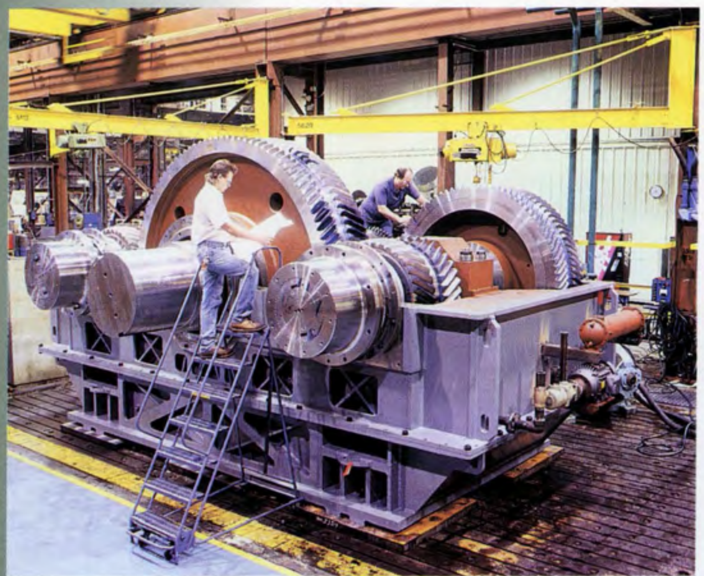
LUFKIN

1994 Annual Report

Corporate Profile

The Company sells power transmission products, oil field pumping units, foundry castings and highway trailers throughout the world. The Company has vertically integrated all vital technologies required to design, manufacture and market its products. Lufkin's common stock is traded on The Nasdaq Stock Market under the symbol LUFK.



This 6,000 horsepower ball mill drive is the largest gear box built by Lufkin Industries. It is used to crush limestone for a Florida cement plant.

Notice of Annual Meeting

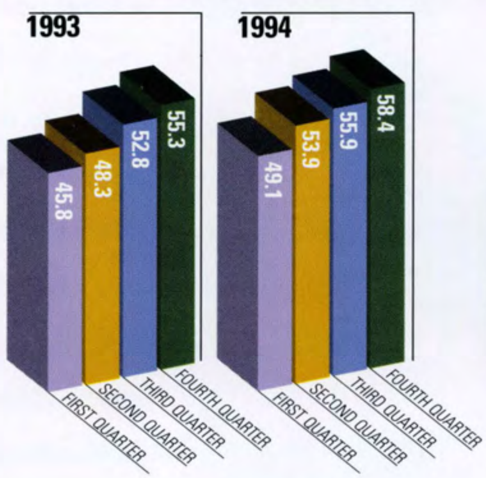
The Annual Meeting of Shareholders of Lufkin Industries, Inc. will be held at the Lufkin Civic Center, 601 North Second Street, Lufkin, Texas on May 17, 1995, at 9:00 a.m. local time.

FINANCIAL HIGHLIGHTS

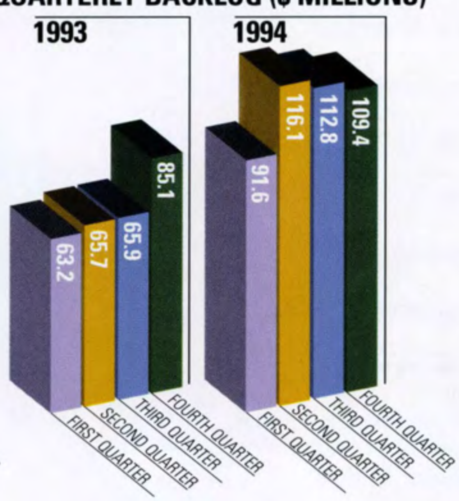
(Thousands of dollars, except per share amounts)

	December 31, 1994	1993
Sales	**$217,273**	$202,225
Operating expenses	**210,724**	200,836
Special inventory provision	**11,224**	-
Earnings (loss) before income taxes	**(1,799)**	4,294
Net earnings (loss)	**(1,207)**	2,549
Earnings (loss) per share	**(.18)**	.38
Dividends per share	**.60**	.60
Total assets	**176,774**	182,546
Working capital	**70,831**	71,570
Stockholders' equity	**137,964**	143,491

QUARTERLY REVENUE ($ MILLIONS)



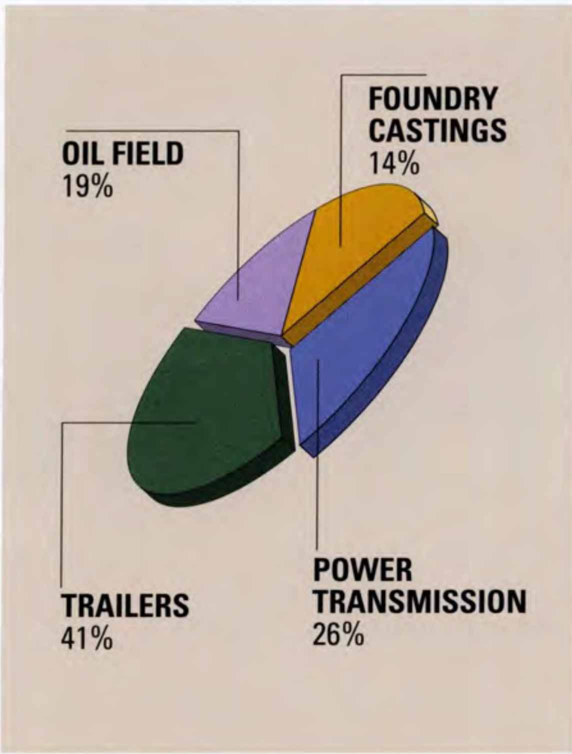
QUARTERLY BACKLOG ($ MILLIONS)



Letter To Shareholders

For the year ended December 31, 1994, Lufkin Industries made great strides in improving our operating results. The actions taken the last two years to increase our competitive position in each of our major product groups are producing positive results. Sales in 1994 increased 7% to $217.3 million compared with $202.2 million for the year ended December 31, 1993. Three out of our four major product groups — power transmission products, foundry castings, and trailers — showed strong increases in sales compared with 1993.

The general improvement in economic conditions created stronger demand which contributed to trailer sales being up 37% to $87.8 million. Sales of power transmission products were up 16% to $55.3 million. This increase reflects a greater presence in the international markets we serve and in the repair and after-service markets. Our foundry castings sales increased 25% in 1994 to $30.2 million as Lufkin continued to expand its market share in engineered castings and maintained our strong presence in the forklift counterweight market.



Oil field equipment sales, which declined 30% to $40.9 million in 1994, continued to be adversely affected by the record low levels of activity in the oil fields, particularly in the United States. To partially offset the decline in revenues, we have significantly reduced operating costs through consolidation in the Lufkin, Texas facility as well as a restructuring of our sales and marketing functions. Product redesign to better serve our customers and to reduce costs is an ongoing process. Our more efficient operations provide the Company with added flexibility to meet the needs of our worldwide customers.

Lufkin reported a net loss for the year ended December 31, 1994, of $1.2 million, or $.18 per share, including the $11.2 million

pre-tax special inventory write-downs taken during the second and third quarters. Because of the severe decline in oil field sales during 1994 and the unstable economic conditions in both Russia and Venezuela, the Company reviewed its inventories and made the decision to write down certain high quality products that were built primarily for the Russian and Venezuelan markets to a conservative estimate of their net realizable value based on current market conditions.

Lufkin continues to review its product offerings and look for new opportunities. During 1994, Lufkin exited the industrial supply business to focus on engineered products which are our core businesses.

Lufkin ended fiscal 1994 in a stronger operating position. At December 31, 1994, the Company's working capital was $70.8 million and our backlog totaled $109 million. The balance sheet and financial strength of the Company were improved with the sale of surplus assets and through cash generated from operations.

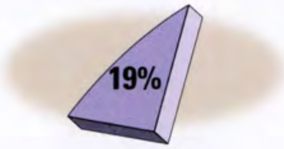
We enter 1995 in an improved position to continue to leverage on the success we have achieved in improving our operations and in developing new products. For the future, our focus remains clear. Lufkin will continue to capitalize on its reputation for manufacturing the highest quality products for the industries we serve. In addition, we are dedicated to maximizing our many strengths to achieve further improvement in our financial results.

Sincerely,

Douglas V. Smith

Douglas V. Smith
President and Chief Executive Officer

Oil Field Pumping Units



The decline in the domestic market for pumping units stems from a 30-year low in activity mainly reflecting the decline in oil prices since 1993. As a result, drilling rig counts were down and oil well completions were at a historic low. However, Lufkin's well-established position in the major oil producing areas of the world has enabled the Company to maintain its presence in all major markets.

Oil Field Pumping Units

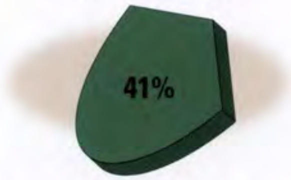
Lufkin's oil field pumping units are known throughout the world as the industry standard. The types of units produced include conventional, beam-balanced, air-balanced, low profile, slant hole, and trailer mounted. The Company's units are extremely adaptable to meet customers' various production demands.

Lufkin's success in the world's market for pumping units has been achieved in part by our production engineering which utilizes machining cells and a conveyor system for mechanical handling. The manufacturing process uses a continuous flow operation that reduces manufacturing time and improves efficiency. Lufkin also has local manufacturing capability in many of our international markets which allows us to meet specific country content requirements. The ability to deliver quality products, the availability of on-site installation and necessary technical support, and the capability to respond to customers' needs in a timely fashion will allow Lufkin to capitalize on its strengths when the oil market improves.

The domestic oil field pumping unit market remains the largest in the world with over 580,000 wells in operation. Approximately 96% of these wells require some type of artificial lift or pumping unit and around 87% need the type of beam-pumping unit Lufkin manufactures. Internationally, there are bright spots in certain markets of South America as privatization of state-owned oil industries takes place; in Canada, where there have been government incentives to drill for natural gas and oil; and in forming alliances with oil companies to supply some of the less developed, but rapidly growing areas of the world.

The future for the type of equipment Lufkin manufactures is brighter today than it has been during the recent past. Our worldwide surplus of oil is declining as economies around the world continue to expand. As supply and demand factors for oil continue to come more closely in line, Lufkin is in an excellent position to participate in the growth of this market.

TRAILERS



The U.S. trailer market is estimated to be approximately $3.5 billion. Historically, it is a market that is sensitive to overall economic conditions in the transportation industry as well as to the general economy. Demand for trailers was very strong in 1994 and Lufkin was positioned to improve its operating results.

Lufkin manufactures many sizes and styles of vans, platforms, and high capacity, lightweight dump trailers. The Company's trailers are known for their quality construction, reliability, innovation of design, and competitive price, all of which are important to Lufkin's diverse customer base.

Lufkin's ability to design products using the most effective engineering technology was enhanced in 1994 with the addition of several CAD-CAM work stations. Lufkin's use of the latest technology has been incorporated into two new trailer products, a composite flat bed introduced in June 1994 which has been well received and a plate trailer which is being introduced in 1995 with full production scheduled for 1996.

The outlook for trailers is expected to remain strong through 1995 driven in part by a robust U.S. manufacturing sector. Coming out of the slower economic environment of the last few years, there has been a pent-up demand for trailers. Additionally, the demand for trailers has increased as a result of many shippers' adopting just-in-time inventory systems which require more frequent deliveries, companies choosing to outsource their transportation needs and more trailers being used as warehouses for short-term storage. NAFTA has also offered some opportunity for sales into Mexico and Canada. These trends, as well as a general aging of trailer fleets, bode well for Lufkin trailers in the future.

Foundry Castings

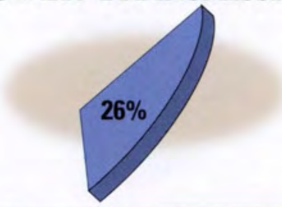
The past year was an excellent one for Lufkin's foundry castings. The general improvement in the overall domestic economy led to a record year. Contributing also to the year's achievement was the unleashing of pent-up demand from the previous business cycle and the effect of several players in the foundry industry being forced out during the last business cycle, which reduced the supply available — all to the benefit of Lufkin.

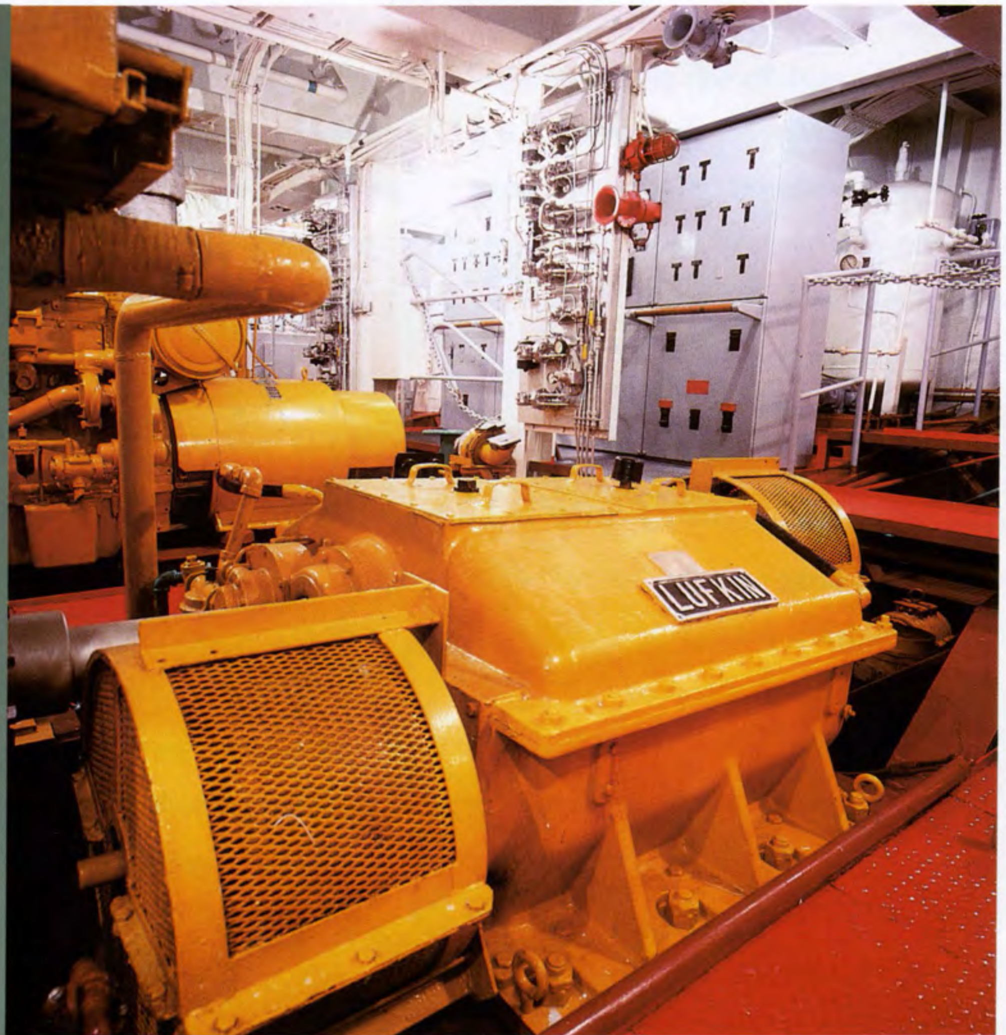
Lufkin's foundry casting capabilities span the spectrum of castings specifications used in many industrial applications from gray iron to ductile iron. The Company has the capability to produce over 300 tons of iron castings a day.

Customers for Lufkin's foundry castings are mainly in the manufacturing segment of the economy. They include those in the heavy equipment, pump and compressor, valve, and machine tool industries. Lufkin has targeted the more technically demanding ductile and gray iron castings used in the valve, compressor, and machine tools industries as good growth prospects.

The goal for the coming year is to build on the success achieved in 1994. Lufkin is dedicated to manufacturing the highest quality products and improving further its well-engineered products while maximizing its manufacturing capabilities.

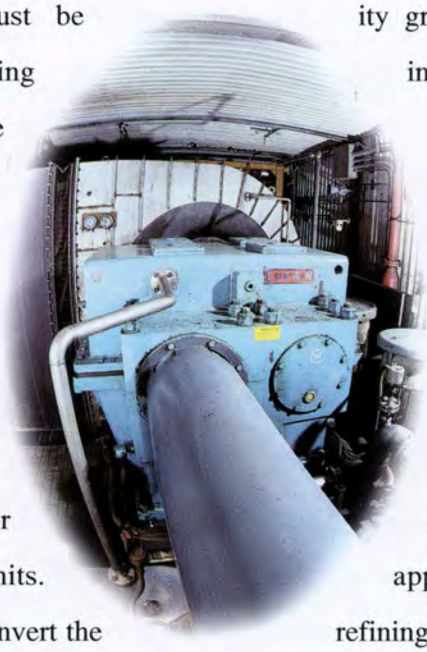
POWER TRANSMISSION





Lufkin is a leading manufacturer of power transmission equipment used throughout the world. The Company's precision-made gears range in sizes up to 192 inches in diameter, in weights from 300 pounds to 250 tons, and in power requirements from 20 to 85,000 horsepower. By serving a wide array of applications in the power generation, petro-chemical, gas transmission, and marine propulsion markets to applications in the steel, rubber, sugar, and mining industries, many of the Company's products become integral parts of large processing units.

Lufkin Industries' power transmission products are primarily parallel shaft, enclosed gear drives. However, the product line is being expanded to encompass other types of gearing. Customers for the full range of Lufkin products have very stringent performance requirements. Often these requirements must be proved through extensive testing prior to shipment. Lufkin has one of the most advanced test facilities in the industry, staffed by experienced test engineers.



The expanding market for gas turbine-powered generators for use in electrical power generation is fueling demand for Lufkin's high-speed gear units. Lufkin's gears are required to convert the energy from the turbine to the correct speed to drive the generators. High performance demands of these applications require state-of-the-art design, manufacturing, assembly, and testing capabilities. In the global market for these products, Lufkin is recognized as an industry leader.

The demand for power generation equipment has grown significantly in developing countries, particularly in China and Southeast Asia. In this rapidly developing part of the world, the demand for electricity far exceeds current supply. The small-to-medium-size gas-powered generators can be brought on stream much faster and more economically than larger power stations, thereby enabling quick, incremental additions to electricity grids that are unable to meet the increased local demand.

Demand for co-generation applications is also expected to increase in the medium-term, as emphasis is placed on energy efficiency in response to both environmental concerns and energy conservation. Lufkin's gears are also used in a variety of applications in the petroleum refining and petro-chemical industry. The petro-chemical industry is experiencing a resurgence, driven in part by relatively cheap feedstocks, coupled with the general expansion in the global economy, which is stimulating demand for chemicals, plastics, and other petrochemical products.

POWER TRANSMISSION

Another significant market for Lufkin's gear products is in the field of energy transforming equipment. In these applications Lufkin gears drive pumps and compressors. Gas transmission, as well as oil and gas drilling and refining, are end markets for products of this type.

The industries that call for Lufkin's low-speed, high-torque gears are also showing signs of growth. The sugar refining sector will be modernizing and consolidating to achieve higher efficiencies. Demand for sugar products is growing, particularly in the developing world. Rubber and steel industries have been expanding as the U.S. and Europe move out of recession and as demand for automobiles and industrial products increases. The demand by mining and cement industries for Lufkin's low-speed units is steadily increasing as activity associated with economic revitalization gathers pace in the rebuilding of infrastructure around the globe.

Lufkin also manufactures and markets a line of heavy duty winches that is respected throughout the timber industry. This product line is being expanded through the creation of new, lighter weight, higher capacity winches designed to meet the changing needs of timber harvesters around the world.

Lufkin has successfully expanded its worldwide power transmission markets by providing its customers with a full range of new high value-added products coupled with superior marketing and technical support. Through the Company's vertical integration of its engineering, manufacturing, and service capabilities, these expanded product and service offerings can be custom tailored for applications in both the new equipment and aftermarket markets. Lufkin continues to develop new products for existing markets and to select new market niches for new product technologies. The Company maintains a strong commitment to ongoing investments in technology, training, and recruitment of high caliber people. These factors, combined with Lufkin's focus on continuous improvement, have resulted in the Company being recognized as an industry leader in quality, as demonstrated by the Company's certification to ISO 9001.

FINANCIAL REVIEW

Lufkin Industries, Inc. and Subsidiaries

Common Stock Information

	1994			1993		
	Stock Price			Stock Price		
Quarter	High	Low	Dividend	High	Low	Dividend
First	$19.50	$16.50	$.15	$20.00	$14.50	$.15
Second	20.00	17.63	.15	17.50	15.00	.15
Third	20.75	18.00	.15	19.00	14.75	.15
Fourth	18.75	15.50	.15	21.75	16.75	.15

The Company's common stock is traded on The Nasdaq Stock Market under the symbol LUFK and as of February 28, 1995, there were approximately 900 record holders of its common stock.

The Company has paid cash dividends for 55 consecutive years. Total dividend payments were $4,075,000 in 1994 and 1993.

Quarterly Financial Data (Unaudited)

In millions, except per share data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1994				
Net sales	$49.1	$53.9	$55.9	$58.4
Gross margin	5.7	5.0 (a)	(3.7) (a)(b)	9.2 (b)
Net earnings (loss)	.4	.5 (a)	(5.1) (a)(b)	3.0 (b)
Earnings (loss) per share	.06	.07 (a)	(.75)(a)(b)	.44 (b)
1993				
Net sales	$45.8	$48.3	$52.8	$55.3
Gross margin	4.4	4.7	7.0	10.0
Net earnings (loss)	(1.2)	(1.1)	1.3	3.5
Earnings (loss) per share	(.17)	(.16)	.19	.52

(a) Gross margins in the second and third quarters of 1994 were reduced by special inventory provisions of $1.0 million and $12.7 million, respectively. The net after tax effect of these special write downs was $.7 million or $.10 per share in the second quarter and $8.4 million or $1.23 per share in the third quarter of 1994.

(b) Includes LIFO benefits of $2.5 million and $2.9 million in the third and fourth quarters of 1994, respectively. The net after tax effect of these LIFO benefits was $1.7 million or $.25 per share in the third quarter and $1.9 million or $.28 per share in the fourth quarter of 1994.

Additional Financial Information

Stockholders may obtain additional information for the year ended December 31, 1994, 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 75902-0849.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Lufkin Industries, Inc. and Subsidiaries

Results of operations

Net sales for 1994 were $217.3 million compared to $202.2 million and $178.6 million for 1993 and 1992, respectively. The Company reported an operating loss of $3.1 million for 1994. In 1993 and 1992, the Company had operating income of $1.7 million and an operating loss of $41.5 million, respectively. The Company reported a net loss of $1.2 million for 1994, compared to net income of $2.5 million in 1993 and a net loss of $34.8 million in 1992. The 1994 results include an $11.2 million pre-tax charge for special inventory write downs and the 1992 results include restructuring charges totaling $24.3 million.

In 1994, the Company experienced revenue growth in three of its four major product groups. The Company sold its Industrial Supplies unit in June of 1994. The annual percentage increase (decrease) of revenues for the Company's product groups for the three years ended December 31, 1994 were as follows:

	Annual increase (decrease)		
	1994	1993	1992
Oil field pumping units	(30)%	6%	(56)%
Power transmission products	16	9	(7)
Foundry castings	25	21	31
Trailers	37	24	(3)
Total company	7%	13%	(28)%

The sales mix of the Company's products for the three years ended December 31, 1994 were as follows:

	Percent of total sales		
	1994	1993	1992
Oil field pumping units	19%	29%	31%
Power transmission products	25	23	25
Foundry castings	14	12	11
Trailers	41	32	29
Industrial supplies	1	4	4
Total company	100%	100%	100%

During 1994, U.S. drilling activities continued at record low levels. The Company experienced a 30% reduction of its 1994 oil field revenues compared to 1993. Oil field revenues in 1994 were $40.9 million compared to $58.6 million and $55.1 million in 1993 and 1992, respectively. In contrast to the declining revenues, the Company strengthened oil field margins by reducing operating costs through the completion of the consolidation of all U.S. manufacturing into the Lufkin, Texas facility and through the realization of a favorable product mix due to larger sized pumping units being sold into the Argentine market. Oil field bookings for 1994 were $42.9 million and the year-end backlog was $8.5 million, compared to 1993 bookings of $56.0 million and backlog of $6.8 million.

Power Transmission sales of $55.3 million in 1994 were 16% higher than 1993 sales. Sales for 1993 and 1992 were $47.6 million and $43.6 million, respectively. In 1994, the Company booked new orders totalling $54.0 million compared to $48.2 million in 1993. The increase in new orders reflects the Company's focused efforts to expand its international presence and its participation in the higher margin repair and service after markets. Power Transmission ended 1994 with a $21.1 million backlog, compared to $22.1 million and $21.6 million in 1993 and 1992, respectively.

Foundry castings sales increased 25% to $30.2 million in 1994 as compared to $24.2 million in 1993 and $20.0 million in 1992. The increase in the 1994 sales continues the favorable growth reported in 1993 and 1992 which included sales increases of 21% and 31%, respectively. During 1994, the Company expanded its participation in the engineered castings market and maintained its strong position in the forklift counterweight market. By expanding the product offering to a full range of engineered grey and ductile iron castings, the Company realized an improved product mix with improved profit margins. In 1994, the Company booked $30.3 million in new orders compared to $27.0 million in 1993. At December 31, 1994, the Company ended the year with a $4.2 million backlog compared to $4.9 million in 1993 and $2.3 million in 1992.

Trailer product sales of $87.8 million were up 37% over 1993 and up 69% over 1992. This strong performance followed the Company's January 1994 decision to not sell its Trailer Division as previously announced. During 1994, the Company increased its production capacity while maintaining its favorably restructured cost position enabling the Company to respond to strong near term market conditions. In 1994, the Company booked $112.4 million in new trailer business compared to $93.0 million in 1993. The Company ended the year on December 31, 1994 with a Trailer backlog of $75.6 million compared to $51.3 million in 1993.

The Company's 1994 gross profit before special inventory write downs and the 1993 gross profit were 13% in both years compared to 7% in 1992. The Company maintained its gross profit margin in 1994 through improved product mixes in the Company's Oil Field, Power Transmission and Foundry Castings business groups and with focused cost reduction programs as higher margin oil field sales were replaced with historically lower margin trailer sales.

During the second and third quarters of 1994, the Company reported special inventory write downs, which totaled $13.7 million (pre-tax/pre-LIFO benefit), to reduce inventory values for certain oil field inventories previously manufactured for the former Soviet Union and Venezuelan markets as well as certain other slow moving products. An estimated LIFO benefit of $2.5 million was recognized as part of the third quarter write down. During the fourth quarter, the final LIFO impacts were determined and an additional year end LIFO benefit of $2.9 million was recorded as a credit to cost of sales.

Selling, General and Administrative expenses (S. G. & A.) decreased by 16% in 1994 to $20.9 million, compared to $24.7 million in 1993. S. G. & A. expenses in 1992 were $27.5 million. The major components of the 1994 expense reductions were reduced sales commissions to overseas representatives, reduced salaries and related benefits, reduced travel costs and reduced expenses associated with the consolidation of the Company's Churchill unit formerly in Chanute, Kansas into the Company's Lufkin, Texas facilities and the sale of the Company's Industrial Supply facility.

Other income increased to $1.6 million in 1994 compared to income of $.3 million in 1993 and a net expense of $1.6 million in 1992. The primary reason for this favorable improvement was a gain of $1.4 million recognized during 1994 on the sale of the Company's Oil field Division Churchill manufacturing facility and related equipment in Chanute, Kansas, which was partially offset by a minor loss from the sale of the Company's Industrial Supply unit. Investment income decreased $1.3 million in 1994. The 1994 investment income totaled $1.3 million compared to $2.6 million in 1993 and $3.3 million in 1992. Although the average balance of temporary investments increased during the year, the Company realized capital losses on investments of $.9 million and the interest income from notes receivable declined $.8 million as the balance of notes receivable was reduced during the year.

Liquidity and capital resources

At December 31, 1994, the Company had working capital of $70.8 million compared to $71.6 million in 1993 and $62.1 million in 1992. The Company generated $25.6 million net cash from operating activities in 1994. The net cash provided from operating activities in 1993 and 1992 was $24.3 million and $25.5 million, respectively. Dividends totaling $4.1 million were paid in both 1994 and 1993. The 1992 dividends were $9.2 million. The Company believes that existing working capital will be sufficient to satisfy its 1995 requirements. In recent years, the expansion of facilities has been financed with internally generated funds, and the Company plans to finance future improvements of its facilities in this manner. No significant commitments were outstanding at December 31, 1994.

CONSOLIDATED BALANCE SHEET

Lufkin Industries, Inc. and Subsidiaries

December 31, 1994 and 1993
(Thousands of dollars)

Assets	1994	1993
Current assets:		
Cash	$ 207	$ 816
Temporary investments	36,716	19,539
Receivables, net	28,262	37,603
Inventories	21,919	33,158
Deferred income taxes	4,522	3,130
Total current assets	91,626	94,246
Property, plant and equipment:		
Land and improvements	8,801	8,974
Buildings	52,076	51,493
Machinery and equipment	167,387	165,327
Total property, plant and equipment	228,264	225,794
Less accumulated depreciation	(167,558)	(161,538)
Total property, plant and equipment - net	60,706	64,256
Prepaid pension costs	17,784	14,156
Assets held for sale	-	3,164
Other assets	6,658	6,724
Total	$176,774	$182,546

Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 10,661	$ 9,865
Accrued liabilities:		
Payrolls and benefits	4,574	4,683
Accrued warranty expenses	2,265	2,941
Property taxes	2,158	2,786
Commissions and other	1,137	2,401
Total current liabilities	20,795	22,676
Deferred income taxes	6,172	4,752
Post retirement benefits	11,843	11,627
Stockholders' equity:		
Common stock, par $1 per share; 20,000,000 shares authorized; 6,792,381 shares issued	6,792	6,792
Capital in excess of par	15,372	15,372
Retained earnings	116,845	122,127
Cumulative translation adjustment	(1,045)	(800)
Total stockholders' equity	137,964	143,491
Total	$176,774	$182,546

See notes to consolidated financial statements

CONSOLIDATED STATEMENT OF EARNINGS

Lufkin Industries, Inc. and Subsidiaries

Years ended December 31, 1994, 1993 and 1992
(Thousands of dollars, except per share data)

	1994	1993	1992
Sales	**$217,273**	$202,225	$178,565
Costs and expenses:			
Cost of sales	**189,826**	176,099	166,620
Selling, general and administrative expenses	**20,898**	24,737	27,539
Special inventory provision	**11,224**	-	-
Restructuring charges	**-**	-	24,339
Other expense (income), net	**(1,610)**	(347)	1,552
Total costs and expenses	**220,338**	200,489	220,050
Operating income (loss)	**(3,065)**	1,736	(41,485)
Investment income	**1,266**	2,558	3,255
Earnings (loss) before income taxes	**(1,799)**	4,294	(38,230)
Income taxes (benefits)	**(592)**	1,745	(10,977)
Earnings (loss) before cumulative effect of a change in accounting for post retirement benefits	**(1,207)**	2,549	(27,253)
Cumulative effect of a change in accounting for post-retirement benefits including applicable income tax benefit of $3,866	**-**	-	(7,506)
Net earnings (loss)	**$ (1,207)**	$ 2,549	$(34,759)
Earnings (loss) per share:			
Net earnings (loss) before cumulative effect of change in accounting	**$ (.18)**	$ .38	$ (4.01)
Cumulative effect of change in accounting	**-**	-	(1.11)
Net earnings (loss) per share	**$ (.18)**	$ .38	$ (5.12)

See notes to consolidated financial statements

Consolidated Statement of Stockholders' Equity

Lufkin Industries, Inc. and Subsidiaries

Years ended December 31, 1994, 1993 and 1992
(Thousands of dollars, except share data)

	Common Stock		Capital In Excess	Retained	Cumulative Translation
	Shares	Amount	Of Par	Earnings	Adjustment
Balance December 31, 1991	6,792,381	$6,792	$15,372	$167,582	$ -
Net loss				(34,759)	
Cash dividends, $1.35 per share				(9,170)	
Foreign currency translation adjustment					(736)
Balance December 31, 1992	6,792,381	6,792	15,372	123,653	(736)
Net earnings				2,549	
Cash dividends, $.60 per share				(4,075)	
Foreign currency translation adjustment					(64)
Balance December 31, 1993	6,792,381	6,792	15,372	122,127	(800)
Net loss				(1,207)	
Cash dividends, $.60 per share				(4,075)	
Foreign currency translation adjustment					(245)
Balance December 31, 1994	6,792,381	$6,792	$15,372	$116,845	$ (1,045)

See notes to consolidated financial statements

CONSOLIDATED STATEMENT OF CASH FLOWS

Lufkin Industries, Inc. and Subsidiaries

Years ended December 31, 1994, 1993 and 1992
(Thousands of dollars)

	1994	1993	1992
Cash flows from operating activities:			
Net earnings (loss)	**$ (1,207)**	$ 2,549	$ (34,759)
Adjustments to reconcile earnings (loss) to net cash provided by operating activities:			
Depreciation	**7,895**	9,890	11,613
Restructuring charges	**-**	-	21,002
Deferred income tax provision (benefit)	**28**	1,622	(14,843)
Post retirement benefits	**216**	255	11,372
Changes in assets and liabilities:			
Receivables	**9,341**	3,821	31,887
Inventories	**11,239**	921	(3,962)
Accounts payable	**796**	4,324	(2,762)
Accrued liabilities	**(2,677)**	884	5,955
Net cash provided by operating activities	**25,631**	24,266	25,503
Cash flows from investing activities:			
Additions to property, plant and equipment	**(5,238)**	(5,885)	(9,373)
Retirement of property, plant and equipment	**4,057**	483	472
Increase in other assets	**(3,562)**	(5,938)	(665)
Net cash used by investing activities	**(4,743)**	(11,340)	(9,566)
Cash flows from financing activities:			
Dividends paid	**(4,075)**	(4,075)	(9,170)
Net cash used by financing activities	**(4,075)**	(4,075)	(9,170)
Effect of translation on cash and temporary investments	**(245)**	(64)	(736)
Net increase in cash and temporary investments	**16,568**	8,787	6,031
Cash and temporary investments, at beginning of year	**20,355**	11,568	5,537
Cash and temporary investments, at end of year	**$ 36,923**	$ 20,355	$ 11,568

See notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Lufkin Industries, Inc. and Subsidiaries

(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.

Translation of foreign currencies: Assets and liabilities of foreign operations are translated into U.S. dollars at the exchange rate in effect at the end of each accounting period and income statement accounts are translated at the average exchange rates prevailing during the period.

Temporary Investments: The Company's temporary investments consisting of highly liquid government and debt securities have been classified as trading securities which are carried at market value. All realized and unrealized gains and losses are recognized currently in investment income.

Receivables: The following is a summary of the Company's receivable balances (thousands of dollars):

	1994	1993
Accounts receivable	**$24,803**	$29,296
Notes receivable	**3,838**	7,736
Other receivables	**221**	1,171
	28,862	38,203
Allowance for doubtful accounts	**(600)**	(600)
Net receivables	**$28,262**	$37,603

Installment notes due after one year which equalled $584,000 at December 31, 1994 and $2,958,000 at December 31, 1993 are included in current assets.

Inventories: The Company reports its inventories by using the last-in, first-out (LIFO) and the first-in, first-out (FIFO) methods less reserves necessary to report inventories at the lower of cost or estimated market. 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. Accelerated depreciation methods are used for tax purposes. In 1992, restructuring charges of $21,002,000 were reported as additional accumulated depreciation to reflect the write down of certain assets. Expenditures for maintenance and repairs were $8,924,000 in 1994, $8,240,000 in 1993 and $7,644,000 in 1992.

Earnings per share: Earnings per share amounts are based on the weighted average number of shares of common stock outstanding during the period. The weighted average number of shares used to compute earnings per share was 6,792,381 shares, 6,801,131 shares, and 6,792,381 shares for 1994, 1993 and 1992, respectively.

Other: Certain items have been reclassified in the 1993 and 1992 consolidated financial statements to conform with 1994 classifications.

(2) Income taxes

During the fourth quarter of 1992, the Company changed its method of accounting for income taxes to adopt Statement of Financial Accounting Standards (SFAS) No. 109 "Accounting for Income Taxes," effective January 1, 1992. Previously, the Company was using SFAS No. 96 for income tax accounting. This change had no effect on the Company's consolidated financial statements. Under SFAS No. 109, deferred tax assets or liabilities are computed based on the difference between the financial statement and income tax bases of assets and liabilities using enacted tax rates. The net deferred tax liability is comprised of the following (thousands of dollars):

	1994	1993
Current deferred tax assets		
Gross assets	**$ 4,648**	$ 3,343
Gross liabilities	**(126)**	(213)
Total, net	**4,522**	3,130
Noncurrent deferred tax payable		
Gross assets	**6,851**	7,148
Gross liabilities	**(13,023)**	(11,900)
Total, net	**(6,172)**	(4,752)
Net deferred income taxes payable	**$ (1,650)**	$ (1,622)

The tax effects of significant temporary differences representing deferred tax assets and liabilities are as follows (thousands of dollars):

	1994	1993
Inventory	**$ 3,092**	$ 1,160
Prepaid pension costs	**(6,055)**	(4,805)
Accrued warranty expenses	**770**	1,025
Post retirement benefits	**4,027**	3,953
Net operating loss and tax credit carry forwards	**2,077**	2,501
Depreciation	**(6,588)**	(6,380)
Other, net	**1,027**	924
Net deferred income taxes payable	**$(1,650)**	$(1,622)

The income tax provision (benefit) for 1994, 1993, and 1992 consisted of the following (thousands of dollars):

	1994	1993	1992
Current	**$(620)**	$ 123	$ -
Deferred	**28**	1,622	(10,977)
Accounting change for post retirement benefits	**-**	-	(3,866)
Total	**$(592)**	$1,745	$(14,843)

A reconciliation of the income tax provision (benefit) as computed at the statutory U.S. income tax rate and the income tax provision (benefit) presented in the consolidated financial statements is as follows (thousands of dollars):

	1994	1993	1992
Tax provision (benefit) computed at statutory rate	**$(612)**	$1,460	$(16,865)
Tax effect of:			
Expenses for which no benefit was realized	**-**	300	2,100
Tax-exempt interest and dividend income exclusion	**(72)**	(52)	(116)
Other, net	**92**	37	38
Actual provision (benefit)	**$(592)**	$1,745	$(14,843)

Cash payments for income taxes were $235,000, $801,000, and $1,036,000 for 1994, 1993 and 1992, respectively.

For income tax reporting purposes, the Company has net operating loss carry forwards at December 31, 1994 of approximately $2,121,000 which are available to reduce future U.S. taxable income. These carry forwards begin to expire in the year 2007. The Company also has unused alternative minimum tax carry forwards of $1,356,000 which can be carried forward indefinitely.

(3) Inventories

Inventories used in determining cost of sales were as follows (thousands of dollars):

	1994	1993
Finished goods	**$ 7,995**	$13,123
Work in process	**4,911**	6,773
Raw materials	**9,013**	13,262
Total	**$21,919**	$33,158

Inventories accounted for on a LIFO basis were $15,514,000 and $22,530,000 and on a FIFO basis were $6,405,000 and $10,628,000 at December 31, 1994 and 1993, respectively. Had the FIFO method been used in determining all inventory values, inventories would have been $16,581,000 and $23,146,000 higher at December 31, 1994 and 1993, respectively. During 1994, LIFO inventories were reduced and these reductions resulted in a liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years. The after tax effect of these LIFO inventory liquidations reduced the net loss in 1994 by approximately $3,600,000 or $.53 per share.

(4) 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 not more than 400,000 shares of the Company's stock at fair market value on the date of grant. One fourth of granted options generally 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:

	1994	1993	1992
Outstanding, beginning of year	**260,715**	172,715	82,715
Granted (per share)			
1992 ($17.50)	**-**	-	90,000
1993 ($15.31 to $21.375)	**-**	122,000	-
1994 ($15.875 to $18.625)	**94,750**	-	-
Forfeited	**-**	(34,000)	-
Outstanding, end of year	**355,465**	260,715	172,715

At December 31, 1994, there were 152,515 options exercisable at a price of $15.31 to $30.00 per share.

(5) Capital stock

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.

The Company is authorized to issue 2.0 million shares of Preferred Stock, the terms and conditions to be determined by the Board of Directors in creating any particular series.

(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, United States government securities and cash equivalents.

The following tables provide the detail of 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)	**1994**	1993	1992
Components of pension income:			
Service cost	**$ 2,092**	$ 2,269	$ 2,207
Interest cost	**5,334**	5,334	5,184
Actual return on plan assets	**97**	(7,178)	(6,353)
Net amortization and deferral	**(11,151)**	(3,700)	(4,208)
Net pension income	**$ (3,628)**	$ (3,275)	$ (3,170)
Plan assets at fair value	**$105,902**	$110,752	$108,035
Actuarial present value of projected benefit obligations:			
Accumulated benefit obligations			
Vested	**(56,406)**	(58,120)	(50,074)
Nonvested	**(5,358)**	(6,446)	(6,014)
Provision for future salary increases	**(8,259)**	(11,569)	(14,039)
Plan assets over projected benefit obligations	**35,879**	34,617	37,908
Unrecognized transition gain	**(12,683)**	(13,609)	(14,536)
Unrecognized gain	**(3,161)**	(3,888)	(8,630)
Unrecognized prior service cost	**(2,251)**	(2,964)	(3,861)
Net prepaid pension cost	**$ 17,784**	$ 14,156	$ 10,881
Major assumptions at year end:			
Discount rate	**8.25%**	7.25%	8%
Rate of increase in compensation levels	**5%**	5%	6%
Expected long-term rate of return on plan assets	**9%**	9%	9%

The Company also has defined contribution retirement plans covering substantially all of its employees. During the year, the Company makes contributions of 75% of employee contributions up to a maximum of 6% of employee earnings. All obligations of the Company are funded through December 31, 1994. Pension expense for these plans totaled $1,444,000, $1,456,000 and $1,295,000 in 1994, 1993 and 1992, respectively.

The Company sponsors two defined benefit post retirement plans that cover both salaried and hourly employees. One plan provides medical benefits, and the other plan provides life insurance benefits. Both plans are contributory, with retiree contributions adjusted periodically. Prior to 1992, the costs of these plans were charged to expense when paid. Effective January 1, 1992, the Company adopted SFAS No. 106 "Employers' Accounting for Post-retirement Benefits Other Than Pensions." This standard requires that the Company accrue the estimated costs of these plans over the employee service period. The accumulated obligation at January 1, 1992 was approximately $11,000,000 and this estimated amount, net of tax benefit, was recorded as the cumulative effect of an accounting change in the 1992 Consolidated Statement of Earnings.

(6) Retirement benefits (continued)

The following table sets forth the plans' combined funded status reconciled with the amount shown in the Company's balance sheet at December 31, 1994 and 1993 (thousands of dollars):

	1994	1993
Accumulated post retirement benefit obligation:		
Retirees	**$ 9,208**	$ 9,400
Fully eligible active plan participants	**883**	1,176
Other active plan participants not yet eligible	**1,932**	2,320
Total accumulated post retirement benefit obligation	**12,023**	12,896
Unrecognized net actuarial gain	**(180)**	(1,269)
Accrued post retirement benefit cost	**$ 11,843**	$ 11,627
Net periodic cost of post retirement benefit:		
Service cost	**$ 168**	$ 108
Interest cost	**882**	931
Net periodic post retirement benefit cost	**$ 1,050**	$ 1,039

The Company's post retirement health care plan is unfunded and there are no plan assets. For measurement purposes, the submitted claims medical trend was assumed to be 12% in 1994, grading down to 5.5% in years 2006 and thereafter. A one percentage point increase in each year's healthcare costs trend rate would increase the accumulated post retirement benefit obligations as of December 31, 1994 by approximately $242,000 and the aggregate of the service and interest costs components of net periodic post retirement cost for the year ended December 31, 1994 by $25,000. In determining the accumulated post retirement obligation, weighted-average discount rates of 8.25% in 1994 and 7.25% in 1993 were used.

(7) Business segment information

The Company manufactures, sells and services various types of oil field pumping units, power transmission products, foundry castings and trailers. Corporate expenses are allocated to industry segments primarily based upon outside revenues. The following is a summary of key business segment and product group information:

(Thousands of dollars)	**1994**	1993	1992
Net sales:			
Machinery Division			
Oil field pumping units	**$ 40,938**	$ 58,579	$ 55,116
Power transmission products	**55,334**	47,561	43,580
Foundry castings	**30,165**	24,169	20,028
Industrial supplies	**3,051**	7,761	7,912
Trailer Division	**87,785**	64,155	51,929
Total net sales	**$217,273**	$202,225	$178,565
Net sales by geographic region:			
United States	**$183,147**	$165,446	$133,704
Europe	**2,916**	7,262	21,838
Canada	**8,273**	7,520	5,544
Latin America	**14,765**	14,473	9,292
Other	**8,172**	7,524	8,187
Total net sales	**$217,273**	$202,225	$178,565

(7) Business segment information (continued)

	1994	1993	1992
Operating income (loss):			
Machinery Division	**$ (9,382)**	$ 1	$ (41,485)
Trailer Division	**6,317**	1,735	-
Total operating income (loss)	**$ (3,065)**	$ 1,736	$ (41,485)
Assets:			
Machinery Division	**$ 83,155**	$105,709	$101,703
Trailer Division	**19,046**	19,270	22,770
General Corporate	**74,573**	57,567	51,812
Total assets	**$176,774**	$182,546	$176,285
Capital expenditures:			
Machinery Division	**$ 4,016**	$ 5,255	$ 9,103
Trailer Division	**356**	283	195
General Corporate	**866**	347	75
Total capital expenditures	**$ 5,238**	$ 5,885	$ 9,373
Depreciation:			
Machinery Division	**$ 6,345**	$ 7,378	$ 9,859
Trailer Division	**930**	1,909	965
General Corporate	**620**	603	789
Total depreciation	**$ 7,895**	$ 9,890	$ 11,613

Report of Independent Public Accountants

Lufkin Industries, Inc. and Subsidiaries

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, 1994 and 1993, and the related consolidated statements of earnings, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1994. 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, 1994 and 1993, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1994, in conformity with generally accepted accounting principles.

As discussed in notes 2 and 6 to the consolidated financial statements, effective January 1, 1992, the Company changed its method of accounting for income taxes and post retirement benefits other than pensions.

ARTHUR ANDERSEN LLP

Houston, Texas
February 14, 1995

Board of Directors

* S. W. Henderson, III, *Manager of his own investments*
L. R. Jalenak, Jr., *Retired 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*
B. H. O'Neal, *President and Chief Executive Officer, Stewart & Stevenson*
* D. V. Smith, *President and Chief Executive Officer*
F. B. Stevenson, *Retired Chairman of the Board and Chief Executive Officer*
* H. J. Trout, Jr., *Manager of his own investments*
W. W. Trout, Jr., *Retired Vice President*
* T. E. Wiener, *Attorney, Wiener & Caplan, P.C. (law firm)*

* Member Executive Committee

Officers

D. V. Smith, President, Chief Executive Officer
J. H. Barber, Vice President
J. F. Finney, Vice President
J. F. Glick, Vice President
J. R. Partridge, Vice President
M. A. Penn, Vice President
E. G. Pittman, Vice President
S. H. Semlinger, Vice President
C. J. Haley, Jr., Secretary-Treasurer
R. E. Myers, Jr., Assistant Secretary
R. D. Leslie, Assistant Treasurer

LUFKIN

LUFKIN INDUSTRIES, INC.
P.O. Box 849
Lufkin, Texas 75902