year	**17,636**	27,567	21,440
Cash and temporary investments, at end of year	**$ 5,537**	$17,636	$27,567

See 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 other investment: 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.

Other investments consisting of corporate and tax exempt bonds, government securities and common and preferred stock are carried at cost and had a market value of $4,010,000 and $9,384,000 at December 31, 1991 and 1990, respectively.

Installment notes: Installment notes due after one year which equaled $16,404,000 at December 31, 1991 and $23,115,000 at December 31, 1990 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 $7,300,000 in 1991, $5,177,000 in 1990, and $3,731,000 in 1989.

Income taxes: A provision or 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 1990 and 1989 consolidated financial statements to conform with 1991 classifications.

(2) Sales by product line and geographic information

The Company manufactures, sells and services various types of oilfield pumping units, power transmission products and commercial castings and fabrications. The Company also sells industrial supplies. The following is a summary of net sales for each of these product lines:

(Thousands of dollars)	**1991**	1990	1989
Oilfield pumping units	**$124,123**	$ 66,868	$ 50,325
Power transmission	**46,595**	45,003	33,629
Commercial products	**15,301**	15,452	8,586
Industrial supplies	**7,566**	8,572	7,967
Total	**$193,585**	$135,895	$100,507

Sales by geographic areas are as follows:

(Thousands of dollars)	**1991**	1990	1989
United States	**$108,513**	$109,971	$ 81,331
Europe	**39,703**	1,786	731
Canada	**7,744**	7,131	6,281
Latin America	**29,375**	5,969	6,797
Other	**8,250**	11,038	5,367
Total	**$193,585**	$135,895	$100,507

Sales to a customer accounted for 20% of net sales in 1991.

(3) Income taxes

The income tax provision (benefit) for 1991, 1990 and 1989 consisted of the following:

(Thousands of dollars)	**1991**	1990	1989
Current	**$1,346**	$283	$ (53)
Deferred	**2,928**	880	(3,841)
Discontinued operations	**(1,083)**	(283)	53
Total	**$3,191**	$880	$(3,841)

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

(Thousands of dollars)	**1991**	1990	1989
Taxes computed at statutory rate	**$3,420**	$988	$(3,488)
Tax-exempt interest	**(16)**	(21)	(206)
Dividend income exclusion	**(118)**	(122)	(145)
Other, net	**(95)**	35	(2)
Actual provision (benefit)	**$3,191**	$880	$(3,841)

Cash payments for taxes were $2,383,000, $167,000 and $1,000 for 1991, 1990 and 1989, respectively.

(4) Inventories

Inventories used in determining cost of sales were as follows:

(Thousands of dollars)	**1991**	1990	1989	1988
Finished goods	**$ 4,294**	$ 5,946	$ 3,936	$ 4,299
Work in process	**8,752**	6,369	6,315	8,569
Raw materials	**10,634**	4,838	6,999	11,841
Total	**$23,680**	$17,153	$17,250	$24,709

Had the first-in, first-out method been used in determining inventory values, inventories would have been $23,958,000, $22,277,000, $23,479,000 and $23,848,000 higher at December 31, 1991, 1990, 1989, and 1988, respectively.

During 1990 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 $56,000 or $.01 per share.

(5) Discontinued operations

In November 1991, the Company announced its decision to exit the trailer business. Accordingly, these operations including the direct administrative expenses related thereto and the applicable provision or benefit for income taxes have been reported as the results of discontinued operations for all periods in the restated consolidated statement of earnings. The Company is currently seeking a buyer of these operations and the related net assets are included in the balance sheet under the caption Net Assets of Discontinued Operations.

(6) 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, corporate and United States government 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)	**1991**	1990	1989
Components of pension (credit) expense			
Service cost	**$ 1,946**	$ 2,338	$ 2,246
Interest cost	**4,872**	4,977	4,640
Actual return on plan assets	**(17,981)**	(5,305)	(14,448)
Net amortization and deferral	**8,709**	(3,588)	6,453
Net pension credit	**(2,454)**	$ (1,578)	$ (1,109)
Plan assets at fair value	**$105,971**	$92,165	$90,868
Actuarial present value of			
projected benefit obligations			
Accumulated benefit obligations			
Vested	**(47,455)**	(46,789)	(42,213)
Nonvested	**(5,627)**	(5,274)	(5,870)
Provision for future salary increases	**(12,604)**	(15,662)	(14,628)
Plan assets over projected benefit obligations	**40,285**	24,440	28,157
Unrecognized transition gain	**(15,462)**	(16,389)	(17,315)
Unrecognized (gain) loss	**(12,728)**	(3,183)	(7,224)
Unrecognized prior service cost	**(4,386)**	387	60
Net prepaid pension cost	**$ 7,709**	$ 5,255	$ 3,678
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 employees. The Company makes contributions of 75% of employee contributions during the year. All obligations of the Company were funded currently through December 31, 1991. Pension expense for these plans totaled $1,394,000, $541,000 and $488,000 in 1991, 1990 and 1989, 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.

(7) 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.

The following table summarizes activity under the Company's stock option plans:

	1991	1990
Outstanding, beginning of year	**73,200**	—
Granted (per share):		
1990 ($30.00)		73,200
1991 ($28.50)	**9,800**	
Exercised (per share):		
1991 ($30.00)	**(285)**	
Outstanding, end of year	**82,715**	73,200

At December 31, 1991, there were 18,015 options exercisable at a price of $30 per share.

(8) 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.

PRODUCT LINE INFORMATION

LUFKIN has a hobbing capacity of 157" diameter and 72" face width.

A LUFKIN 400 series winch design is field tested on a log skidder in a Mississippi hardwood forest.

OILFIELD EQUIPMENT. Over two-thirds of LUFKIN pumping units shipped in 1991 went to destinations outside the U.S., accounting for most of the 86% increase in unit shipments over the previous year. Consequently, in spite of weak markets at home after the Persian Gulf crisis, strong pricing pressures from North American and foreign manufacturers, and a 50-year low in U.S. drilling activity during the fourth quarter, pumping unit shipments in 1991 increased more than in any year since 1984.

Recognizing the potential of international markets, LUFKIN continues to strengthen its global position. In 1991, The Republic of Russia was our largest customer. In addition to complete pumping units, we also produced Russian-designed gear reducers for pumping unit structures that are manufactured in that country. We expanded manufacturing capabilities in Indonesia and manufactured our first pumping unit components in Turkey.

The Venezuelan government has been actively supporting efforts to export oil, and LUFKIN is firmly established in the growing Venezuelan market. Our Churchill operation in Chanute, Kansas, where small and medium size pumping units are built, has also become more involved in the export market, although the U.S. market for these units remains very soft. LUFKIN is making the necessary adjustments in our sales organization in recognition of the increasing international focus of oilfield equipment sales.

In the latter part of 1991, LUFKIN continued to upgrade and expand pumping unit service facilities throughout the U.S. and in several of our international locations.

POWER TRANSMISSION. Lufkin Industries' Industrial Gear marketing group targeted both domestic and international markets for its diversified industrial gear product line. Over 30 percent of sales revenues for industrial gears was for installations outside the United States.

LUFKIN's gear 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. Higher performance gear drives were the largest segment of the gear business in 1991 and accounted for approximately 33 percent of total gear revenues. To date, the Company has built several units transmitting 80,000 horsepower, and units transmitting 30,000 horsepower to 60,000 horsepower are not uncommon.

The Company is continuing to develop markets in standard and open gearing lines where higher volume sales and production rates are possible. The standard gear lines have undergone extensive redesign, and utilize more sophisticated materials. As a result, they are more compact and less costly to manufacture.

The expansion of repair and service work has broadened the scope of the Company's power transmission business. Almost 33 percent of the total power transmission equipment sales came from the after-market parts, repair and service business. To remain competitive in this business, the Company must maintain diverse facilities and respond quickly to customers' needs.

Power transmission bookings in 1991

totaled $47.5 million, with an end-of-the-year backlog of $22.3 million.

In 1991, the Company continued to invest in capital improvements. Additional gear grinding machines were installed to enhance our position in the high performance gear market. The new carburizing facility was completed and began operation in 1991. This facility increases the scope of the gear product line, gives the Company greater control of the process, reduces delivery time and improves quality.

COMMERCIAL PRODUCTS. LUFKIN's commercial products group includes commercial castings, commercial fabrications and a line of winches for the timber industry. Castings and fabrications are sold as components to a broad group of domestic manufacturers and industries. LUFKIN has become one of the leading domestic producers of counterweights for the fork lift truck industry. The LUFKIN winch, manufactured in the Churchill facility, is installed on skidder tractors utilized in timber harvesting.

INDUSTRIAL SUPPLIES. The increased sale of industrial supplies during 1991 was a direct result of LUFKIN's increased export sales. Russian exports had a significant impact on sales of electric motors, wire rope, tools, and fasteners. Various industrial supplies are also sold with packaged industrial gear reducers or speed increasers. The industrial supplies business will continue to grow as the sale of products manufactured by the Company increases.

In addition to power transmission and oil field customers, LUFKIN sells industrial supplies to those involved in the sale of building products and newsprint, utility companies, and contractors and homeowners needing plumbing supplies. Because the Company's major industrial supply customers anticipate a resurgence in their industries, 1992 promises to be a year of continued sales growth of industrial supplies.

ENGINEERING CAPABILITIES. While the Company continued to upgrade CAD/CAM systems in engineering and manufacturing areas, it is the knowledge, skill and dedication of our people that allows LUFKIN to develop innovative solutions to customer problems. Enhanced communication between engineering disciplines is expediting the flow of information from the design engineers to the shop floor users. These more efficient design and production functions are expected to improve LUFKIN's competitive edge and market share.

An automated welding device is used to weld small parts and assemblies for pumping units and commercial fabrication products.

A technician checks shaft end play on a large high speed gear, rated for 35,000 horsepower.

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W.T. Little, *Management consultant*
* R.L. Poland, *Retired Chairman of the Board and Chief Executive Officer*
* F.B. Stevenson, *Chairman of the Board and Chief Executive Officer*
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LUFKIN

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