

**LUFKIN**

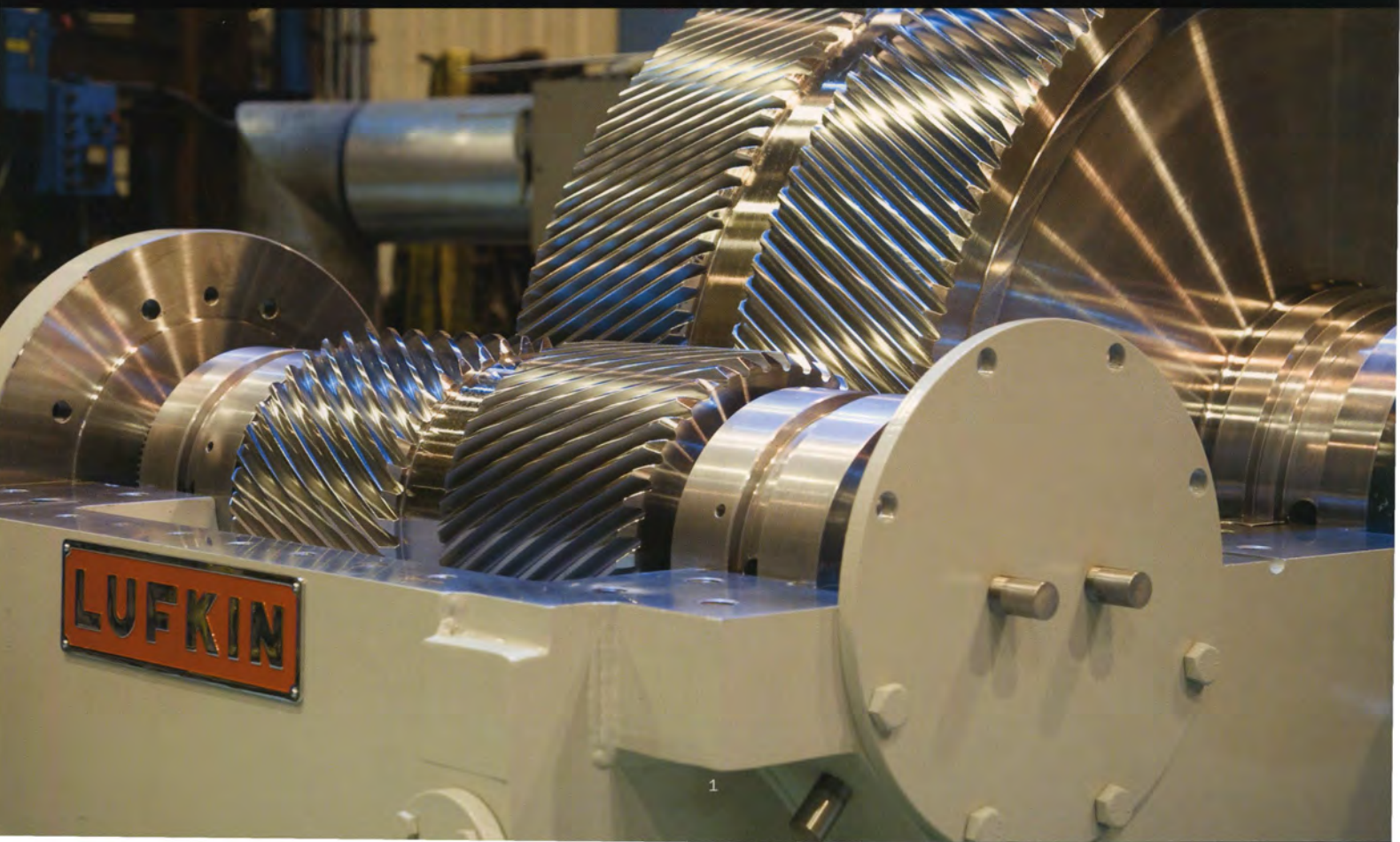
# *The Energy Flows Through Us™*

2009 ANNUAL REPORT





Founded in 1902, Lufkin Industries, Inc. (Nasdaq: LUFK) is a vertically integrated company that designs, engineers, manufactures, sells, installs and services high-quality and high-value-added oilfield equipment and power transmission products across the globe.





## OILFIELD PRODUCTS AND SERVICES

Lufkin is a leading global provider of artificial lift oilfield equipment and services, primarily consisting of highly adaptable pumping units, gas and plunger lift systems, automation technology equipment and a variety of services including on-site installation, technical support and maintenance. Additionally, the Company operates a gray and ductile iron foundry producing up to 300 tons per day of captive and commercial castings for the heavy equipment, valve and machine tool markets. Lufkin maintains a significant presence in all major oil markets.

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## POWER TRANSMISSION PRODUCTS AND SERVICES

Lufkin is a major supplier to the global power transmission equipment market. Our products are primarily custom high-precision gear units ranging in power to 125,000 horsepower and above, with weights up to 250 tons. These highly engineered products are used in a wide variety of industrial and marine applications, such as oil and gas, power generation, refining, marine propulsion, petrochemicals, steel, rubber and sugar. Lufkin's global aftermarket and field service organization targets the repair and refurbishment of gear installations worldwide, while supporting the sales of new power transmission equipment.



The Annual Meeting of Shareholders will be held at the Crown Colony Country Club,  
900 Crown Colony Drive, Lufkin, TX, on May 5, 2010, at 9:00 a.m. CDT.





## FINANCIAL HIGHLIGHTS

|                                                  | December 31, |           |           |           |           |
|--------------------------------------------------|--------------|-----------|-----------|-----------|-----------|
| (Thousands of dollars, except per share amounts) | 2009         | 2008      | 2007      | 2006      | 2005      |
| Sales from continuing operations                 | \$521,359    | \$741,194 | \$555,806 | \$526,122 | \$413,691 |
| Operating income from continuing operations      | 31,424       | 136,100   | 104,686   | 100,448   | 68,016    |
| Net earnings from continuing operations          | 22,479       | 88,025    | 71,785    | 71,272    | 43,780    |
| Net earnings                                     | 22,026       | 88,239    | 74,211    | 72,994    | 44,544    |
| Earnings per share:                              |              |           |           |           |           |
| Basic                                            | \$1.48       | \$5.97    | \$4.98    | \$4.92    | \$3.10    |
| Diluted                                          | \$1.48       | \$5.92    | \$4.92    | \$4.83    | \$3.03    |
| Dividends per share                              | \$1.00       | \$1.00    | \$0.88    | \$0.62    | \$0.38    |
| Total assets                                     | 541,590      | 530,718   | 500,656   | 429,069   | 359,795   |
| Working capital                                  | 253,744      | 296,925   | 224,733   | 181,957   | 133,628   |
| Long-term notes payable, net of current portion  | 1,516        |           |           |           |           |
| Shareholders' equity                             | 435,678      | 413,937   | 384,653   | 328,140   | 261,078   |

## LETTER TO THE SHAREHOLDERS

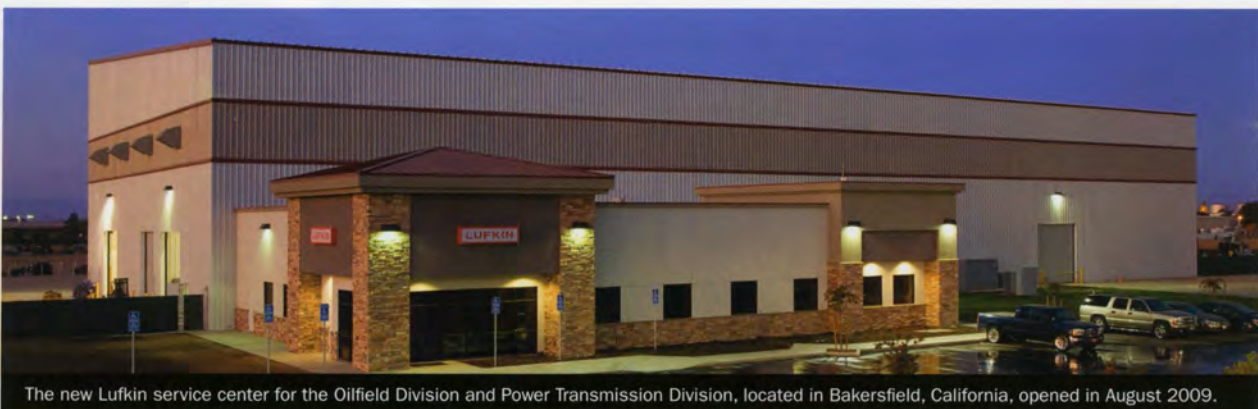
### DEAR FELLOW SHAREHOLDERS

Lufkin Industries weathered a very challenging down cycle in the energy industry during 2009, but we emerged a stronger and more competitive company as we enter 2010.

The global recession that began in the third quarter of 2008 as the result of a crisis in the financing sector and cascaded through literally every segment of the world economy had a dramatic effect on our business: As economic activity slowed and large-scale job losses occurred at a rapid rate, demand for all sources of energy – including oil and natural gas – dropped, and with it, demand for our products.

U.S. and global drilling and production activity that just a year earlier had reached record levels – driven by \$146 a barrel crude oil – suddenly plunged. Uncertainty over near-term demand, coupled with surplus supplies of oil in U.S. storage, caused oil prices to dip into the low \$40's by the end of 2008. As confidence was gradually restored and oil inventories were reduced, prices steadied in a \$60 - \$70 a barrel trading range during the second half of 2009, albeit with a significant amount of daily volatility as the markets reacted to worrisome headlines on the financial pages and rapidly changing economic and geopolitical events.

As a result, throughout much of 2009, demand for Lufkin's products remained depressed. Revenues in 2009 fell to \$521.4 million, compared with \$741.2 million for 2008. Excluding the pre-tax \$6.0 million, or \$0.26 per diluted share, impact of a legal provision, earnings from continuing operations were \$20.3 million, or \$1.77 per diluted share, versus \$91.8 million, or \$6.16 per diluted share, for 2008.



The new Lufkin service center for the Oilfield Division and Power Transmission Division, located in Bakersfield, California, opened in August 2009.



Our Oilfield Division began the year with a very strong backlog, but order cancellations that began in late 2008 continued at a brisk pace during the first quarter of 2009. New orders for pumping units were depressed by the field inventories that customers had put in place when oil prices were at record levels in early and mid-2008. The rate at which those surplus units were consumed was slowed by the falling rig count during the first part of 2009. The cancellations of existing orders halted by the second quarter, but new bookings continued to be weak in the second half of last year.

Our Power Transmission Division also began 2009 with a record backlog of orders, and business was generally steady through the first half, although the pace of new orders was slowed in the first quarter and remained sluggish until late in the fourth quarter, leading to reduced factory activity and declining revenues late in the third quarter and throughout the fourth quarter.

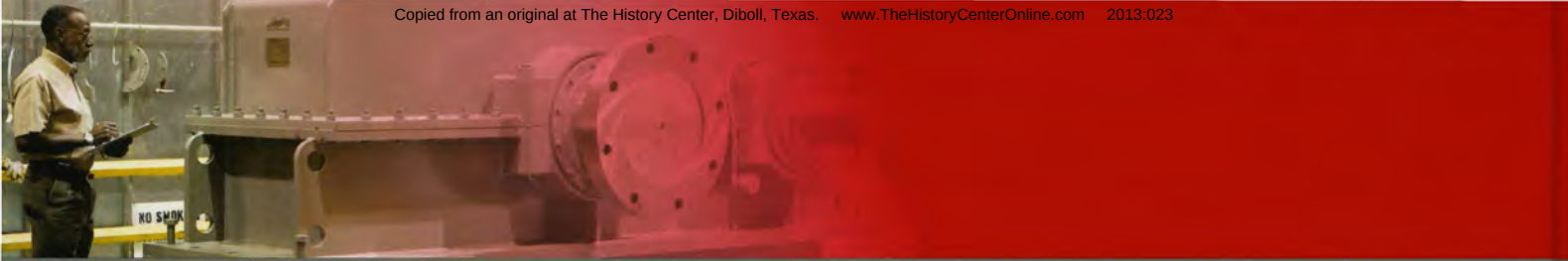
Throughout 2009, energy industry experts predicted that demand for oil would recover as the global economy emerged from recession and that production removed from the market by OPEC, together with reduced investment in new production, would bring supply back into balance. Over the longer term, the global appetite for oil will test the industry's ability to find new sources to replace the existing fields, which are in steady decline around the world. We believe the accelerating rate of decline will create an ever-growing need for Lufkin's artificial lift products as the natural lift pressure within these formations is exhausted.

Our confidence in the future shaped the way we dealt with the downturn during 2009. Our objective was to manage our costs during the downturn, while at the same time improving Lufkin's ability to capitalize on opportunities as oil markets recovered. To do this, we reduced expenses by adjusting our production capacity to match the reduced market demand for our products. At the same time, through a focused recruiting effort, we strategically

“...we emerged a stronger and more competitive company as we enter 2010.”



John F. "Jay" Glick  
President and Chief Executive Officer



Oilfield Services .....

added several key people to our management, sales and technical teams to improve our access to global markets and to develop service capabilities and product technologies. Geographic expansion and new technologies will yield higher returns in the future by enabling Lufkin to deliver greater value to our customers in regions where demand growth for artificial lift and power transmission products will be the highest.

We also acquired two companies in 2009 that brought new products and new capabilities to Lufkin Industries. International Lift Systems (ILS), acquired in March, added gas lift and plunger lift products to our portfolio of artificial lift products. Rotating Machinery Technology (RMT), acquired in July, brought industry-leading high-speed bearing design, rotor dynamics analysis and aftermarket repair capabilities. The integration efforts went smoothly, and customer reaction was very positive. We see huge potential to capitalize on synergies with our automation products and to open new channels to market through Lufkin's existing sales and service network.

In addition to acquisitions, capital spending was aimed at two areas of need: improving our service center network and upgrading our manufacturing capabilities. We completed construction on the new Bakersfield, California, service center, which will support both divisions in aftermarket services. We purchased land and began construction on an additional service center in Odessa, Texas. These facilities position Lufkin to provide the best artificial lift and power transmission service support and training in the areas each facility serves. Investments in new machine tools were aimed at expanding our production capabilities, while at the same time ensuring that our manufacturing processes are globally competitive.

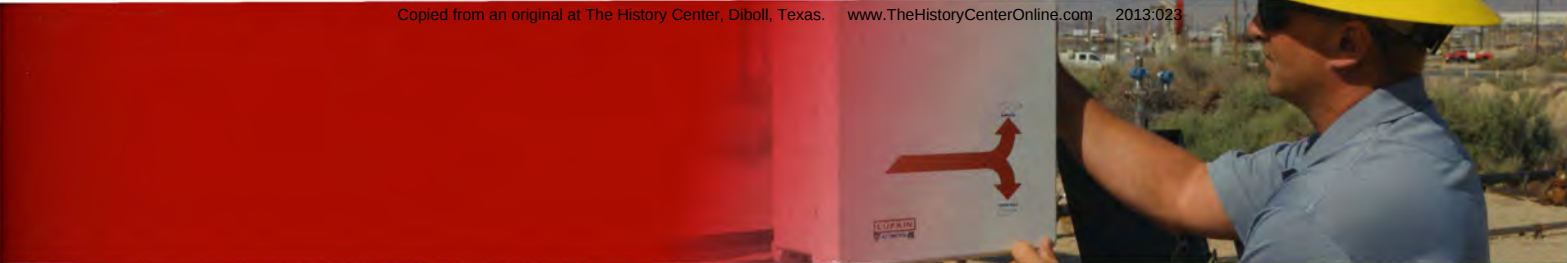
As we enter a new decade, Lufkin Industries is very well positioned to compete successfully in today's environment. Beyond that, we remain focused on anticipating the products and services required in the future to produce energy and to drive processes in the industrial sectors. On behalf of the management team and our board of directors, we thank you for your investment in Lufkin Industries.

John F. "Jay" Glick  
President and Chief Executive Officer



## OILFIELD DIVISION





## OILFIELD DIVISION

Lufkin's Oilfield Division is a vertically integrated global leader in the manufacture, installation and service of artificial lift systems for crude oil and natural gas field applications. The Company commands a significant share of the markets we serve, which include:

*Beam pumping units for rod lift • Gas lift and plunger lift systems*  
*Automation and control systems • Installation, maintenance and repair services*

To serve these markets, Lufkin operates manufacturing facilities in the United States, Canada and Argentina, and it also has an international network of service centers, sales offices and sales representative affiliates in more than 40 countries.

With a more than 80-year history of providing quality oilfield products and superior service to our customers, Lufkin delivers a comprehensive, high-reliability portfolio of artificial lift systems, sophisticated automation and control systems, and superior aftermarket services that minimize downtime, maximize equipment life, optimize reservoir performance and increase production.

Lufkin produces a broad line of beam lift pumping units, which are customized and installed for the particular depth and producing characteristics of each well or reservoir. In addition to traditional oil well lifting applications used in maturing fields to counter natural production declines, Lufkin pumping units are increasingly used to remove water from gas wells to enhance recovery. The acquisition of International Lift Systems (ILS) in early 2009 added proven gas lift and plunger lift technologies to our artificial lift product line.

In 2009, the Oilfield Division saw overall revenues fall by 37 percent from record levels in 2008 to \$349.2 million, driven by the sharp and rapid fall in the price of oil and natural gas starting in the second half of 2008. Weak commodity prices late in 2008, decreased demand for energy and ongoing economic uncertainty throughout most of 2009 drove operators to significantly reduce drilling budgets, capital projects spending and maintenance budgets.

## OILFIELD DIVISION



Lufkin proactively responded to the downturn by reducing manufacturing and service capacity – primarily in North America – while continuing our emphasis on “lean manufacturing” techniques to further reduce costs, optimize production and improve operating efficiencies. Almost without exception, all of the key producing areas in North America were impacted by the cut in spending by E&P companies, with higher-cost plays such as the Barnett and Haynesville shales most impacted. International projects were less affected during the first half of 2009, with significant levels of activity maintained in Brazil, the Middle East and Southeast Asia. A slowdown in international markets did begin to materialize in the second half of 2009, however, and that is expected to continue into the first part of 2010.

Driven largely by stabilizing commodity prices and oil-directed rig counts that trended upward in the last half of 2009, Lufkin expects improvement in most areas of the North American market during 2010. International markets are expected to recover slowly through the course of 2010 as the global economy improves and the demand for oil and gas recovers.

Lufkin’s automation business was equally affected by the market downturn in 2009. Automation revenues fell by 36 percent in 2009, but we anticipate strengthening in 2010 as producers refocus on optimizing production and maximizing equipment life. Lufkin’s systems automate the operation of beam lift pumping units to improve well performance using sophisticated software, instrumentation and variable-speed drives. Lufkin also supplies control equipment to automate progressive cavity pump wells and plunger lift systems.

Sales of variable-speed drives continued to grow as a percentage of total automation sales in 2009. These drives adjust the system power requirements in real time depending on production conditions in the wellbore to optimize power consumption, minimize wear and tear on pumping equipment and maximize its productive life.

Through the ILS acquisition, Lufkin now offers a broader line of artificial lifting systems using gas lift and plunger lift technologies. In 2009, Lufkin focused on expanding ILS internationally through additional marketing resources and local product qualification efforts.

Lufkin supports its installed base of equipment globally with a well-trained service organization, through which the Company installs, repairs and maintains equipment in the field. Service personnel work with oil and gas producers to develop and safely execute comprehensive maintenance and well optimization programs.

Lufkin operates service centers in key producing areas in the U.S., Canada, the Middle East and Latin America. The Company also maintains warehouses around the world stocked with original equipment manufacturers' spare parts to maintain maximum uptime for oil and gas producers.

In addition, Lufkin operates a gray and ductile iron foundry capable of producing high-quality castings for both captive and commercial applications. The foundry produces castings ranging in size from 100 pounds to 15 tons for pumping units as well as for external customers in the heavy equipment, valve and machine tool markets. Having dedicated foundry capacity has cemented Lufkin's competitive advantage by reducing lead times to a minimum for production of oilfield and power transmission castings. This enables Lufkin to respond to tight customer delivery and quality requirements.



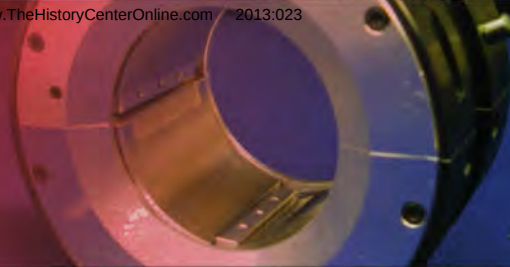
Lufkin Pumping Unit .....



Automation – Motor Control Panel .....  
with Rod Pump Controller

## POWER TRANSMISSION DIVISION





## POWER TRANSMISSION DIVISION

Lufkin Industries is one of the world's leading suppliers of mechanical power transmission products and services. Our highly engineered precision gear drives are used across a wide spectrum of industrial applications.

We differentiate ourselves in the industry by combining our industry-leading expertise in engineering, manufacturing technology and metallurgy to produce machinery with a proven history of reliability, industry-recognized superior performance and long service life. We deliver best-in-class customer service, rapid delivery and strong global after-sales support. Lufkin also derives competitive and logistical advantages with its design, manufacturing and product performance testing platforms in both Europe and the United States. We are the only turbo gear manufacturer that offers this full range of global support.

Our Power Transmission Division provides both high-speed turbo-machinery units and low-speed high-torque units. One of the primary markets for Lufkin's high-speed turbo gears is the oil and gas sector. The gearbox is used to transfer power from the prime mover – such as a gas turbine or electric motor – to the driven machine – such as a centrifugal compressor or pump. Our turbo gear products are used on land and on offshore platforms for such applications as gas compression and oil production, on pipelines for crude oil and natural gas transmission, and for oil refining. Other strategic applications for our high-speed units include electrical power generation, petrochemicals production, liquefied natural gas (LNG) production and distribution, and marine propulsion.

The Power Transmission Division reported \$172.2 million of sales last year – its second-best year ever – down about 9 percent from record sales the prior year. New order intake, however, declined by 29 percent to \$139.9 million from 2008. The weak global energy demand during 2009 led to a contraction in bookings for most of the division's primary product lines, particularly gasoline refining, petrochemicals, power generation and marine propulsion.

As the global economic crisis began to stabilize in the latter part of 2009, however, signs of cautious optimism emerged in several of the division's market sectors. The economics of large-scale oil and gas projects improved as construction and equipment procurement costs declined steadily throughout the year, and major oil companies began to reactivate once-promising projects that had been previously suspended. Our confidence in a near-term recovery was validated when numerous "drawing board" projects that the division had monitored closely throughout 2009 began to materialize late in the fourth quarter.

While the timing of gearbox order placements has been slower than expected, primarily due to protracted negotiations between the end users and the prime OEMs, the outlook for 2010 is encouraging.



## POWER TRANSMISSION DIVISION



Activity in the oil and gas sector is concentrated in LNG projects, primarily offshore Western Australia and the west coast of Africa. There are approximately six world-class-scale LNG projects in advanced stages of design or procurement, and Lufkin expects to compete successfully for several of these projects.

We expect to benefit from orders for high-speed, high-power speed increasers that drive centrifugal compressors and from orders for custom-engineered high-end bearings supplied to compressor manufacturers by our Rotating Machinery Technology (RMT) subsidiary, based in Wellsville, New York, which we acquired in July 2009.

RMT has built a reputation in the industry as a leader in high-end bearings for critical service turbo-machinery. RMT's patented bearing product lines, proprietary bearing design software and collaborative relationships with its global clients position RMT as the bearing provider of choice for critical applications. Through the RMT acquisition, Lufkin enjoys significant synergies with regard to client bases, technical expertise and innovative solutions.

Lower new order activity in 2009 from our traditional markets led us to search for new markets: One was the civil infrastructure projects market. In 2009 we won a major flood control contract from the U.S. Army Corps of Engineers to furnish 11 large gear drives to power huge pumps designed to protect a major Gulf Coast city against catastrophic flooding.

"Green" power generation is another new market we made significant inroads into last year. Our factory in France was selected to design and supply a large number of high-reliability drives for cooling water pumps destined for two Asian nuclear power stations. This new product line positions the division to compete successfully for similar projects in the growing nuclear power industry.

We also won new business for specialty gear drives for hydroelectric power generation. We remain committed to the growing wind power industry. As the installed base of wind turbines steadily expands, we see significant growth opportunity in the underserved aftermarket. We have invested in manufacturing and repair facilities to enhance our capabilities to maintain, repair and refurbish the complex gearboxes driving each wind turbine.

The new service center Lufkin opened in Bakersfield, California, in August 2009 will enable us to support regional industrial customers as well as wind turbine installations in the West. The reception by the end user community has been extremely encouraging.

The benefits of our "lean enterprise" initiatives, begun in 2008, have yielded improved product costs, shorter cycle times and enhanced quality in our products and order fulfillment processes from proposal to order capture and from design to testing. We continue to drive improvement with continual training of our team, a focused value analysis/value engineering initiative and a capital investment program to support targeted processes.

Our unique position as the only turbo gear manufacturer with a total package of manufacturing, design and performance testing facilities in North America and Europe positions Lufkin well for future growth, and we will continue to explore promising expansion opportunities to profitably grow our Power Transmission business.



Lufkin RMT Bearing .....



Lufkin Gear Repair .....



Top Row (From Left to Right): Richard R. Stewart, John F. Anderson, J. F. Glick, Douglas V. Smith, John Hofmeister, John H. Lollar, B. H. O'Neal  
Bottom Row (From Left to Right): H. J. Trout, Jr., J. T. Jongebloed, Suzanne V. Baer, Thomas E. Wiener

## 2009 LUFKIN INDUSTRIES BOARD MEMBERS

### **Douglas V. Smith**

Chairman of the Board  
Chairman – Executive Committee  
Board member since 1993

### **J. F. Glick**

President  
Chief Executive Officer  
Board member since 2007

### **H. J. Trout, Jr.**

Chairman – Pension Committee  
Member – Executive Committee,  
Nominating / Governance Committee  
Board member since 1980

### **Thomas E. Wiener**

Member – Executive Committee,  
Pension Committee,  
Nominating / Governance Committee  
Board member since 1987

### **B. H. O'Neal**

Chairman – Compensation Committee  
Member – Audit Committee,  
Nominating / Governance Committee  
Board member since 1992

### **John H. Lollar**

Chairman – Audit Committee  
Member – Compensation Committee  
Board member since 1997

### **J. T. Jongebloed**

Chairman – Nominating / Governance  
Committee  
Member – Audit Committee,  
Compensation Committee  
Board member since 2002

### **John F. Anderson**

Member – Executive Committee,  
Pension Committee  
Board member since 2003

### **Suzanne V. Baer**

Member – Audit Committee,  
Pension Committee  
Board member since 2005

### **Richard R. Stewart**

Board member since 2009

### **John Hofmeister**

Board member since January 2010

LUFKIN INDUSTRIES, INC.

**LUFKIN**

FORM 10-K

## 2012 LUKKIN INDUSTRIES BOARD MEMBERS

### Executive Committee

**Michael J. Boren**  
President & CEO  
1998 - Present

### Chairman

**Robert L. Boren**  
Chairman  
1998 - Present

### Board Members

**James L. Boren**  
Vice President & General Manager  
1998 - Present

**Robert L. Boren**  
Vice President & General Manager  
1998 - Present

### Chairman

**Michael J. Boren**  
President & CEO  
1998 - Present

### Chairman

**Robert L. Boren**  
Chairman  
1998 - Present

### Chairman

**Michael J. Boren**  
President & CEO  
1998 - Present

### Chairman

**Robert L. Boren**  
Chairman  
1998 - Present

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**Michael J. Boren**  
President & CEO  
1998 - Present

### Chairman

**Robert L. Boren**  
Chairman  
1998 - Present

### Chairman

**Michael J. Boren**  
President & CEO  
1998 - Present

## LUFKIN INDUSTRIES, INC.

The following is a discussion of the Company's business, financial results and financial condition. This report is part of the Company's Annual Report on Form 10-K that has been filed with the Securities and Exchange Commission. Certain parts of that filing in this report have been omitted, such as the cover page and exhibits. A complete copy of the Company's Annual Report on Form 10-K is available on the SEC's website at [www.sec.gov](http://www.sec.gov) or free of charge on the Company's website at [www.lufkin.com](http://www.lufkin.com). The Company will also provide to any shareholder a copy of that report without charge upon written request. Please mail your requests to Investor Relations, P.O. Box 849, Lufkin, Texas 75902.

## PART I

### Item 1. Business

Lufkin Industries, Inc. (the "Company") was incorporated under the laws of the State of Texas on March 4, 1902, and since that date has maintained its principal office and manufacturing facilities in Lufkin, Texas. The Company employed approximately 2,600 people at December 31, 2009, including approximately 1,600 that were paid on an hourly basis. Certain operations are subject to a union contract that expires in October 2011. The Company, a global supplier of oil field and power transmission products, is divided into two operating segments: Oil Field and Power Transmission.

In January 2008, the Company announced the decision to suspend its participation in the commercial trailer markets and to develop a plan to run-out existing inventories, fulfill contractual obligations and close all trailer facilities during 2008. During the second quarter of 2008, this plan was completed, with the majority of the remaining inventory and manufacturing equipment sold and all facilities closed. As a result, the former Trailer segment was classified as a discontinued operation during 2008.

### **Oil Field**

#### **Products:**

The Oil Field segment manufactures and services artificial lift products, including reciprocating rod lift, commonly referred to as pumping units, gas lift, plunger lift equipment and related products.

**Pumping Units-** Four basic types of pumping units are manufactured: an air-balanced unit; a beam-balanced unit; a crank-balanced unit; and a Mark II Uitorque 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 oil field pumping units within the four basic types.

**Pumping Unit Service-** Through a network of service centers, the Company transports and repairs pumping units. The service centers also refurbish used pumping units.

**Automation-** The Company designs, manufactures, installs and services computer control equipment and analytical services for artificial lift equipment that lower production costs and optimize well efficiency.

**Lufkin ILS-** Through this acquisition in 2009, the Company now designs, manufactures, installs and services gas lift, plunger lift and completion equipment.

**Foundry Castings-** As part of the Company's vertical integration strategy, the Oil Field segment operates an iron foundry to produce castings for new pumping units. In order to maximize utilization of this facility, castings for third parties are also produced.

#### **Raw Materials & Labor:**

Oil Field purchases a variety of raw materials in manufacturing its products. The principal raw materials are structural and plate steel, round alloy steel and iron castings from both its own foundry and third-party foundries. Casting costs are subject to change from raw material prices on scrap iron and pig iron in addition to natural gas and electricity prices. Due to the many configurations of its products and thus sizes of raw material used, Oil Field does not enter into long-term contracts for raw materials but generally does not experience shortages of raw materials. During the period of 2007 through 2009, Oil Field did not experience any significant material shortages. During the first three quarters of 2008, raw material prices for steel and castings increased significantly but started declining in the fourth quarter of 2008 and through 2009. As the global economy improves in 2010, raw material prices are expected to moderately increase. Raw material prices may continue to increase and availability may decrease with little notice.

The nature of the products manufactured and serviced generally requires skilled labor. Oil Field's ability to increase capacity could be limited by its ability to hire and train qualified personnel. Also, the main U.S. manufacturing facilities are unionized, so any labor disruption could have a significant impact on Oil Field's ability to maintain production levels. The current labor contract expires in October 2011.

#### **Markets:**

Demand for artificial lift equipment primarily depends on the level of new onshore oil well and workover drilling activity as well as the depth and fluid conditions of that drilling. Drilling activity is driven by the available cash flow of the Company's customers as well as their long-term perceptions of the level and stability of the price of oil. The higher energy prices experienced since 2004 have increased the demand for artificial lift equipment and related service and products from higher drilling activity, activation of idle wells and the upgrading of existing wells. During 2008, demand in the North American market increased significantly compared to 2007 levels due to the impact of increased drilling in response to higher oil prices and recapturing certain market share from lower-priced imported equipment as customers reevaluated the total life-cycle cost differences. Traditionally, as pumping unit demand increases and availability of used equipment diminishes, demand for new equipment increases. Increasingly in 2007, lower-priced imported pumping units entered the North American market in place of used equipment and reduced the incremental demand for the Company's new pumping units. In the fourth quarter of 2008, oil prices decreased significantly and

stayed at reduced levels throughout the first half of 2009. As drilling activity reduced in response to lower oil prices, demand for artificial lift equipment and related service was also negatively impacted. Also, as raw material costs declined and surplus equipment increased, there was competitive pressure to lower selling prices. Lower selling prices combined with the negative impact of low capacity utilization in manufacturing facilities, gross margins declined in 2009. In the second half of 2009, oil prices increased back to 2007 levels and drilling activity, especially for oil, increased. This trend is expected to continue in 2010, with higher drilling activity and lower surplus equipment inventory driving demand for new artificial lift equipment. Longer-term, the demand for artificial lift equipment will continue to increase in international markets. While a majority of the segment's revenues are in North America, international opportunities continue to increase as new drilling increases and existing fields mature, requiring increased use of artificial lift, especially in the South American, Russian and Middle Eastern markets. An Oilfield customer and its related subsidiaries represented 11.0%, 15.4% and 15.9% of consolidated company sales in 2009, 2008 and 2007, respectively. The loss of this customer would have a material adverse effect on this segment.

#### Competition:

The primary global competitor for artificial lift equipment is Weatherford International, but Chinese manufacturers of artificial lift equipment are increasingly present in the market. Used pumping units are also an important factor in the North American market, as customers will generally attempt to satisfy requirements through used equipment before purchasing new equipment. While the Company believes that it is one of the larger manufacturers of artificial lift equipment in the world, manufacturers of other types of units like electric submersible pumps have a significant share of the total artificial lift market. While Weatherford International is the Company's single largest competitor in the service market, small independent operators provide significant competitive pressures.

Because of the competitive nature of the business and the relative age of many of the product designs, price, delivery time, product quality and customer service are important factors in winning orders. To this end, the Company maintains strategic levels of inventories in order to ensure delivery times and invests in new capital equipment to maintain quality and price levels.

#### Power Transmission

##### Products:

The Power Transmission segment designs, manufactures and services speed increasing and reducing gearboxes for industrial applications. Speed increasers convert lower speed and higher torque input to higher speed and lower torque output while speed reducers convert higher speed and lower torque input to lower speed and higher torque output. The Company produces numerous sizes and designs of gearboxes depending on the end use. While there are standard designs, the majority of gearboxes are customized for each application.

**High-Speed Gearboxes-** Single stage gearboxes with pitch line velocities equal to or greater than 35 meters per second or rotational speeds greater than 4500 rpm or multi-stage gearboxes with at least one stage having a pitch line velocity equal to or greater than 35 meters per second and other stages having pitch line velocities equal to or greater than 8 meters per second are classified as high-speed gearboxes. These gearboxes require extremely high precision manufacturing and testing due to the stresses on the gearing. The ratio of increasers to reducers is fairly even. These gearboxes more typically service the energy related markets of petrochemicals, refineries, offshore production and transmission of oil and gas.

**Low-Speed Gearboxes-** Gearboxes which do not meet the pitch line or rotational speed criteria of high-speed gearboxes are classified as low-speed gearboxes. The majority of low-speed gearboxes are reducers. While still requiring close tolerances, these gearboxes do not require the same precision of manufacturing and testing. These gearboxes more typically service commodity-related industries like rubber, sugar, paper, steel, plastics, mining and cement as well as marine propulsion.

**Parts-** The Company manufactures capital spares for customers in conjunction with the production of new gearboxes, as well as producing parts for aftermarket service.

**Gearbox Repair & Service-** The Company provides on and off-site repair and service for not only its own products but also those manufactured by other companies. Repair work is performed in dedicated facilities due to the quick turn-around times required.

**Lufkin RMT-** Through this acquisition in 2009, the Company now participates in the turbo-machinery industry, specializing in the analysis design and manufacture of precision, custom-engineered tilting-pad bearings and related components for high-speed turbo equipment operating in critical duty applications. RMT also services, repairs and upgrades turbo-expander process units for air and gas separation.

##### Raw Materials & Labor:

Power Transmission purchases a variety of raw materials in manufacturing its products. The principal raw materials are steel plate, round alloy steel, iron castings and steel forgings. Due to the customized nature of its products, Power Transmission generally does not enter into long-term contracts for raw materials. Though raw material shortages are infrequent, lead times can be long due to the custom nature of many of its orders. Raw material prices are not expected to decline significantly in the short-term and may continue to increase with little notice. Certain materials like steel round, steel plate, steel forgings and bearings have continued to experience price increases and longer lead times. Raw material and component part shortages are not expected in the short-term, but certain supplier lead-times have grown, especially bearing suppliers.

The nature of the products manufactured and serviced generally requires skilled labor. Power Transmission's ability to increase capacity could be limited by its ability to hire and train qualified personnel. Also, the main U.S. manufacturing facilities are unionized, so any labor disruption could have a significant impact on Power Transmission's ability to maintain production levels. The current labor contract expires in October 2011.

#### **Markets:**

Power Transmission services many diverse markets, with high-speed gearing for markets such as petrochemicals, refineries, offshore production and transmission of oil and low-speed gearing for the gas, rubber, sugar, paper, steel, plastics, mining, cement and marine propulsion, each of which has its own unique set of drivers. Favorable conditions for one market may be unfavorable for another market. Generally, if general global industrial capacity utilizations are not high, spending on new equipment lags. Also impacting demand are government regulations involving safety and environmental issues that can require capital spending. Recent market demand increases have come from energy-related markets such as refining, petrochemical, drilling, coal, marine and power generation in response to higher global energy prices. RMT products generally follow the market for high-speed gearboxes. During the latter part of 2008, energy prices decreased significantly, global growth slowed and large project financing became difficult to secure. New order booking declined in the first half of 2009, which negatively impacted sales starting in late 2009. While sales will remain at these lower levels during the first half of 2010, new order and quotation activity, especially from large LNG projects, during this period is expected to increase and should translate into higher sales in the latter half of 2010.

#### **Competition:**

Despite the highly technical nature of the products in this segment, there are many competitors. While several North American competitors have de-emphasized the market, many European companies remain in the market. Competitors include Flender Graffenstaden, BHS, Renk, Rientjes, CMD, Philadelphia Gear and Horsburgh & Scott. While price is an important factor, proven designs, workmanship and engineering support are critical factors. Due to this, the Company outsources very little of the design and manufacturing processes.

#### **Federal Regulation and Environmental Matters**

The Company's operations are subject to various federal, state and local laws and regulations, including those related to air emissions, wastewater discharges, the handling of solid and hazardous wastes and occupational safety and health. Environmental laws have, in recent years, become more stringent and have generally sought to impose greater liability on a larger number of potentially responsible parties. While the Company is not currently aware of any situation involving an environmental claim that would likely have a material adverse effect on its business, it is always possible that an environmental claim with respect to one or more of the Company's current businesses or a business or property that one of our predecessors owned or used could arise that could have a material adverse effect. The Company's operations have incurred, and will continue to incur, capital and operating expenditures and other costs in complying with these laws and regulations in both the United States and abroad. However, the Company does not anticipate the future costs of environmental compliance will have a material adverse effect on its business, financial results or results of operations.

#### **Available Information**

The Company makes available, free of charge, through our website, [www.lufkin.com](http://www.lufkin.com), its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended. Access to these electronic filings is available as soon as reasonably practicable after the Company files such material with, or furnishes it to, the Securities and Exchange Commission. You may also request printed copies of these documents free of charge by writing to the Company Secretary at P.O. Box 849, Lufkin, Texas 75902. Our reports filed with the SEC are also made available to read and copy at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C., 20549. You may obtain information about the Public Reference Room by contacting the SEC at 1-800-SEC-0330. Reports filed with or furnished to the SEC are also made available on its website at [www.sec.gov](http://www.sec.gov).

**Item 1A. Risk Factors.**

*The risks described below are those which the Company believes are the material risks that it faces. Any of the risk factors described below could significantly and adversely affect its business, prospects, financial condition and results of operations.*

***A decline in domestic and worldwide oil and gas drilling activity would adversely affect the Company's results of operations.***

The Oil Field segment is materially dependent on the level of oil and gas drilling activity in North America and worldwide, which in turn depends on the level of capital spending by major, independent and state-owned exploration and production companies. This capital spending is driven by current prices for oil and gas and the perceived stability and sustainability of those prices. Oil and gas prices have been subject to significant fluctuation in recent years in response to changes in the supply and demand for oil and gas, market uncertainty, world events, governmental actions, and a variety of additional factors that are beyond the Company's control, including:

- the level of North American and worldwide oil and gas exploration and production activity;
- worldwide economic conditions, particularly economic conditions in North America;
- oil and gas production costs;
- weather conditions;
- the expected costs of developing new reserves;
- national government political requirements and the policies of OPEC;
- the price and availability of alternative fuels;
- the effect of worldwide energy conservation measures;
- environmental regulation; and
- tax policies.

***Increases in the prices of our raw materials could adversely affect our margins and results of operations.***

The Company uses large amounts of steel, iron and electricity in the manufacture of its products. The price of these raw materials has a significant impact on the cost of producing products. Steel and electricity prices have increased significantly in the last five years, caused primarily by higher energy prices and increased global demand. Since most of the Company's suppliers are not currently parties to long-term contracts with us, the Company is vulnerable to fluctuations in prices of such raw materials. Factors such as supply and demand, freight costs and transportation availability, inventory levels of brokers and dealers, the level of imports and general economic conditions may affect the price of cast iron and steel. Raw material prices may increase significantly in the future. Certain items such as steel round, bearings and aluminum have continued to experience price increases, price volatility and longer lead times. If the Company is unable to pass future raw material price increases on to its customers, margins, results of operations, cash flow and financial condition could be adversely affected.

***Interruption in our supply of raw materials could adversely affect our results of operations.***

The Company relies on various suppliers to supply the components utilized to manufacture our products. The availability of the raw materials is not only a function of the availability of steel and iron, but also the alloy materials that are utilized by our suppliers. To date, these shortages have not caused a material disruption in availability or our manufacturing operations. However, material disruptions may occur in the future. Raw material shortages and allocations may result in inefficient operations and a build-up of inventory, which can negatively affect the Company's working capital position. The loss of any of the Company's suppliers or their inability to meet its price, quality, quantity and delivery requirements could have an adverse effect on the Company's business and results of operations.

***The inherent dangers and complexity of the Company's products and services could subject it to substantial liability claims that could adversely affect our results of operations.***

The products that the Company manufactures and the services that it provides are complex, and the failure of this equipment to operate properly or to meet specifications may greatly increase our customers' costs. In addition, many of these products are used in inherently hazardous industries, such as the oil and gas drilling and production industry where an accident or product failure can cause personal injury or loss of life, damage to property, equipment, or the environment, regulatory investigations and penalties and the suspension of the end-user's operations. If the Company's products or services fail to meet specifications or are involved in accidents or failures, we could face warranty, contract, or other litigation claims for which it may be held responsible and its reputation for providing quality products may suffer.

The Company's insurance may not be adequate in risk coverage or policy limits to cover all losses or liabilities that we may incur or be responsible. Moreover, in the future we may not be able to maintain insurance at levels of risk coverage or policy limits that we deem adequate or at premiums that are reasonable for us, particularly in the recent environment of significant insurance premium increases. Further, any claims made under the Company's policies will likely cause its premiums to increase.

Any future damages deemed to be caused by the Company's products or services that are assessed against it and that are not covered by insurance, or that are in excess of policy limits or subject to substantial deductibles, could have a material adverse effect on our results of operations and financial condition. Litigation and claims for which we are not insured can occur, including employee claims, intellectual property claims, breach of contract claims, and warranty claims.

***We may not be able to successfully integrate future acquisitions, which will cause us to fail to realize expected returns.***

The Company continually explores opportunities to acquire related businesses, some of which could be material to the Company. The ability to continue to grow, however, may depend upon identifying and successfully acquiring attractive companies, effectively integrating these companies, achieving cost efficiencies and managing these businesses as part of the Company. The Company may not be able to effectively integrate the acquired companies and successfully implement appropriate operational, financial and management systems and controls to achieve the benefits expected to result from these acquisitions. The Company's efforts to integrate these businesses could be affected by a number of factors beyond its control, such as regulatory developments, general economic conditions and increased competition. In addition, the process of integrating these businesses could cause the interruption of, or loss of momentum in, the activities of our existing business. The diversion of management's attention and any delays or difficulties encountered in connection with the integration of these businesses could negatively impact the Company's business and results of operations. Further, the benefits that the Company anticipates from these acquisitions may not develop.

***Labor dispute or the expiration of our current labor contract could have a material adverse effect on our business.***

The Company's main U.S. manufacturing facilities are unionized and the current labor contract with respect to those facilities expires in October 2011. The Company cannot assure that any disputes, work stoppages or strikes will not arise in the future. In addition, when our existing collective bargaining agreement expires, the Company cannot assure that it will be able to reach a new agreement with its employees or that any new agreement will be on substantially similar terms as the existing agreement. Future disputes with and labor concessions to the Company's employees could have a material adverse effect upon its results of operations and financial position.

***The inability to hire and retain qualified employees may hinder our growth.***

The ability to provide high-quality products and services depends in part on the Company's ability to hire and retain skilled personnel in the areas of management, product engineering, servicing and sales. Competition for such personnel is intense and competitors can be expected to attempt to hire the Company's skilled employees from time to time. In particular, the Company's business and results of operations could be materially adversely affected if it is unable to retain the customer relationships and technical expertise provided by the Company's management team and professional personnel.

***Significant competition in the industries in which the Company operates may result in its competitors offering new or better products and services or lower prices, which could result in a loss of customers and a decrease in revenues.***

The industries in which the Company operates are highly competitive. The Company competes with other manufacturers and service providers of varying sizes, some of which may have greater financial and technological resources than it does. If the Company is unable to compete successfully with other manufacturers and service providers, it could lose customers and its revenues may decline. In addition, competitive pressures in the industry may affect the market prices of the Company's new and used equipment, which, in turn, may adversely affect its sales margins, results of operations, cash flow and financial condition.

***Disruption of our manufacturing operations or management information systems would have an adverse effect on our financial condition and results of operations.***

While the Company owns numerous facilities domestically and internationally, its primary manufacturing facilities in and around Lufkin, Texas account for a significant percentage of its manufacturing output. An unexpected disruption in the Company's production at these facilities or in its management information systems for any length of time would have an adverse effect on our business, financial condition and results of operations.

***The Company has foreign operations that would be adversely impacted in the event of war, political disruption, civil disturbance, economic and legal sanctions and changes in global trade policies.***

The Company has operations in certain international areas, including parts of the Middle East and South America, that are subject to risks of war, political disruption, civil disturbance, economic and legal sanctions (such as restrictions against countries that the U.S. government may deem to sponsor terrorism) and changes in global trade policies. The Company's operations may be restricted or prohibited in any country in which these risks occur. In particular, the occurrence of any of these risks could result in the following events, which in turn, could materially and adversely impact the Company's results of operations:

- disruption of oil and natural gas exploration and production activities;
- restriction of the movement and exchange of funds;
- inhibition of our ability to collect receivables;
- enactment of additional or stricter U.S. government or international sanctions; and
- limitation of our access to markets for periods of time.

***Results of operations could be adversely affected by actions under U.S. trade laws.***

Although the Company is a U.S.-based manufacturing and services company, it does own and operate international manufacturing operations that support its U.S.-based business. If actions under U.S. trade laws were instituted that limited the Company's access to these products, the ability to meet its customer specifications and delivery requirements would be reduced. Any adverse effects on the Company's ability to import products from its foreign subsidiaries could have a material adverse effect on our results of operations.

***The Company is subject to currency exchange rate risk, which could adversely affect its results of operations.***

The Company is subject to currency exchange rate risk with intercompany debt denominated in U.S. dollars owed by its Canadian subsidiary. The Company cannot assure that future currency exchange rate fluctuations will not have an adverse affect on its results of operations.

***Significant changes in pension fund investment performance or assumptions relating to pension costs may have a material effect on the valuation of pension obligations, the funded status of pension plans, and our pension cost.***

Our funding policy for our pension plan is to accumulate plan assets that, over the long-run, will approximate the present value of projected benefit obligations. Our pension cost is materially affected by the discount rate used to measure pension obligations, the level of plan assets available to fund those obligations at the measurement date and the expected long-term rate of return on plan assets. Our pension plan is supported by pension fund investments that are volatile and subject to financial market risk, including fixed income, domestic and foreign equity securities, real estate and hedge funds. Significant changes in investment performance or a change in the portfolio mix of invested assets could result in corresponding increases and decreases in the valuation of plan assets or in a change of the expected rate of return on plan assets. A change in the discount rate would result in a significant increase or decrease in the valuation of pension obligations, affecting the reported funded status of our pension plans as well as the net periodic pension cost in the following fiscal years. Similarly, changes in the expected return on plan assets could result in significant changes in the net periodic pension cost for subsequent fiscal years.

***The Company's common stock has experienced, and may continue to experience, price volatility.***

The trading price of the Company's common stock has been and may continue to be subject to large fluctuations. The Company's common stock price may increase or decrease in response to a number of events and factors, including:

- trends in the Company's industries and the markets in which it operates;
- changes in the market price of the products the Company sells;
- the introduction of new technologies or products by the Company or its competitors;
- changes in expectations as to the Company's future financial performance, including financial estimates by securities analysts and investors;
- operating results that vary from the expectations of securities analysts and investors;
- announcements by the Company or its competitors of significant contracts, acquisitions, strategic partnerships, joint ventures, financings or capital commitments;
- the price of oil;
- changes in laws and regulations; and
- general economic and competitive conditions.

***Due to the recent financial and credit crisis, certain of our counterparties may be unable to meet their financial obligations to the Company or, alternatively, may be forced to postpone or otherwise cancel their contracts with the Company.***

The recent credit crisis and the related turmoil in the global financial system have had an adverse impact on the Company's business and financial condition and the business and financial condition of our counterparties. The Company may face challenges if conditions in the financial markets do not improve. The Company may be subject to increased counterparty risks whereby its counterparties may not be willing or able to meet their financial obligations to the Company or, alternatively, may be forced to postpone or otherwise cancel their contracts with the Company. To the extent a third-party is unable to meet its obligations to the Company, the earnings and results of operations of the Company could be negatively impacted in future reporting periods. A sustained decline in the ability of the Company's counterparties to meet their financial obligations to the Company would adversely affect its business, results of operations and financial condition.

***Climate change legislation limiting and reducing greenhouse gas emissions through a "cap and trade" system of allowances and credits could result in increased operating costs and reduced demand for our products or services.***

On June 26, 2009, the U.S. House of Representatives passed the American Clean Energy and Security Act of 2009 ("ACESA"), which would establish an economy-wide cap-and-trade program to reduce U.S. emissions of greenhouse gases, including carbon dioxide and methane. ACESA would require a 17% reduction in greenhouse gas emissions from 2005 levels by 2020 and just over an 80% reduction of such emissions by 2050. Under this legislation, the EPA would issue a capped and steadily declining number of tradable emissions allowances to certain major sources of greenhouse gas emissions so that such sources could continue to emit greenhouse gases into the atmosphere. These allowances would be expected to escalate significantly in cost over time. The net

effect of ACESA will be to impose increasing costs on the combustion of carbon-based fuels such as oil, refined petroleum products, and natural gas. Similarly, on September 30, 2009, the Clean Energy Jobs and American Power Act of 2009 was introduced in the U.S. Senate. The Obama Administration has indicated its support of legislation to reduce greenhouse gas emissions through an emission allowance system. Although it is not possible at this time to predict when the Senate may act on climate change legislation or how any bill passed by the Senate would be reconciled with ACESA, any future federal laws or implementing regulations that may be adopted to address greenhouse gas emissions could require the Company to incur increased operating costs, could adversely impact customers' operations or demand for customers' products, or could adversely affect demand for the Company's products or services.

***An array of international climate change accords focused on limiting and reducing greenhouse gas emissions could result in increased operating costs and reduced demand for our products or services.***

The Company services customers in numerous foreign countries. As such, we are subject not only to U.S. climate change legislation but may also be subject to certain international climate change accords. A variety of regulatory developments, proposals or requirements have been introduced and/or adopted in the international regions in which we operate that are focused on restricting the emission of carbon dioxide, methane and other greenhouse gases. Among these developments are the United Nations Framework Convention on Climate Change, also known as the "Kyoto Protocol," and the European Union Emissions Trading System ("EU ETS"), which was launched as an international "cap and trade" system on allowances for emitting greenhouse gases. These international regulatory developments may curtail production and demand for fossil fuels such as oil and gas in areas of the world where the Company and our customers operate and thus adversely affect future demand for the Company's products and services, which may in turn adversely affect the Company's future results of operations.

***Climate change regulations restricting emissions of greenhouse gases could result in increased operating costs and reduced demand for our products or services.***

On December 15, 2009, the U.S. Environmental Protection Agency (the "EPA") officially published its findings that emissions of carbon dioxide, methane and other greenhouse gases present an endangerment to human health and the environment because emissions of such gases are, according to the EPA, contributing to warming of the Earth's atmosphere and other climatic changes. These findings by the EPA allow the agency to proceed with the adoption and implementation of regulations that would restrict emissions of greenhouse gases under existing provisions of the federal Clean Air Act. In late September 2009, the EPA had proposed two sets of regulations in anticipation of finalizing its findings that would require a reduction in emissions of greenhouse gases from motor vehicles and that could also lead to the imposition of greenhouse gas emission limitations in Clean Air Act permits for certain stationary sources. In addition, on September 22, 2009, the EPA issued a final rule requiring the reporting of greenhouse gas emissions from specified large greenhouse gas emission sources in the United States beginning in 2011 for emissions occurring in 2010. The adoption and implementation of any regulations imposing reporting obligations on, or limiting emissions of greenhouse gases from, our equipment and operations could require the Company to incur costs to reduce emissions of greenhouse gases associated with operations, could adversely impact customers' operations or demand for customers' products, or could adversely affect demand for the Company's products or services.

#### **Item 1B. Unresolved Staff Comments.**

None

## **Item 2. Properties**

The Company's major manufacturing facilities are located in and near Lufkin, Texas, are company-owned and include approximately 150 acres, a foundry, machine shops, structural shops, assembly shops and warehouses. The facilities by segment are:

### **Oil Field:**

|                            |                 |
|----------------------------|-----------------|
| Pumping Unit Manufacturing | 240,000 sq. ft. |
| Foundry Operations         | 687,000 sq. ft. |

### **Power Transmission:**

|                        |                 |
|------------------------|-----------------|
| New Unit Manufacturing | 458,000 sq. ft. |
| Repair Operations      | 84,000 sq. ft.  |

Former Trailer Manufacturing 388,000 sq. ft.

Corporate Facilities 33,000 sq. ft.

Through the acquisitions of ILS and RMT in 2009, the Company added two leased manufacturing facilities:

Lufkin ILS- Houston, TX 50,000 sq. ft.

Lufkin RMT- Wellsville, NY 23,500 sq. ft.

Also, the Company has numerous service centers throughout the U.S. to support the Oil Field and Power Transmission segments. The majority of these locations are company-owned, with some leased. None of these leases qualify as capital leases.

Internationally, there are company-owned facilities for the production and servicing of pumping units and power transmission products. The facilities by segment are:

### **Oil Field (Pumping unit manufacturing and repair):**

|                               |                 |
|-------------------------------|-----------------|
| Nisku, Alberta, Canada        | 66,000 sq. ft.  |
| Comodoro Rivadavia, Argentina | 125,000 sq. ft. |

### **Power Transmission (New unit manufacturing and repair):**

|                     |                 |
|---------------------|-----------------|
| Fougerolles, France | 377,000 sq. ft. |
|---------------------|-----------------|

Also, the Company has several international service centers to support the Oil Field segment. The majority of these locations are owned by the Company, with some leased. None of these leases qualify as capital leases.

## **Item 3. Legal Proceedings**

On March 7, 1997, a class action complaint was filed against Lufkin Industries, Inc. (the "Company") in the U.S. District Court for the Eastern District of Texas by an employee and a former employee of the Company who alleged race discrimination in employment. Certification hearings were conducted in Beaumont, Texas in February 1998 and in Lufkin, Texas in August 1998. In April 1999, the District Court issued a decision that certified a class for this case, which included all black employees employed by the Company from March 6, 1994, to the present. The case was administratively closed from 2001 to 2003 while the parties unsuccessfully attempted mediation. Trial for this case began in December 2003, and after the close of plaintiff's evidence, the court adjourned and did not complete the trial until October 2004. Although plaintiff's class certification encompassed a wide variety of employment practices, plaintiffs presented only disparate impact claims relating to discrimination in initial assignments and promotions at trial.

On January 13, 2005, the District Court entered its decision finding that the Company discriminated against African-American employees in initial assignments and promotions. The District Court also concluded that the discrimination resulted in a shortfall in income for those employees and ordered that the Company pay those employees back pay to remedy such shortfall, together with pre-judgment interest in the amount of 5%. On August 29, 2005, the District Court determined that the back pay award for the class of affected employees was \$3.4 million (including interest to January 1, 2005) and provided a formula for attorney fees that the Company estimates will result in a total not to exceed \$2.5 million. In addition to back pay with interest, the District Court (i) enjoined and ordered the Company to cease and desist all racially biased assignment and promotion practices and (ii) ordered the Company to pay court costs and expenses.

### Item 3. Legal Proceedings (continued)

The Company reviewed this decision with its outside counsel and on September 19, 2005, appealed the decision to the U.S. Court of Appeals for the Fifth Circuit. On April 3, 2007, the Company appeared before the appellate court in New Orleans for oral argument in this case. The appellate court subsequently issued a decision on Friday, February 29, 2008 that reversed and vacated the plaintiff's claim regarding the initial assignment of black employees into the Foundry Division. The court also denied plaintiff's appeal for class certification of a class disparate treatment claim. Plaintiff's claim on the issue of the Company's promotional practices was affirmed but the back pay award was vacated and remanded for recomputation in accordance with the opinion. The District Court's injunction was vacated and remanded with instructions to enter appropriate and specific injunctive relief. Finally, the issue of plaintiff's attorney's fees was remanded to the District Court for further consideration in accordance with prevailing authority.

On December 5, 2008, the U.S. District Court Judge Clark held a hearing in Beaumont, Texas during which he reviewed the 5<sup>th</sup> U.S. Circuit Court of Appeals class action decision and informed the parties that he intended to implement the decision in order to conclude this litigation. At the conclusion of the hearing Judge Clark ordered the parties to submit positions regarding the issues of attorney fees, a damage award and injunctive relief. Subsequently, the Company reviewed the plaintiff's submissions which described the formula and underlying assumptions that supported their positions on attorney fees and damages. After careful review of the plaintiff's submission to the court the Company continued to have significant differences regarding legal issues that materially impacted the plaintiff's requests. As a result of these different results, the court requested further evidence from the parties regarding their positions in order to render a final decision. The judge reviewed both parties arguments regarding legal fees, and awarded the plaintiffs an interim fee, but at a reduced level from the plaintiffs original request. The Company and the plaintiffs reconciled the majority of the differences and the damage calculations which also lowered the originally requested amounts of the plaintiffs on those matters. Due to the resolution of certain legal proceedings on damages during first half of 2009 and the District Court awarding the plaintiffs an interim award of attorney fees and cost totaling \$5.8 million, the Company recorded an additional provision of \$5.0 million in the first half of 2009 above the \$6.0 million recorded in fourth quarter of 2008. The plaintiffs filed an appeal of the District Court's interim award of attorney fees with the U.S. Fifth Circuit Court of Appeals. The Fifth Circuit subsequently dismissed these appeals on August 28, 2009 on the basis that an appealable final judgment in this case had not been issued. The court commented that this issue can be reviewed with an appeal of final judgment.

On January 15, 2010, the U.S. District Court for the Eastern District of Texas notified the Company that it had entered a final judgment related to the Company's ongoing class-action lawsuit. The Court ordered the Company to pay the plaintiffs \$3.3 million in damages, \$2.2 million in pre-judgment interest and 0.41% interest for any post-judgment interest. The Company had previously estimated the total liability for damages and interest to be approximately \$5.2 million. The Court also ordered the plaintiffs to submit a request for legal fees and expenses from January 1, 2009 through the date of the final judgment. The plaintiffs are required to submit this request within 14 days of the final judgment. On January 29, 2010, the plaintiffs filed a motion with the U.S. District Court for the Eastern District of Texas for a supplemental award of \$0.7 million for attorney's fees, costs and expenses incurred between January 1, 2009 and January 15, 2010, as allowed in the final judgment issued by the Court on January 15, 2010, related to the Company's ongoing class-action lawsuit. In the fourth quarter of 2009, the Company recorded a provision of \$1.0 million for these legal expenses and accrual adjustments for the final judgment award of damages.

On January 15, 2010, the plaintiffs filed a notice of appeal with the U.S. Fifth Circuit Court of Appeals of the District Court's final judgment. On January 21, 2010, The Company filed a notice of cross-appeal with the same court. In addition, the Company filed a motion with the District Court to stay the payment of damages referenced in the District Court's final judgment pending the outcome of the Fifth Circuit's decision on both parties' appeals. The District Court granted this motion to stay.

There are various other claims and legal proceedings arising in the ordinary course of business pending against or involving the Company wherein monetary damages are sought. For certain of these claims, the Company maintains insurance coverage while retaining a portion of the losses that occur through the use of deductibles and retention limits. Amounts in excess of the self-insured retention levels are fully insured to limits believed appropriate for the Company's operations. Self-insurance accruals are based on claims filed and an estimate for claims incurred but not reported. While the Company does maintain insurance above its self-insured levels, a decline in the financial condition of its insurer, while not currently anticipated, could result in the Company recording additional liabilities. It is management's opinion that the Company's liability under such circumstances or involving any other non-insured claims or legal proceedings would not materially affect its consolidated financial position, results of operations, or cash flow.

### Item 4. Reserved

None

## PART II

### Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

#### Common Stock Information

The Company's common stock is traded on the NASDAQ National Market under the symbol "LUFK." As of January 31, 2010, there were approximately 387 record holders of the Company's common stock. This number does not include any beneficial owners for whom shares of common stock may be held in "nominee" or "street" name. The following table sets forth, for each quarterly period during fiscal 2009 and 2008, the high and low sales price per share of the Company's common stock and the dividends paid per share on the Company's common stock.

| Quarter | 2009        |          |          | 2008        |          |          |
|---------|-------------|----------|----------|-------------|----------|----------|
|         | Stock Price |          | Dividend | Stock Price |          | Dividend |
|         | High        | Low      |          | High        | Low      |          |
| First   | \$ 41.25    | \$ 26.96 | \$ 0.25  | \$ 65.50    | \$ 50.85 | \$ 0.25  |
| Second  | 48.16       | 29.51    | 0.25     | 86.82       | 62.53    | 0.25     |
| Third   | 53.81       | 36.38    | 0.25     | 95.23       | 70.93    | 0.25     |
| Fourth  | 75.74       | 49.53    | 0.25     | 79.25       | 31.45    | 0.25     |

The Company has paid cash dividends for 70 consecutive years. Total dividend payments were \$14.9 million, \$14.8 million and \$13.1 million in 2009, 2008 and 2007, respectively.

#### Equity Compensation Plan Information

The following table sets forth securities of the Company authorized for issuance under equity compensation plans at December 31, 2009.

| Plan Category                                              | Number of securities to be issued upon exercise of outstanding options, warrants and rights (a) | Weighted-average exercise price of outstanding options, warrants and rights (b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|------------------------------------------------------------|-------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by security holders     | 709,015                                                                                         | \$52.56                                                                         | 786,592                                                                                                                                     |
| Equity compensation plans not approved by security holders | -                                                                                               | -                                                                               | -                                                                                                                                           |
| Total                                                      | <u>709,015</u>                                                                                  | <u>\$52.56</u>                                                                  | <u>786,592</u>                                                                                                                              |

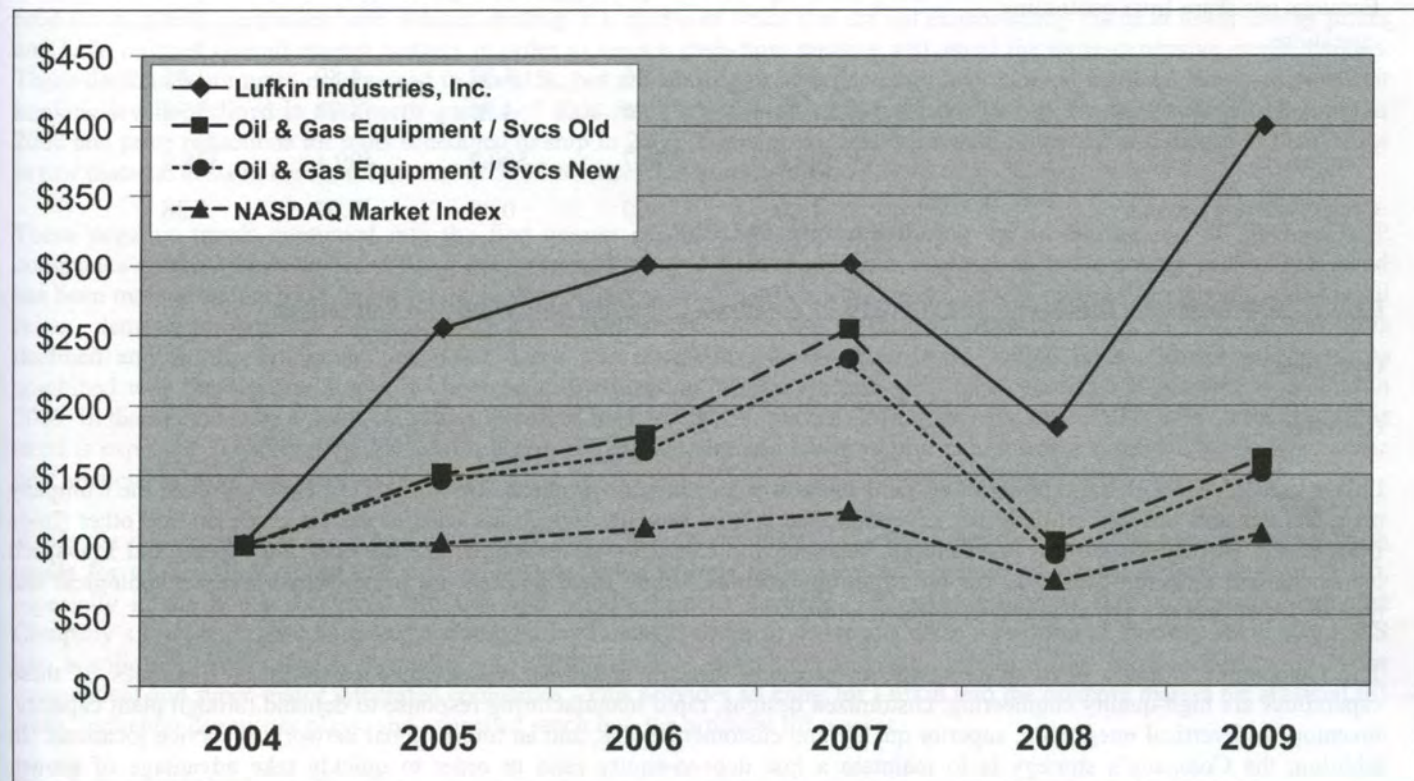
300,000 shares were authorized for issuance pursuant to the 1996 Nonemployee Director Stock Option Plan and 3,800,000 shares were authorized for issuance pursuant to the Incentive Stock Compensation Plan 2000. Awards may be granted pursuant to the Incentive Stock Compensation Plan 2000 include options, restricted stock, performance awards, phantom shares, bonus shares and other stock-based awards.

# Performance Graph- Total Stockholder Return

The following is a line graph comparing cumulative, five -year total shareholder return with a general market index (the NASDAQ Market Index) and a published industry index of oil and gas equipment/service providers (Hemscott Industry Group 124).

The graph shall not be deemed incorporated by reference by any general statement incorporating by reference this Form 10-K into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the Company specifically incorporates this information by reference, and shall not otherwise be deemed filed under such acts.

**Comparison of 5 Year Cumulative Total Return\***  
**Among Lufkin Industries, Inc., the NASDAQ Market Index and an Industry Index**



\* \$100 invested on 12/31/04 in stock and index-including reinvestment of dividends for fiscal years ending December 31.

Performance graph data provided by R. R. Donnelley Financial.

## **Item 6. Selected Financial Data**

### **Five Year Summary of Selected Consolidated Financial Data**

The following table sets forth certain selected historical consolidated financial data from continuing operations and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and Notes thereto included elsewhere in this annual report on Form 10-K. The following information may not be indicative of future operating results.

| (In millions, except per share data)           | 2009     | 2008     | 2007     | 2006     | 2005     |
|------------------------------------------------|----------|----------|----------|----------|----------|
| Sales                                          | \$ 521.4 | \$ 741.2 | \$ 555.8 | \$ 526.1 | \$ 413.7 |
| Earnings from continuing operations            | 22.5     | 88.0     | 71.8     | 71.3     | 44.5     |
| Earnings per share from continuing operations: |          |          |          |          |          |
| Basic                                          | 1.51     | 5.96     | 4.82     | 4.80     | 3.05     |
| Diluted                                        | 1.51     | 5.91     | 4.76     | 4.71     | 2.98     |
| Total assets                                   | 541.6    | 530.7    | 500.7    | 409.1    | 338.3    |
| Cash dividends per share                       | 1.00     | 1.00     | 0.88     | 0.62     | 0.38     |

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

### **Overview**

#### **General**

Lufkin Industries is a global supplier of oil field and power transmission products. Through its Oil Field segment, the Company manufactures and services artificial lift equipment and related products, which are used to extract crude oil and other fluids from wells. Through its Power Transmission segment, the Company manufactures and services high-speed and low-speed increasing and reducing gearboxes for industrial applications. While these markets are price-competitive, technological and quality differences can provide product differentiation.

The Company's strategy is to differentiate its products through additional value-added capabilities. Examples of these capabilities are high-quality engineering, customized designs, rapid manufacturing response to demand through plant capacity, inventory and vertical integration, superior quality and customer service, and an international network of service locations. In addition, the Company's strategy is to maintain a low debt-to-equity ratio in order to quickly take advantage of growth opportunities and pay dividends even during unfavorable business cycles.

In support of the above strategy, the Company has been making capital investments in Oil Field to increase manufacturing capacity and capabilities in its three main manufacturing facilities in Lufkin, Texas, Canada and Argentina. These investments should reduce production lead times, improve quality and reduce manufacturing costs. Investments also continue to be made to expand the Company's presence in automation products and international service. During the first quarter of 2009, the Company purchased International Lift Systems ("ILS"), which manufactures and services gas lift, plunger lift and completion equipment for the oil and gas industry. In Power Transmission, the Company continues to expand its gear repair network by opening and expanding facilities in various locations in the U.S. and Canada. The Company is making targeted capital investments in the U.S. and France to expand capacity, develop new product lines and reduce manufacturing lead times, in addition to certain capital investments targeting cost reductions. On July 1, 2009, the Company purchased Rotating Machinery Technology, Inc. (RMT), which specializes in the analysis, design and manufacture of precision, custom-engineered tilting-pad bearings and related components for high-speed turbo equipment operating in critical duty applications. RMT also services, repairs and upgrades turbo-expander process units for air and gas separation, both on-site with its skilled field service team and at its repair facility in Wellsville, New York.

## Trends/Outlook

### Oil Field

Demand for artificial lift equipment is primarily dependent on the level of new onshore oil wells, workover drilling activity, the depth and fluid conditions of such drilling activity and general field maintenance budgets. Drilling activity is driven by the available cash flow of the Company's customers as well as their long-term perceptions of the level and stability of the price of oil. Increasing energy prices from 2004 to late 2008 increased the demand for pumping units and related service and products from higher drilling activity, activation of idle wells and the upgrading of existing wells. During the first nine months of 2008, demand levels in North America increased over the levels experienced in 2007 as higher energy prices drove increased drilling and workover activity. Additionally, the demand for pumping units, oilfield services and automation equipment continued to increase in international markets as well as a partial recapture of market share from imported equipment domestically.

In the fourth quarter of 2008, energy prices dramatically declined due to reductions in global demand. Planned new drilling and workover activity has also reduced significantly as capital and operating budgets have been reduced. Exploration and production (E&P) companies have reduced drilling in higher-cost fields that are not economically viable at lower energy prices and have reduced overall capital budgets in order to remain cash-flow positive and avoid the more-expensive credit markets. These declines were more pronounced in the U.S., but are starting to be reflected in international markets. New pumping unit booking levels declined in the fourth quarter of 2008 from lower demand, order cancellations for units scheduled to ship in 2009 and price reductions for units scheduled to ship in 2009. These price reductions were primarily in response to the decline in raw material costs in the fourth quarter of 2008 for steel and iron castings.

These negative trends continued into the first quarter of 2009 and worsened during the second quarter of 2009 as E&P companies deferred or cancelled drilling programs and reduced field spending in response to lower energy prices. This trend has been more pronounced in North America than in international markets. As drilling activity reduced in response to lower oil prices, demand for artificial lift equipment and related service also was negatively impacted. Also, as raw material costs declined and surplus equipment increased, there was competitive pressure to lower selling prices. Lower selling prices combined with the negative impact of low capacity utilization in manufacturing facilities caused gross margins to decline in 2009. In the second half of 2009, oil prices increased back to 2007 levels and drilling activity, especially for oil, increased. This trend is expected to continue in 2010, with higher drilling activity and lower surplus equipment inventory driving demand for new artificial lift equipment.

While the market is suffering a cyclical decline, the Company continues to believe that there are long-term positive growth trends for artificial lift equipment, and as existing fields mature, the market will require an increased use of artificial lift, especially in the South American, Russian and Middle Eastern markets. The acquisition of ILS is consistent with the Company's long-term growth strategy of integrating strategic assets to leverage Lufkin's position of industry leadership. ILS has a solid reputation for high-quality products, customer responsiveness and long-standing relationships with major independent and super-major integrated companies. This provides an entry for Lufkin into the offshore market for artificial lift wells, including deepwater plays, and expanded reach into the artificial lift market.

### Power Transmission

Power Transmission services many diverse markets, with high-speed gearing for markets such as petrochemicals, refineries, offshore production and transmission of oil and slow-speed gearing for the gas, rubber, sugar, paper, steel, plastics, mining, cement and marine propulsion, each of which has its own unique set of drivers. Generally, if global industrial capacity utilizations are not high, spending on new equipment lags. Also impacting demand are government regulations involving safety and environmental issues that can require capital spending. Recent market demand increases have come from energy-related markets such as refining, petrochemical, drilling, coal, marine and power generation in response to higher global energy prices. During the latter part of 2008, energy prices decreased significantly, global growth slowed and large project financing became difficult to secure. New order booking declined in the first half of 2009, which negatively impacted sales starting in late 2009. While sales will remain at these lower levels during the first half of 2010, new order and quotation activity, especially from large LNG projects, during this period is expected to increase and should translate into higher sales in the latter half of 2010.

### Discontinued Operations

During the second quarter of 2008, the Trailer segment was classified as a discontinued operation. In January 2008, the Company announced the decision to suspend its participation in the commercial trailer markets and to develop a plan to run-out existing inventories, fulfill contractual obligations and close all trailer facilities in 2008. During the second quarter of 2008, this plan was completed, with the majority of the remaining inventory and manufacturing equipment sold and all facilities closed.

Trailer generated expense of \$0.5 million in 2009 and income of \$0.2 million and \$2.4 million, net of tax, during 2008, and 2007, respectively.

**Other**

During both 2009 and 2008, the Company booked a contingent liability provision of \$6.0 million (pre-tax) per year for its ongoing class-action lawsuit. For additional information, please see Part I, Item 3 of this Form 10-K.

**Summary of Results**

The Company generally monitors its performance through analysis of sales, gross margin (gross profit as a percentage of sales) and net earnings, as well as debt/equity levels, short-term debt levels, and cash balances

Overall, sales for 2009 decreased to \$521.4 million from \$741.2 million for 2008, or 29.7%, and were \$555.8 million for 2007. This decrease was primarily driven by decreased sales of Oil Field products and services in the U.S. market but also weakness in Power Transmission sales.

Gross margin for 2009 decreased to 21.6% from 28.9% for 2008 and 29.2% for 2007, primarily due to lower selling prices due to lower customer demand and the availability of surplus equipment combined with the negative impact of lower plant utilization in the Oilfield segment.

Higher selling, general and administrative expenses also negatively impacted net earnings, with these expenses increasing to \$75.1 million during 2009 from \$72.0 million during 2008 and \$57.6 million during 2007. This increase in 2009 was primarily related to resources added from the ILS and RMT acquisitions. As a percentage of sales, selling, general and administrative expenses increased to 14.4% during 2009 compared to 9.7% during 2008 and 10.4% during 2006. The Company has made the strategic decision to maintain employment levels in this area to focus on new product and geographic expansion opportunities. Operating income was also impacted by a litigation reserve of \$6.0 million during 2009 and \$6.0 million during 2008 related to its ongoing class-action lawsuit.

The Company reported net earnings from continuing operations of \$22.5 million, or \$1.51 per share (diluted), for 2009, compared to net earnings from continuing operations of \$88.0 million, or \$5.91 per share (diluted), for 2008, and net earnings from continuing operations of \$71.8 million, or \$4.76 per share (diluted), for 2007.

Debt/equity (long-term debt net of current portion as a percentage of total equity) levels were 0.3% as of December 31, 2009 and 0.0% as of December 31, 2008 and December 31, 2007. Cash balances at December 31, 2009, were \$100.9 million, down from \$107.8 million at December 31, 2008.

**Year Ended December 31, 2009 Compared to Year Ended December 31, 2008:**

The following table summarizes the Company's sales and gross profit by operating segment (in thousands of dollars):

| <u>Year Ended December 31</u> | <u>2009</u>       | <u>2008</u>       | <u>Increase/<br/>(Decrease)</u> | <u>% Increase/<br/>(Decrease)</u> |
|-------------------------------|-------------------|-------------------|---------------------------------|-----------------------------------|
| <u>Sales</u>                  |                   |                   |                                 |                                   |
| Oil Field                     | \$ 349,168        | \$ 551,814        | \$ (202,646)                    | (36.7)                            |
| Power Transmission            | 172,191           | 189,380           | (17,189)                        | (9.1)                             |
| Total                         | <u>\$ 521,359</u> | <u>\$ 741,194</u> | <u>\$ (219,835)</u>             | <u>(29.7)</u>                     |
| <u>Gross Profit</u>           |                   |                   |                                 |                                   |
| Oil Field                     | \$ 65,510         | \$ 153,673        | \$ (88,163)                     | (57.4)                            |
| Power Transmission            | 47,034            | 60,286            | (13,252)                        | (22.0)                            |
| Adjustment*                   | -                 | 115               | (115)                           | (100.0)                           |
| Total                         | <u>\$ 112,544</u> | <u>\$ 214,074</u> | <u>\$ (101,530)</u>             | <u>(47.4)</u>                     |

\*Due to the discontinuation of the Trailer segment, certain items previously allocated to that segment in cost of sales have been reclassified to continuing operations. The adjustment is related to pension and postretirement charges associated with Trailer personnel that will continue to be a liability in future years.

**Oil Field**

Oil Field sales decreased to \$349.2 million, or by 36.7%, for the year ended December 31, 2009, from \$551.8 million for the year ended December 31, 2008. New pumping unit sales of \$188.2 million during 2009 were down \$153.9 million, or 45.0%, compared to \$342.1 million during 2008, primarily from lower U.S. demand and pricing pressure. Pumping unit service sales of \$84.9 million during 2009 were down \$18.1 million, or 17.6%, compared to \$103.0 million during 2008, from declines in the U.S. market. Automation sales of \$51.4 million during 2009 were down \$30.9 million, or 37.5%, compared to \$82.4 million during 2008, from lower sales in the U.S. and pricing pressure. Commercial casting sales of \$9.3 million during 2009 were down \$15.1 million, or 61.6%, compared to \$24.4 million during 2008, from lower sales to the machine tool market. Sales from Lufkin ILS contributed \$15.3 million during 2009. Oil Field's backlog decreased to \$43.3 million as of December 31, 2009, from \$188.1 million at December 31, 2008. This decrease was caused primarily by lower orders for new pumping units as U.S. and international customers deferred or cancelled drilling programs in response to lower energy prices.

Gross margin (gross profit as a percentage of sales) for the Oil Field segment decreased to 18.8% for year ended December 31, 2009, compared to 27.8% for the year ended December 31, 2008, or 9.0 percentage points. This gross margin decrease was related to price reductions in response to material price decreases and lower customer demand and the negative impact of lower plant utilization on fixed cost coverage.

Direct selling, general and administrative expenses for Oil Field increased to \$26.7 million, or by 18.2%, for the year ended December 31, 2009, from \$22.6 million for the year ended December 31, 2008. The majority of this increase is related to higher international sales commissions as well as the resources added with the ILS acquisition. Direct selling, general and administrative expenses as a percentage of sales increased to 7.6% for the year ended December 31, 2009, from 4.1% for the year ended December 31, 2008.

**Power Transmission**

Sales for the Company's Power Transmission segment decreased to \$172.2 million, or by 9.1%, for the year ended December 31, 2009, compared to \$189.4 million for the year ended December 31, 2008. New unit sales of \$131.8 million during 2009 were down \$13.1 million, or 9.0%, compared to \$144.9 million during 2008. Repair and service sales of \$38.4 million during 2009 were down \$6.1 million, or 13.7%, compared to \$44.5 million during 2008 as customers deferred spending on maintenance projects due to poor economic conditions. Sales from Lufkin RMT contributed \$2.0 million during 2009. Power Transmission backlog at December 31, 2009, decreased to \$97.0 million from \$129.3 million at December 31, 2008, primarily from decreased bookings of new units for the energy-related and marine markets.

Gross margin for the Power Transmission segment decreased to 27.3% for the year ended December 31, 2009, compared to 31.8% for the year ended December 31, 2008, or 4.5 percentage points. This gross margin decrease was primarily from the unfavorable impact of lower production levels in manufacturing and repair on fixed cost coverage.

Direct selling, general and administrative expenses for Power Transmission remained at \$23.5 million for the year ended December 31, 2009, compared to the year ended December 31, 2008. However, direct selling, general and administrative expenses as a percentage of sales increased to 13.7% for the year ended December 31, 2009, from 12.4% for the year ended December 31, 2008.

### **Corporate/Other**

Corporate administrative expenses, which are allocated to the segments primarily based on budgeted sales levels, were \$24.9 million for the year ended December 31, 2009, a decrease of \$1.0 million or 4.0%, from \$25.9 million for the year ended December 31, 2008.

Interest income, interest expense and other income and expense for the year ended December 31, 2009, increased to \$1.6 million of income compared to \$0.3 million of income for the year ended December 31, 2008, from currency gains offsetting reduced interest income and increased interest expense.

Pension expense, which is reported as an increase in cost of sales, increased to \$10.7 million for the year ended December 31, 2009, compared to pension income of \$1.3 million for the year ended December 31, 2008. This expense increase was primarily due to lower expected returns on asset balances and the amortization of previously deferred market losses out of other comprehensive income. Pension expense in 2010 is expected to be consistent with 2009 levels.

The net tax rate for the year ended December 31, 2009, was 31.9%, compared to 35.5% for the year ended December 31, 2008. The net tax rate in 2009 benefitted from adjustments to prior period tax filings in the U.S., the settlement of the 2006 IRS tax audit, revised 199 manufacturing deduction claims and R&E tax credit estimate adjustments. The tax rate for 2010 is expected to be approximately 36.0%.

## Year Ended December 31, 2008 Compared to Year Ended December 31, 2007:

The following table summarizes the Company's sales and gross profit by operating segment (in thousands of dollars):

| Year Ended December 31 | 2008              | 2007              | Increase/<br>(Decrease) | % Increase/<br>(Decrease) |
|------------------------|-------------------|-------------------|-------------------------|---------------------------|
| <b>Sales</b>           |                   |                   |                         |                           |
| Oil Field              | \$ 551,814        | \$ 397,354        | \$ 154,460              | 38.9                      |
| Power Transmission     | 189,380           | 158,452           | 30,928                  | 19.5                      |
| Total                  | <u>\$ 741,194</u> | <u>\$ 555,806</u> | <u>\$ 185,388</u>       | 33.4                      |
| <b>Gross Profit</b>    |                   |                   |                         |                           |
| Oil Field              | \$ 153,673        | \$ 109,091        | \$ 44,582               | 40.9                      |
| Power Transmission     | 60,286            | 52,476            | 7,810                   | 14.9                      |
| Adjustment*            | 115               | 701               | (586)                   | (83.6)                    |
| Total                  | <u>\$ 214,074</u> | <u>\$ 162,268</u> | <u>\$ 51,806</u>        | 31.9                      |

\*Due to the discontinuation of the Trailer segment, certain items previously allocated to that segment in cost of sales have been reclassified to continuing operations. The adjustment is related to pension and postretirement charges associated with Trailer personnel that will continue to be a liability in future years.

### Oil Field

Oil Field sales increased to \$551.8 million, or by 38.9%, for the year ended December 31, 2008, from \$397.4 million for the year ended December 31, 2007. New unit sales of \$342.1 million during 2008 were up \$113.9 million, or 49.9%, compared to \$228.2 million during 2007, primarily from higher U.S. demand. Service sales of \$103.0 million during 2008 were up \$20.8 million, or 25.3%, compared to \$82.2 million during 2007, from growth in the U.S. market. Automation sales of \$82.4 million during 2008 were up \$25.5 million, or 44.8%, compared to \$56.9 million during 2007, from growth in U.S. sales. Commercial casting sales of \$24.4 million during 2008 were down \$5.7 million, or 19.0%, compared to \$30.1 million during 2007, from lower sales to the machine tool market. Oil Field's backlog also increased to \$188.1 million as of December 31, 2008, from \$76.9 million at December 31, 2007. This increase was driven by increased bookings for new units for the U.S. and Latin American markets as higher energy prices drove increased drilling and workover activity. Also, certain U.S. customers placed orders for new units to be shipped through the first half of 2009 versus their normal buying practice of ordering units as needed.

Gross margin (gross profit as a percentage of sales) for the Oil Field segment increased to 27.8%, or 0.3 percentage points, for year ended December 31, 2008, compared to 27.5% for the year ended December 31, 2007. This gross margin increase was related to price increases instituted to offset material price increases and the favorable mix effect of increased new unit sales, partially offset by higher raw material costs resulting in an increase to LIFO inventory reserves of \$4.1 million, or 0.7 percentage points of gross margin, related to the inflationary impact of higher raw material prices for steel and castings.

Direct selling, general and administrative expenses for Oil Field increased to \$22.6 million, or by 31.8%, for the year ended December 31, 2008, from \$17.1 million for the year ended December 31, 2007. This increase is due to higher employee-related expenses in support of increased sales volumes, third-party commissions and bad debt provisions. In the fourth quarter of 2008, a provision of \$1.2 million was made for the probable bankruptcy of a Middle East customer. However, direct selling, general and administrative expenses as a percentage of sales decreased to 4.1% for the year ended December 31, 2008, from 4.3% for the year ended December 31, 2007.

### Power Transmission

Sales for the Company's Power Transmission segment increased to \$189.4 million, or by 19.5%, for the year ended December 31, 2008, compared to \$158.5 million for the year ended December 31, 2007. New unit sales of \$144.9 million during 2008 were up \$24.7 million, or 20.5%, compared to \$120.2 million during 2007, from increased sales of high-speed units for the oil and gas markets and increased sales of marine units for the coastal, river and inland-waterway transportation markets. Repair and service sales of \$44.5 million during 2008 were up \$6.3 million, or 16.4%, compared to \$38.2 million during 2007. Power Transmission backlog at December 31, 2008, increased to \$129.3 million from \$122.2 million at December 31, 2007, primarily from increased bookings of new units for the energy-related and marine markets.

Gross margin for the Power Transmission segment decreased to 31.8%, or by 1.3 percentage points, for the year ended December 31, 2008, compared to 33.1% for the year ended December 31, 2007. This gross margin decrease was primarily from higher raw material costs resulting in additions to LIFO inventory reserves of \$1.7 million, or 0.9 percentage points of gross margin, related to the inflationary impact of higher raw material prices for steel and castings and from the unfavorable mix effect of increased marine unit sales.

Direct selling, general and administrative expenses for Power Transmission increased to \$23.5 million, or by 32.1%, for the year ended December 31, 2008, from \$17.8 million for the year ended December 31, 2007. This increase was due to higher employee-related expenses in support of increased sales volumes, third-party commissions in certain international markets and bad debt provisions. In the fourth quarter of 2008, a provision of \$1.2 million was made for the bankruptcy of a U.S. petrochemical customer. Direct selling, general and administrative expenses as a percentage of sales increased to 12.4% for the year ended December 31, 2008, from 11.2% for the year ended December 31, 2007.

### **Corporate/Other**

Corporate administrative expenses, which are allocated to the segments primarily based on historical third-party revenues, were \$25.9 million for the year ended December 31, 2008, an increase of \$3.2 million or 12.5%, from \$22.7 million for the year ended December 31, 2007, primarily from higher personnel-related expenses in support of sales volume growth and increased professional service fees.

Interest income, interest expense and other income and expense for the year ended December 31, 2008, decreased to \$0.3 million of income compared to income of \$4.8 million for the year ended December 31, 2007, primarily due to lower interest rates on invested cash balances and the unfavorable currency impact of the weakening Canadian dollar during 2008 compared to 2007.

Pension income, which is reported as a reduction of cost of sales, decreased to \$1.3 million for the year ended December 31, 2008, or by 60%, compared to \$3.3 million for the year ended December 31, 2007. This decrease was primarily due to lower expected returns on asset balances.

The net tax rate for the year ended December 31, 2008, was 35.5% compared to 34.4% for the year ended December 31, 2007. The net tax rate in 2007 benefitted from a reduction in tax reserves on items falling out of statute. Also, the 2008 net tax rate was unfavorably impacted by higher state taxes due to the mix of sales shifting towards higher-tax jurisdictions.

Due to the discontinuation of the Trailer segment, certain items previously allocated to that segment have been reclassified to continuing operations. One adjustment is related to pension and postretirement charges associated with Trailer personnel that will continue to be a liability in future years. The other adjustment is for corporate allocations previously charged to Trailer, as these expenses will continue in the future.

## Liquidity and Capital Resources

The Company has historically relied on cash flows from operations and third-party borrowing to finance its operations, including acquisitions, dividend payments and stock repurchases. The Company believes that its cash flows from operations and its available borrowing capacity under its credit agreements will be sufficient to fund its operations, including planned capital expenditures, dividend payments and stock repurchases, through December 31, 2010, and the foreseeable future.

The Company's cash balance totaled \$100.9 million at December 31, 2009, compared to \$107.8 million at December 31, 2008. For the year ended December 31, 2009, net cash provided by operating activities was \$101.8 million, net cash used in investing activities totaled \$91.8 million and net cash used in financing activities amounted to \$17.4 million. Significant components of cash provided by operating activities included net earnings from continuing operations, adjusted for non-cash expenses, of \$48.7 million and a decrease in working capital of \$53.1 million. This working capital decrease was primarily due to a reduction in trade receivables balances of \$59.3 million and inventory balances of \$28.7 million due to sales volumes declines since the fourth quarter of 2008, partially offset by reductions in accounts payable and accrued liabilities of \$29.4 million. Net cash used in investing activities included net capital expenditures totaling \$38.9 million and the ILS and RMT acquisitions totaling \$51.7 million. Capital expenditures in 2009 were primarily for new facilities to support geographical and product line expansions in the Oil Field and Power Transmission segments. Capital expenditures for 2010 are projected to approximately remain at the 2009 spending levels, primarily for the new facilities to support geographical and product line expansions and equipment replacement for efficiency improvements in the Oil Field and Power Transmission segments and will be funded by operating cash flows. The Company is reviewing additional international expansion opportunities that would require significant capital spending over several years, but these plans have not been finalized. Significant components of net cash used by financing activities included dividend payments of \$14.9 million, or \$1.00, per share and debt repayments of \$3.4 million.

The Company has a three-year credit facility with a domestic bank (the "Bank Facility") consisting of an unsecured revolving line of credit that provides up to \$40.0 million of aggregate borrowing. This Bank Facility expires on December 31, 2010. Borrowings under the Bank Facility bear interest, at the Company's option, at either the greater of (i) the prime rate, (ii) the base CD rate plus an applicable margin or (iii) the Federal Funds Effective Rate plus an applicable margin or the London Interbank Offered Rate plus an applicable margin, depending on certain ratios as defined in the Bank Facility. As of December 31, 2009, no debt was outstanding under the Bank Facility and the Company was in compliance with all financial covenants under the terms of the Bank Facility. Deducting outstanding letters of credit of \$16.4 million, \$23.6 million of borrowing capacity was available at December 31, 2009. The fair market value of the outstanding debt as of December 31, 2009 is not materially different than its carrying value.

The Company assumed various notes payable and entered into purchase price hold back agreements in conjunction with the ILS and RMT acquisitions in 2009. These obligations will require principal payments of \$1.3 million during 2010.

The following table summarizes the Company's expected cash outflows from financial contracts and commitments as of December 31, 2009. Information on recurring purchases of materials for use in manufacturing and service operations has not been included. These amounts are not long-term in nature (less than three months) and are generally consistent from year to year.

| (In thousands of dollars)                           |                  | Payments due by period |                 |                 |                      |
|-----------------------------------------------------|------------------|------------------------|-----------------|-----------------|----------------------|
| Contractual obligations                             | Total            | Less than<br>1 year    | 1 - 3<br>years  | 3 - 5<br>years  | More than<br>5 years |
| Operating lease obligations                         | \$ 9,748         | \$ 1,800               | \$ 1,997        | \$ 1,331        | \$ 4,620             |
| Contractual commitments<br>for capital expenditures | 6,105            | 6,105                  | -               | -               | -                    |
| Contractual debt obligations                        | 2,888            | 1,372                  | 1,516           | -               | -                    |
| Total                                               | <u>\$ 18,741</u> | <u>\$ 9,277</u>        | <u>\$ 3,513</u> | <u>\$ 1,331</u> | <u>\$ 4,620</u>      |

Since the Company has no significant tax loss carryforwards, the Company expects to make quarterly estimated tax payments in 2010 based on taxable income levels. Also, the Company has various qualified retirement plans for which the Company has committed a certain level of benefit. The Company expects to make contributions to its pension plans of \$5.4 million and to its post-retirement health and life plans of approximately \$0.6 million in 2010. Contribution levels to these plans after 2010 will depend on participation in the plans, possible plan changes, discount rates and actual rates of return on plan assets.

As discussed in Note 17 – "Business Segment Information" in the Notes to Consolidated Financial Statements, set forth in Part II, Item 6 of this Form 10-K, the Consolidated Balance Sheet at December 31, 2009 includes approximately \$1.5 million of

liabilities associated with uncertain tax positions in the jurisdictions in which Lufkin conducts business. Due to the uncertain and complex application of tax regulations, combined with the difficulty in predicting when tax audits throughout the world may be concluded, Lufkin cannot make reliable estimates of the timing of cash outflows relating to these liabilities.

### **Off-Balance Sheet Arrangements**

None.

### **Recently Issued Accounting Pronouncements**

In September 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009-13, *Revenue Recognition (Topic 605): Multiple – Deliverable Revenue Arrangements* – a consensus of the FASB Emerging Issues Task Force, which changes the accounting for certain revenue arrangements. The new requirements change the allocation methods used in determining how to account for multiple payment streams and will result in the ability to separately account for more deliverables, and potentially less revenue deferrals. Additionally, ASU 2009-13 requires enhanced disclosures in financial statements. ASU 2009-13 is effective for revenue arrangements enter into or materially modified in fiscal years beginning after June 15, 2010 on a prospective basis, with early application permitted. The Company is currently evaluating the impact ASU 2009-13 will have on our financial statements.

In December 2008, the FASB issued guidance under ASC 715, *Compensation – Retirement Benefits – Defined Benefit Plans*, requiring annual disclosure of major categories of plan assets, investment policies and strategies, fair value measurement of plan assets and significant concentration of credit risks related to defined benefit pension or other postretirement plans. This guidance is effective for fiscal years ending after December 15, 2009.

Management believes the impact of other recently issued guidance, which is not yet effective, will not have a material impact on the Company's consolidated financial statements upon adoption.

### **Critical Accounting Policies and Estimates**

The discussion and analysis of financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. The Company evaluates its estimates on an ongoing basis, based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. The Company believes the following critical accounting policies affect its more significant judgments and estimates used in preparation of its consolidated statements.

The Company extends credit to customers in the normal course of business. Management performs ongoing credit evaluations of our customers and adjusts credit limits based upon payment history and the customer's current credit worthiness. An allowance for doubtful accounts has been established to provide for estimated losses on receivable collections. The balance of this allowance is determined by regular reviews of outstanding receivables and historical experience. As the financial condition of customers change, circumstances develop or additional information becomes available, adjustments to the allowance for doubtful accounts may be required.

Revenue is not recognized until it is realized or realizable and earned. The criteria to meet this guideline are: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price to the buyer is fixed or determinable and collectibility is reasonably assured. In some cases, a customer is not able to take delivery of a completed product and requests that the Company store the product for a defined period of time. The Company will process a Bill-and-Hold invoice and recognize revenue at the time of the storage request if all of the following criteria are met:

- The customer has accepted title and risk of loss;
- The customer has provided a written purchase order for the product;
- The customer, not the Company, requested the product to be stored and to be invoiced under a Bill-and-Hold arrangement. The customer must also provide the business purpose for the storage request;
- The customer must provide a storage period and future shipping date;
- The Company must not have retained any future performance obligations on the product;
- The Company must segregate the stored product and not make it available to use on other orders; and
- The product must be completed and ready for shipment.

The Company has made significant investments in inventory to service its customers. On a routine basis, the Company uses estimates in determining the level of reserves required to state inventory at the lower of cost or market. Management's estimates are primarily influenced by market activity levels, production requirements, the physical condition of products and technological innovation. Changes in any of these factors may result in adjustments to the carrying value of inventory. Also, the Company accounts for a significant portion of its inventory under the LIFO method. The LIFO reserve can be impacted by changes in the LIFO layers and by inflation index adjustments. Generally, annual increases in the inflation rate or the FIFO value of inventory cause the value of the LIFO reserve to increase.

Long-lived assets held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company assesses the recoverability of long-lived assets by determining whether the carrying value can be recovered through projected undiscounted cash flows, based on expected future operating results. Future adverse market conditions or poor operating results could result in the inability to recover the current carrying value and thereby possibly requiring an impairment charge in the future.

Goodwill acquired in connection with business combinations represent the excess of consideration over the fair value of net assets acquired. The Company performs impairment tests on the carrying value of goodwill at least annually or whenever events or changes in circumstances indicate the carrying value of goodwill may be greater than fair value, such as significant underperformance relative to historical or projected operating results and significant negative industry or economic trends. The Company's fair value is primarily determined using discounted cash flows, which requires management to make judgments about future operating results, working capital requirements and capital spending levels. Changes in cash flow assumptions or other factors which negatively impact the fair value of the operations would influence the evaluation and may result in a determination that goodwill is impaired and a corresponding impairment charge.

The application of income tax law is inherently complex. The Company is required to determine if an income tax position meets the criteria of more-likely-than-not to be realized based on the merits of the position under tax laws, in order to recognize an income tax benefit. This requires the Company to make many assumptions and judgments regarding merits of income tax positions and the application of income tax law. Additionally, if a tax position meets the recognition criteria of more-likely-than-not the Company is required to make judgments and assumptions to measure the amount of the tax benefits to recognize based on the probability of the amount of tax benefits that would be realized if the tax position was challenged by the taxing authorities. Interpretations and guidance surrounding income tax laws and regulations change over time. As a consequence, changes in assumptions and judgments can materially affect amounts recognized in the consolidated financial statements.

Deferred tax assets and liabilities are recognized for the differences between the book basis and tax basis of the net assets of the Company. In providing for deferred taxes, management considers current tax regulations, estimates of future taxable income and available tax planning strategies. Changes in state, federal and foreign tax laws as well as changes in the financial position of the Company could also affect the carrying value of deferred tax assets and liabilities. If management estimates that some or all of any deferred tax assets will expire before realization or that the future deductibility is more-likely-than-not, a valuation allowance would be recorded.

The Company is subject to claims and legal actions in the ordinary course of business. The Company maintains insurance coverage for various aspects of its businesses and operations. The Company retains a portion of the insured losses that occur through the use of deductibles. Management regularly reviews estimates of reported and unreported insured and non-insured claims and legal actions and provides for losses through reserves. As circumstances develop and additional information becomes available, adjustments to loss reserves may be required.

The Company sells certain of its products to customers with a product warranty that provides repairs at no cost to the customer or the issuance of credit to the customer. The length of the warranty term depends on the product being sold, but ranges from one year to five years. The Company accrues its estimated exposure to warranty claims based upon historical warranty claim costs as a percentage of sales multiplied by prior sales still under warranty at the end of any period. Management reviews these estimates on a regular basis and adjusts the warranty provisions as actual experience differs from historical estimates or other information becomes available.

The Company offers defined benefit plans and other benefits upon the retirement of its employees. Assets and liabilities associated with these benefits are calculated by third-party actuaries under the rules provided by various accounting standards, with certain estimates provided by management. These estimates include the discount rate, expected rate of return of assets and the rate of increase of compensation and health claims. On a regular basis, management reviews these estimates by comparing them to actual experience and those used by other companies. If a change in an estimate is made, the carrying value of these assets and liabilities may have to be adjusted. Assuming all other variables held constant, differences in the discount rate and expected long-term rate of return on plan assets within reasonably likely ranges would have had the following estimated impact on 2009 results excluding the impact of curtailment:

| (Thousands of dollars)                                  | <u>Pension<br/>Benefits</u> | <u>Other<br/>Benefits</u> |
|---------------------------------------------------------|-----------------------------|---------------------------|
| <b><u>Discount rate</u></b>                             |                             |                           |
| Effect of change on net periodic benefit cost (income): |                             |                           |
| .25 percentage point increase                           | \$ (613)                    | \$ (16)                   |
| .25 percentage point decrease                           | 641                         | 10                        |
| Effect of change on PBO/APBO:                           |                             |                           |
| .25 percentage point increase                           | \$ (5,962)                  | \$ (195)                  |
| .25 percentage point decrease                           | 6,257                       | 203                       |
| <b><u>Long-term rate of return on plan assets</u></b>   |                             |                           |
| Effect of change on net periodic benefit cost (income): |                             |                           |
| .25 percentage point increase                           | \$ (429)                    | \$ -                      |
| .25 percentage point decrease                           | 429                         | -                         |

## Forward-Looking Statements and Assumptions

This annual report on Form 10-K contains forward-looking statements and information, within the meaning of the Private Securities Litigation Reform Act of 1995, that are based on management's beliefs as well as assumptions made by and information currently available to management. When used in this report, the words "will," "anticipate," "believe," "estimate," "expect," "plan," "schedule," "could," "may," "might," "should," "project" or similar expressions are intended to identify forward-looking statements. Similarly, statements that describe the Company's future plans, objectives or goals are also forward-looking statements. Such statements reflect the Company's current views with respect to certain events and are subject to certain assumptions, risks and uncertainties, many of which are outside the control of the Company. Undue reliance should not be placed on forward-looking statements. These risks and uncertainties include, but are not limited to:

- oil prices;
- declines in domestic and worldwide oil and gas drilling;
- capital spending levels of oil producers;
- availability and prices for raw materials;
- the inherent dangers and complexities of our operations;
- uninsured judgments or a rise in insurance premiums;
- the inability to effectively integrate acquisitions;
- labor disruptions and increasing labor costs;
- the availability of qualified and skilled labor;
- disruption of our operating facilities or management information systems;
- the impact on foreign operations of war, political disruption, civil disturbance, economic and legal sanctions and changes in global trade policies;
- currency exchange rate fluctuations in the markets in which the Company operates;
- changes in the laws, regulations, policies or other activities of governments, agencies and similar organizations where such actions may affect the production, licensing, distribution or sale of the Company's products, the cost thereof or applicable tax rates;
- costs related to legal and administrative proceedings, including adverse judgments against the Company if the Company fails to prevail in reversing such judgments; and
- general industry, political and economic conditions in the markets where the Company's procures material, components and supplies for the production of the Company's principal products or where the Company's products are produced, distributed or sold.

These and other risks are described in greater detail in "Risk Factors" included elsewhere in this annual report on Form 10-K. All forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by these factors. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, believed, estimated or expected. The Company undertakes no obligations to update or revise its forward-looking statements, whether as a result of new information, future events or otherwise.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

The Company's financial instruments include cash, accounts receivable, accounts payable, invested funds and debt obligations. The book value of accounts receivable, short-term debt and accounts payable are considered to be representative of their fair market value because of the short maturity of these instruments. While the Company's accounts receivable are concentrated with customers in the energy industry the Company performs credit evaluations on current and potential customers and adjusts credit limits as appropriate. In certain circumstances the Company will obtain collateral to mitigate higher credit risk.

The Company does not utilize financial or derivative instruments for trading purposes or to hedge exposures to interest rates, foreign currency rates or commodity prices. Due to the lack of current debt, the Company does not have any significant exposure to interest rate fluctuations. However, if the Company drew on its line of credit under its Bank Facility, the Company would have exposure since the interest rate is variable. In addition, the Company primarily invoices and purchases in the same currency as the functional currency of its operations, which minimizes exposure to currency rate fluctuations.

The Company uses large amounts of steel, iron and electricity in the manufacture of its products. The price of these raw materials has a significant impact on the cost of producing products. Steel and electricity prices have increased significantly in the last five years, caused primarily by higher energy prices and increased global demand. Since most of the Company's suppliers are not currently parties to long-term contracts with us, the Company is vulnerable to fluctuations in prices of such raw materials. Factors such as supply and demand, freight costs and transportation availability, inventory levels of brokers and dealers, the level of imports and general economic conditions may affect the price of cast iron and steel. Raw material prices may increase significantly in the future. Certain items such as steel round, bearings and aluminum have continued to experience price increases, price volatility and longer lead times. If the Company is unable to pass future raw material price increases on to its customers, margins, results of operations, cash flow and financial condition could be adversely affected.

The Company is exposed to currency fluctuations with intercompany debt denominated in U.S. dollars owed by its French and Canadian subsidiaries. As of December 31, 2009, this inter-company debt was comprised of a \$0.3 million receivable and a \$7.7 million payable from France and Canada, respectively. As of December 31, 2009, if the U.S. dollar strengthened by 10% over these currencies, the net income impact would be \$0.5 million of expense and if the U.S. dollar weakened by 10% over these currencies, the net income impact would be \$0.5 million of income. Also, certain assets and liabilities, primarily employee and tax related in Argentina, denominated in the local currency of foreign operations whose functional currency is the U.S. dollar are exposed to fluctuations in currency rates. As of December 31, 2009, if the U.S. dollar strengthened by 10% over these currencies, the net income impact would be \$0.1 million of expense and if the U.S. dollar weakened by 10% over these currencies, the net income impact would be \$0.1 million of income.

## **Item 8. Financial Statements and Supplementary Data**

### **Management's Report on Internal Control over Financial Reporting**

The management of Lufkin Industries, Inc. (the "Company"), is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and Rule 15d-15(f) promulgated under the Securities Exchange Act of 1934, as amended). The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2009. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in "Internal Control- Integrated Framework."

Based on this assessment, management believes that, as of December 31, 2009, the Company's internal control over financial reporting is effective based on those criteria.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2009, has been audited by Deloitte & Touche LLP, an independent registered accounting firm, as stated in their report which appears herein.

### **Index to Financial Statements**

Report of Independent Registered Public Accounting Firm  
Consolidated Balance Sheets  
Consolidated Statements of Earnings  
Consolidated Statements of Shareholders' Equity & Comprehensive Income  
Consolidated Statements of Cash Flows  
Notes to Consolidated Financial Statements

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Lufkin Industries, Inc.  
Lufkin, Texas

We have audited the accompanying consolidated balance sheets of Lufkin Industries, Inc. and subsidiaries (the "Company") as of December 31, 2009 and 2008, and the related consolidated statements of earnings, stockholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2009. Our audits also included the financial statement schedule listed in the Index at Item 15. We also have audited the Company's internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting at Item 8. Our responsibility is to express an opinion on these financial statements and financial statement schedule and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lufkin Industries, Inc. and subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

DELOITTE & TOUCHE LLP

Houston, Texas  
March 1, 2010

# **LUFKIN INDUSTRIES, INC.** **CONSOLIDATED BALANCE SHEETS**

December 31, 2009 and 2008

(Thousands of dollars, except share and per share data)

|                                                                                                                                   | <u>2009</u>       | <u>2008</u>       |
|-----------------------------------------------------------------------------------------------------------------------------------|-------------------|-------------------|
| Assets                                                                                                                            |                   |                   |
| Current Assets:                                                                                                                   |                   |                   |
| Cash and cash equivalents                                                                                                         | \$ 100,858        | \$ 107,756        |
| Receivables, net                                                                                                                  | 92,506            | 139,144           |
| Income tax receivable                                                                                                             | 4,303             | 978               |
| Inventories                                                                                                                       | 110,605           | 128,627           |
| Deferred income tax assets                                                                                                        | 5,198             | 4,941             |
| Other current assets                                                                                                              | 4,351             | 3,674             |
| Current assets from discontinued operations                                                                                       | 811               | 618               |
| Total current assets                                                                                                              | <u>318,632</u>    | <u>385,738</u>    |
| Property, plant and equipment, net                                                                                                | 159,770           | 130,079           |
| Goodwill, net                                                                                                                     | 45,001            | 11,862            |
| Other assets, net                                                                                                                 | 18,187            | 2,546             |
| Long-term assets from discontinued operations                                                                                     | -                 | 493               |
| Total assets                                                                                                                      | <u>\$ 541,590</u> | <u>\$ 530,718</u> |
| Liabilities and Shareholders' Equity                                                                                              |                   |                   |
| Current liabilities:                                                                                                              |                   |                   |
| Accounts payable                                                                                                                  | \$ 19,993         | \$ 38,543         |
| Current portion of long-term debt                                                                                                 | 1,372             | -                 |
| Accrued liabilities:                                                                                                              |                   |                   |
| Payroll and benefits                                                                                                              | 9,568             | 14,046            |
| Warranty expenses                                                                                                                 | 4,220             | 3,586             |
| Taxes payable                                                                                                                     | 4,562             | 5,894             |
| Other                                                                                                                             | 24,147            | 25,340            |
| Current liabilities from discontinued operations                                                                                  | 1,026             | 1,404             |
| Total current liabilities                                                                                                         | <u>64,888</u>     | <u>88,813</u>     |
| Long-term debt                                                                                                                    | 1,516             | -                 |
| Deferred income tax liabilities                                                                                                   | 10,950            | 9,219             |
| Postretirement benefits                                                                                                           | 7,874             | 7,070             |
| Other liabilities                                                                                                                 | 20,647            | 11,618            |
| Commitments and contingencies                                                                                                     | -                 | -                 |
| Long-term liabilities from discontinued operations                                                                                | 37                | 61                |
| Shareholders' equity:                                                                                                             |                   |                   |
| Common stock, \$1.00 par value per share; 60,000,000 shares authorized;<br>15,808,588 and 15,791,963 shares issued , respectively | 15,809            | 15,792            |
| Capital in excess par                                                                                                             | 70,508            | 63,014            |
| Retained earnings                                                                                                                 | 421,908           | 414,748           |
| Treasury stock, 923,168 and 931,168 shares, respectively, at cost                                                                 | (34,621)          | (34,917)          |
| Accumulated other comprehensive income (loss)                                                                                     | (37,926)          | (44,700)          |
| Total shareholders' equity                                                                                                        | <u>435,678</u>    | <u>413,937</u>    |
| Total liabilities and shareholders' equity                                                                                        | <u>\$ 541,590</u> | <u>\$ 530,718</u> |

See notes to consolidated financial statements.

# LUFKIN INDUSTRIES, INC.

## CONSOLIDATED STATEMENTS OF EARNINGS

Years ended December 31, 2009, 2008 and 2007  
(Thousands of dollars, except per share data)

|                                                                 | 2009                    | 2008                    | 2007                    |
|-----------------------------------------------------------------|-------------------------|-------------------------|-------------------------|
| Sales                                                           | \$ 521,359              | \$ 741,194              | \$ 555,806              |
| Cost of sales                                                   | <u>408,815</u>          | <u>527,120</u>          | <u>393,538</u>          |
| Gross profit                                                    | 112,544                 | 214,074                 | 162,268                 |
| Selling, general and administrative expenses                    | 75,120                  | 71,974                  | 57,582                  |
| Litigation reserve                                              | <u>6,000</u>            | <u>6,000</u>            | <u>-</u>                |
| Operating income                                                | 31,424                  | 136,100                 | 104,686                 |
| Interest income                                                 | 899                     | 1,737                   | 3,751                   |
| Interest expense                                                | (650)                   | (193)                   | (273)                   |
| Other income (expense), net                                     | <u>1,339</u>            | <u>(1,232)</u>          | <u>1,294</u>            |
| Earnings from continuing operations before income tax provision | 33,012                  | 136,412                 | 109,458                 |
| Income tax provision                                            | <u>10,533</u>           | <u>48,387</u>           | <u>37,673</u>           |
| Earnings from continuing operations                             | 22,479                  | 88,025                  | 71,785                  |
| (Loss) earnings from discontinued operations, net of tax        | <u>(453)</u>            | <u>214</u>              | <u>2,426</u>            |
| Net earnings                                                    | <u><u>\$ 22,026</u></u> | <u><u>\$ 88,239</u></u> | <u><u>\$ 74,211</u></u> |
| Basic earnings per share                                        |                         |                         |                         |
| Earnings from continuing operations                             | \$ 1.51                 | \$ 5.96                 | \$ 4.82                 |
| (Loss) earnings from discontinued operations                    | <u>(0.03)</u>           | <u>0.01</u>             | <u>0.16</u>             |
| Net earnings                                                    | <u><u>\$ 1.48</u></u>   | <u><u>\$ 5.97</u></u>   | <u><u>\$ 4.98</u></u>   |
| Diluted earnings per share                                      |                         |                         |                         |
| Earnings from continuing operations                             | \$ 1.51                 | \$ 5.91                 | \$ 4.76                 |
| (Loss) earnings from discontinued operations                    | <u>(0.03)</u>           | <u>0.01</u>             | <u>0.16</u>             |
| Net earnings                                                    | <u><u>\$ 1.48</u></u>   | <u><u>\$ 5.92</u></u>   | <u><u>\$ 4.92</u></u>   |

See notes to consolidated financial statements.

**LUFKIN INDUSTRIES, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY & COMPREHENSIVE INCOME**

| Years Ended December 31, 2009, 2008<br>and 2007<br>(Thousands of dollars, except share data) | Common                              |                 | Capital             |                      | Treasury    | Compre-<br>hensive<br>Income | Accumulated<br>Other<br>Compre-<br>hensive<br>Income (Loss) |  | Total      |
|----------------------------------------------------------------------------------------------|-------------------------------------|-----------------|---------------------|----------------------|-------------|------------------------------|-------------------------------------------------------------|--|------------|
|                                                                                              | Stock<br>Shares, net<br>of Treasury | Common<br>Stock | In Excess<br>of Par | Retained<br>Earnings |             |                              |                                                             |  |            |
| <b>Balance, Dec. 31, 2006</b>                                                                | 14,927,625                          | \$ 15,323       | \$ 38,173           | \$ 280,198           | \$ (4,083)  |                              | \$ (1,471)                                                  |  | \$ 328,140 |
| Comprehensive income:                                                                        |                                     |                 |                     |                      |             |                              |                                                             |  |            |
| Net earnings                                                                                 |                                     |                 |                     | 74,211               |             | 74,211                       |                                                             |  | 74,211     |
| Other comprehensive income, net of tax:                                                      |                                     |                 |                     |                      |             |                              |                                                             |  |            |
| Foreign currency translation adjustments                                                     |                                     |                 |                     |                      |             | 5,057                        | 5,057                                                       |  | 5,057      |
| Defined benefit pension plans                                                                |                                     |                 |                     |                      |             | 6,979                        | 6,979                                                       |  | 6,979      |
| Defined benefit post-retirement plans                                                        |                                     |                 |                     |                      |             | 504                          | 504                                                         |  | 504        |
| Total comprehensive income                                                                   |                                     |                 |                     |                      |             | <u>\$ 86,751</u>             |                                                             |  |            |
| Cash dividends                                                                               |                                     |                 |                     | (13,094)             |             |                              |                                                             |  | (13,094)   |
| Treasury stock purchases                                                                     | (500,000)                           |                 |                     |                      | (27,497)    |                              |                                                             |  | (27,497)   |
| Stock-based compensation                                                                     |                                     |                 | 3,682               |                      |             |                              |                                                             |  | 3,682      |
| Exercise of stock options                                                                    | 211,281                             | 211             | 6,460               |                      |             |                              |                                                             |  | 6,671      |
| <b>Balance, Dec. 31, 2007</b>                                                                | 14,638,906                          | \$ 15,534       | \$ 48,315           | \$ 341,315           | \$ (31,580) |                              | \$ 11,069                                                   |  | \$ 384,653 |
| Comprehensive income:                                                                        |                                     |                 |                     |                      |             |                              |                                                             |  |            |
| Net earnings                                                                                 |                                     |                 |                     | 88,239               |             | 88,239                       |                                                             |  | 88,239     |
| Other comprehensive income, net of tax:                                                      |                                     |                 |                     |                      |             |                              |                                                             |  |            |
| Foreign currency translation adjustments                                                     |                                     |                 |                     |                      |             | (5,503)                      | (5,503)                                                     |  | (5,503)    |
| Defined benefit pension plans                                                                |                                     |                 |                     |                      |             | (50,142)                     | (50,142)                                                    |  | (50,142)   |
| Defined benefit post-retirement plans                                                        |                                     |                 |                     |                      |             | (124)                        | (124)                                                       |  | (124)      |
| Total comprehensive income                                                                   |                                     |                 |                     |                      |             | <u>\$ 32,470</u>             |                                                             |  |            |
| Cash dividends                                                                               |                                     |                 |                     | (14,806)             |             |                              |                                                             |  | (14,806)   |
| Treasury stock purchases                                                                     | (71,890)                            |                 |                     |                      | (4,623)     |                              |                                                             |  | (4,623)    |
| Stock-based compensation                                                                     |                                     |                 | 3,584               |                      |             |                              |                                                             |  | 3,584      |
| Exercise of stock options                                                                    | 293,779                             | 258             | 11,115              |                      | 1,286       |                              |                                                             |  | 12,659     |
| <b>Balance, Dec. 31, 2008</b>                                                                | 14,860,795                          | \$ 15,792       | \$ 63,014           | \$ 414,748           | \$ (34,917) |                              | \$ (44,700)                                                 |  | \$ 413,937 |
| Comprehensive income:                                                                        |                                     |                 |                     |                      |             |                              |                                                             |  |            |
| Net earnings                                                                                 |                                     |                 |                     | 22,026               |             | 22,026                       |                                                             |  | 22,026     |
| Other comprehensive income, net of tax:                                                      |                                     |                 |                     |                      |             |                              |                                                             |  |            |
| Foreign currency translation adjustments                                                     |                                     |                 |                     |                      |             | 3,525                        | 3,525                                                       |  | 3,525      |
| Defined benefit pension plans                                                                |                                     |                 |                     |                      |             | 3,993                        | 3,993                                                       |  | 3,993      |
| Defined benefit post-retirement plans                                                        |                                     |                 |                     |                      |             | (744)                        | (744)                                                       |  | (744)      |
| Total comprehensive income                                                                   |                                     |                 |                     |                      |             | <u>\$ 28,800</u>             |                                                             |  |            |
| Cash dividends                                                                               |                                     |                 |                     | (14,866)             |             |                              |                                                             |  | (14,866)   |
| Treasury stock purchases                                                                     |                                     |                 |                     |                      | 11          |                              |                                                             |  | 11         |
| Tax settlement on stock-based compensation                                                   |                                     |                 | 3,880               |                      |             |                              |                                                             |  | 3,880      |
| Stock-based compensation                                                                     |                                     |                 | 2,943               |                      |             |                              |                                                             |  | 2,943      |
| Exercise of stock options                                                                    | 24,626                              | 17              | 671                 |                      | 285         |                              |                                                             |  | 973        |
| <b>Balance, Dec. 31, 2009</b>                                                                | 14,885,421                          | \$ 15,809       | \$ 70,508           | \$ 421,908           | \$ (34,621) |                              | \$ (37,926)                                                 |  | \$ 435,678 |

See notes to consolidated financial statements.

# LUFKIN INDUSTRIES, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2009, 2008 and 2007

(Thousands of dollars)

|                                                                                 | 2009       | 2008       | 2007      |
|---------------------------------------------------------------------------------|------------|------------|-----------|
| Cash flows from operating activities:                                           |            |            |           |
| Net earnings                                                                    | \$ 22,026  | \$ 88,239  | \$ 74,211 |
| Adjustments to reconcile net earnings to cash provided by operating activities: |            |            |           |
| Depreciation and amortization                                                   | 18,457     | 15,699     | 14,008    |
| (Recovery) provision for losses on receivables                                  | (1,840)    | 2,508      | 11        |
| LIFO (income) expense                                                           | (2,964)    | 7,742      | 1,905     |
| Deferred income tax (benefit)/provision                                         | (913)      | (3)        | 7,250     |
| Excess tax benefit from share-based compensation                                | (259)      | (4,140)    | (3,031)   |
| Share-based compensation expense                                                | 2,943      | 3,584      | 3,682     |
| Pension expense (income)                                                        | 10,665     | (1,274)    | (3,257)   |
| Postretirement expense (income)                                                 | 539        | (48)       | (400)     |
| (Gain) loss on disposition of property, plant and equipment                     | (354)      | 27         | (636)     |
| Loss (income) from discontinued operations                                      | 453        | (214)      | (2,426)   |
| Changes in:                                                                     |            |            |           |
| Receivables, net                                                                | 58,461     | (52,554)   | (2,928)   |
| Income tax receivable                                                           | (3,248)    | 1,409      | (4,573)   |
| Inventories                                                                     | 28,650     | (46,151)   | (15,596)  |
| Other current assets                                                            | (1,376)    | (2,144)    | 177       |
| Accounts payable                                                                | (22,878)   | 24,201     | 7,788     |
| Accrued liabilities                                                             | (6,531)    | 12,060     | 13,532    |
| Net cash provided by continuing operations                                      | 101,831    | 48,941     | 89,717    |
| Net cash (used in) provided by discontinued operations                          | -          | (1,813)    | 593       |
| Net cash provided by operating activities                                       | 101,831    | 47,128     | 90,310    |
| Cash flows from investing activities:                                           |            |            |           |
| Additions to property, plant and equipment                                      | (39,825)   | (29,552)   | (18,815)  |
| Proceeds from disposition of property, plant and equipment                      | 923        | 219        | 1,383     |
| (Increase) decrease in other assets                                             | (1,216)    | 579        | (64)      |
| Acquisition of other companies                                                  | (51,658)   | -          | -         |
| Net cash used in continuing operations                                          | (91,776)   | (28,754)   | (17,496)  |
| Net cash provided by (used in) discontinued operations                          | -          | 1,813      | (593)     |
| Net cash used in investing activities                                           | (91,776)   | (26,941)   | (18,089)  |
| Cash flows from financing activities:                                           |            |            |           |
| Payments of notes payable                                                       | (3,426)    | -          | -         |
| Dividends paid                                                                  | (14,866)   | (14,806)   | (13,094)  |
| Excess tax benefit from share-based compensation                                | 259        | 4,140      | 3,031     |
| Proceeds from exercise of stock options                                         | 612        | 8,295      | 3,467     |
| Purchases of treasury stock                                                     | 11         | (4,623)    | (27,497)  |
| Net cash used in financing activities                                           | (17,410)   | (6,994)    | (34,093)  |
| Effect of translation on cash and cash equivalents                              | 457        | (1,185)    | (177)     |
| Net (decrease) increase in cash and cash equivalents                            | (6,898)    | 12,008     | 37,951    |
| Cash and cash equivalents at beginning of period                                | 107,756    | 95,748     | 57,797    |
| Cash and cash equivalents at end of period                                      | \$ 100,858 | \$ 107,756 | \$ 95,748 |

See notes to consolidated financial statements.

## LUFKIN INDUSTRIES, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### (1) Corporate Organization and Summary of Significant Accounting Policies

Lufkin Industries, Inc. and its consolidated subsidiaries (collectively, the "Company") manufacture and sell oil field pumping units and power transmission products throughout the world.

**Principles of consolidation:** The consolidated financial statements include the accounts of Lufkin Industries, Inc. and its consolidated subsidiaries after elimination of all inter-company accounts and transactions.

**Use of estimates:** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

**Foreign currencies:** Assets and liabilities of foreign operations where the applicable foreign currency is the functional currency are translated into U.S. dollars at the exchange rate in effect at the end of each accounting period, with any resulting gain or loss reflected in accumulated other comprehensive income (loss) in the shareholders' equity section of the balance sheet. Income statement accounts are translated at the average exchange rates prevailing during the period. Gains and losses resulting from balance sheet remeasurement of foreign operations where the U.S. dollar is the functional currency are included in the consolidated statement of earnings as incurred.

Any gains or losses on transactions denominated in a foreign currency are included in the consolidated statements of earnings as incurred.

**Cash equivalents:** The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents.

**Revenue recognition:** Revenue is not recognized until it is realized or realizable and earned. The criteria to meet this guideline are: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price to the buyer is fixed or determinable and collectibility is reasonably assured. The Company will process a Bill-and-Hold invoice and recognize revenue at the time of the storage request if all of the following criteria are met:

- The customer has accepted title and risk of loss;
- The customer has provided a written purchase order for the product;
- The customer, not the Company, requested the product to be stored and to be invoiced under a Bill-and-Hold arrangement. The customer must also provide the business purpose for the storage request;
- The customer must provide a storage period and future shipping date;
- The Company must not have retained any future performance obligations on the product;
- The Company must segregate the stored product and not make it available to use on other orders; and
- The product must be completed and ready for shipment.

Amounts billed for shipping are classified as sales and costs incurred for shipping are classified as cost of sales in the consolidated statements of earnings.

**Accounts & Notes Receivable and Allowance for Doubtful Accounts:** Accounts and notes receivable are stated at cost net of write-offs and allowance for doubtful accounts. The Company establishes an allowance for doubtful accounts based on historical experience and any specific customer issues that the Company has identified. Uncollected receivables are generally reserved before being past due over one year or when the Company has determined that the balance will not be collected.

**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. On a routine basis, the Company uses estimates in determining the level of reserves required to state inventory at the lower of cost or market. Management's estimates are primarily influenced by market activity levels, production requirements, the physical condition of products and technological innovation. Changes in any of these factors may result in adjustments to the carrying value of inventory.

**(1) Corporate Organization and Summary of Significant Accounting Policies (Continued)**

**Property, plant and equipment (P. P. & E.):** The Company records investments in these assets at cost. Improvements are capitalized, while repair and maintenance costs are charged to operations as incurred. Gains or losses realized on the sale or retirement of these assets are reflected in income. The Company periodically reviews its P. P. & E. for possible impairment whenever events or changes in circumstance might indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized if the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. 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. The following is a summary of the Company's P. P. & E. useful lives:

|                                 | Useful Life<br>(in years) |
|---------------------------------|---------------------------|
| Land                            | -                         |
| Land improvements               | 10.0 - 25.0               |
| Buildings                       | 12.5 - 40.0               |
| Machinery and equipment         | 3.0 - 15.0                |
| Furniture and fixtures          | 5.0 - 12.5                |
| Computer equipment and software | 3.0 - 7.0                 |

**Change in Accounting Policy:** We perform our goodwill impairment test at least annually and more often if events or changes in circumstances indicate it is more likely than not that its carrying value exceeds its fair value. Since the adoption of ASC 350, *Intangibles – Goodwill and Other* through March 1, 2009, we have performed the annual impairment testing of goodwill using March 1 as the measurement date. Our financial and strategic planning process, including the preparation of long-term cash flow projections, commences in September and typically concludes in November of the same year. These long-term cash flow projections are a key component in performing our annual impairment test of goodwill. As a result, conducting the annual impairment test using a March 1 measurement date has resulted in inefficiencies and duplicative efforts on our resources. Accordingly, effective in October 2009, we have changed our goodwill impairment measurement date from March 1 to October 31. In the current year, we tested our goodwill for impairment on October 31, 2009 and March 1, 2009, and concluded there was no impairment of the carrying value of the goodwill. In addition, based on the results of impairment tests performed in fiscal years 2008 and 2007, the Company concluded there was no impairment of the carrying value of the goodwill in the prior periods presented in the consolidated financial statements. We believe that using the October 31 measurement date will better align our resources with the completion of our long-term financial projections. We believe that this accounting change is to an alternative accounting principle that is preferable under the circumstances and does not result in the delay, acceleration or avoidance of an impairment charge. We have determined that this change in accounting principle does not result in adjustments to our consolidated financial statements when applied retrospectively.

**Goodwill and other intangible assets:** Goodwill and intangible assets with indefinite lives are not amortized, and are tested for impairment at least annually. During the fourth quarter of 2009, the Company completed its annual impairment evaluation by comparing the fair value of each reporting unit to its carrying amount. No impairment was recorded.

The Company amortizes intangible assets with finite lives over the years expected to be benefited.

**Income taxes:** The Company computes taxes on income in accordance with the tax rules and regulations of the many taxing jurisdictions where the income is earned. The income tax rates imposed by these taxing authorities vary substantially. Taxable income may differ from pretax income for financial accounting purposes. To the extent that differences are due to revenue or expense items reported in one period for tax purposes and in another period for financial accounting purposes, an appropriate provision for deferred income taxes is made. Any effect of changes in income tax rates or tax laws is included in the provision for income taxes in the period of enactment. When it is more likely than not that a portion or all of a deferred tax asset will not be realized in the future, the Company provides a corresponding valuation allowance against deferred tax assets.

Appropriate U.S. and foreign income taxes have been provided for earnings of foreign subsidiary companies that are expected to be remitted in the near future. The cumulative amount of undistributed earnings of foreign subsidiaries that the Company intends to permanently reinvest and upon which no deferred US income taxes have been provided is \$70.0 million at December 31, 2009, the majority of which has been generated in Argentina, Canada and France. Upon distribution of these earnings in the form of dividends or otherwise, the Company may be subject to US income taxes (subject to adjustment for foreign tax credits) and foreign withholding taxes. It is not practical, however, to estimate the amount of taxes that may be payable on the eventual remittance of these earnings after consideration of available foreign tax credits.

The Company is required to determine if an income tax position meets the criteria of more-likely-than-not to be realized based on the merits of the position under tax laws, in order to recognize an income tax benefit. This requires the Company to make many assumptions and judgments regarding merits of income tax positions and the application of income tax law. Additionally, if a tax position meets the recognition criteria of more-likely-than-not the Company is required to make judgments and assumptions to measure the amount of the tax benefits to recognize based on the probability of the amount of tax benefits that would be realized if the tax position was challenged by the taxing authorities. Interpretations and guidance surrounding income tax laws and regulations change over time. As a consequence, changes in assumptions and judgments can materially affect amounts recognized in the consolidated financial statements.

**Financial instruments:** The Company's financial instruments include cash, accounts receivable, and accounts payable. The book value of accounts receivable, short-term debt and accounts payable are considered to be representative of their fair value because of the short maturity of these instruments. As of December 31, 2009 and 2008, the Company had no derivative financial instruments.

**Stock-based compensation:** Employee services received in exchange for stock are expensed. The fair value of the employee services received in exchange for stock is measured based on the grant-date fair value. The fair value is estimated using the Black-Scholes option-pricing model for the stock option. Awards granted are expensed pro-ratably over the service period of the award. As stock based compensation expense is recognized based on awards ultimately expected to vest, compensation expense is reduced for estimated forfeitures based on historical forfeiture rates. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods to reflect actual forfeitures.

**Product warranties:** The Company sells certain of its products to customers with a product warranty that provides repairs at no cost to the customer or the issuance of credit to the customer. The length of the warranty term depends on the product being sold, but ranges from one year to five years. The Company accrues its estimated exposure to warranty claims based upon historical warranty claim costs as a percentage of sales multiplied by prior sales still under warranty at the end of any period. Management reviews these estimates on a regular basis and adjusts the warranty provisions as actual experience differs from historical estimates or other information becomes available.

#### **Recently issued accounting pronouncements:**

In September 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009-13, *Revenue Recognition (Topic 605): Multiple – Deliverable Revenue Arrangements* – a consensus of the FASB Emerging Issues Task Force, which changes the accounting for certain revenue arrangements. The new requirements change the allocation methods used in determining how to account for multiple payment streams and will result in the ability to separately account for more deliverables, and potentially less revenue deferrals. Additionally, ASU 2009-13 requires enhanced disclosures in financial statements. ASU 2009-13 is effective for revenue arrangements enter into or materially modified in fiscal years beginning after June 15, 2010 on a prospective basis, with early application permitted. The Company is currently evaluating the impact ASU 2009-13 will have on our financial statements.

In December 2008, the FASB issued guidance under ASC 715, *Compensation – Retirement Benefits – Defined Benefit Plans*, requiring annual disclosure of major categories of plan assets, investment policies and strategies, fair value measurement of plan assets and significant concentration of credit risks related to defined benefit pension or other postretirement plans. This guidance is effective for fiscal years ending after December 15, 2009. See Footnote 10 "Retirement Benefits" for new disclosure requirements.

Management believes the impact of other recently issued guidance, which is not yet effective, will not have a material impact on the Company's consolidated financial statements upon adoption

## (2) Acquisitions

On March 1, 2009, the Company completed the acquisition of International Lift Systems, LLC ("ILS"), a Louisiana limited partnership. ILS manufactures and services gas lift, plunger lift and completion equipment for the oil and gas industry.

On July 1, 2009 the Company completed the acquisition of Rotating Machinery Technology, Inc. ("RMT"), a New York corporation. RMT is a recognized leader in the turbo-machinery industry, specializing in the analysis design and manufacture of precision, custom-engineered tilting-pad bearings and related components for high-speed turbo equipment operating in critical duty applications. RMT also services, repairs and upgrades turbo-expander process units for air and gas separation, both on-site with its skilled field service team and at its repair facility in Wellsville, New York.

The ILS and RMT acquisitions have been recorded using the acquisition method of accounting and, accordingly, the acquired operations have been included in the results of operations since the date of acquisition. The preliminary purchase price consideration consists of the following (in thousands of dollars):

|                           |                         |
|---------------------------|-------------------------|
| Cash paid at closing, net | \$ 51,658               |
| Holdback consideration    | <u>4,500</u>            |
| Total consideration paid  | <u><u>\$ 56,158</u></u> |

The following table indicates (in thousands of dollars) the preliminary purchase price allocation to net assets acquired, which was based on estimated fair values as of the acquisition date. The excess of the purchase price over the net assets acquired amount to \$33.1 million and has been recorded as goodwill in the accompanying December 31, 2009, consolidated balance sheet. Based on the structure of the transaction, the majority of the goodwill related to the transaction is not expected to be deductible for tax purposes.

|                                      |                         |
|--------------------------------------|-------------------------|
| Purchase price                       | <u><u>\$ 56,158</u></u> |
| Receivables                          | 5,786                   |
| Inventories                          | 5,705                   |
| Other current assets                 | 1,225                   |
| Deferred tax asset                   | 80                      |
| Property, plant and equipment        | 5,794                   |
| Intangible assets                    | 15,280                  |
| Accounts payable                     | (2,426)                 |
| Other short-term accrued liabilities | (575)                   |
| Other long-term accrued liabilities  | (363)                   |
| Deferred tax liability               | (1,100)                 |
| Long-term debt                       | <u>(6,314)</u>          |
| Goodwill recorded                    | <u><u>\$ 33,066</u></u> |

The Company also entered into a hold back agreement with the former owners of ILS. The total hold back is \$4.5 million payable in three equal installments of \$1.5 million each plus interest. Interest is calculated annually at 4% of the remaining balance of the hold back portion. The first installment is due March 1, 2010; the second and third installments, each plus interest to date, are payable on March 1, 2011 and 2012, respectively. These hold back payments are not contingent upon any subsequent events. At December 31, 2009, the liabilities for these hold back payments were included in the accrued liabilities and other liabilities section of the consolidated balance sheet.

Revenues and earnings to date on the aforementioned acquisitions for all 2009 are not material. Pro forma schedules have not been included as the impact on the prior and current periods presented is not material.

The preliminary purchase price allocations, which are based on relevant facts and circumstances and discussions with an independent third-party consultant, are subject to change upon completion of the final valuation analysis by Lufkin management. The final valuations for ILS, which is required to be completed by March 2010, and RMT, which is required to be completed by July 2010, are not expected to result in material changes to the preliminary allocations.

**(3) Discontinued Operations**

During the second quarter of 2008, the Trailer segment was classified as a discontinued operation.

Operating results of discontinued operations were as follows (in thousands of dollars):

|                                                      | 2009            | 2008            | 2007             |
|------------------------------------------------------|-----------------|-----------------|------------------|
| Sales                                                | <u>\$ 36</u>    | <u>\$ 7,135</u> | <u>\$ 41,381</u> |
| Earnings before income tax provision                 | (724)           | 450             | 3,268            |
| Income tax provision                                 | <u>271</u>      | <u>(236)</u>    | <u>(842)</u>     |
| Earnings from discontinued operations,<br>net of tax | <u>\$ (453)</u> | <u>\$ 214</u>   | <u>\$ 2,426</u>  |

|                                               | December 31,<br>2009 | December 31,<br>2008 |
|-----------------------------------------------|----------------------|----------------------|
| Receivables, net                              | \$ 17                | \$ 56                |
| Income tax receivable                         | 302                  | -                    |
| Deferred income tax assets                    | <u>492</u>           | <u>562</u>           |
| Current assets from discontinued operations   | 811                  | 618                  |
| Property, plant and equipment, net            | -                    | -                    |
| Other assets, net                             | <u>-</u>             | <u>493</u>           |
| Long-term assets from discontinued operations | -                    | 493                  |
| Total assets from discontinued operations     | <u>\$ 811</u>        | <u>\$ 1,111</u>      |

|                                                  |                 |                 |
|--------------------------------------------------|-----------------|-----------------|
| Accounts payable                                 | \$ 10           | \$ 154          |
| Accrued liabilities:                             |                 |                 |
| Payroll and benefits                             | 70              | 104             |
| Warranty expenses                                | 240             | 410             |
| Taxes payable                                    | -               | 120             |
| Other                                            | <u>706</u>      | <u>616</u>      |
| Current liabilities from discontinued operations | 1,026           | 1,404           |
| Long-term liabilities                            | <u>37</u>       | <u>61</u>       |
| Total liabilities from discontinued operations   | <u>\$ 1,063</u> | <u>\$ 1,465</u> |

**(4) Receivables**

The following is a summary of the Company's receivable balances at December 31:

| (Thousands of dollars)                     | 2009             | 2008              |
|--------------------------------------------|------------------|-------------------|
| Accounts receivable                        | \$ 87,497        | \$ 138,706        |
| Notes receivable                           | 482              | 157               |
| Other receivables                          | 4,767            | 1,015             |
| Gross receivables                          | <u>92,746</u>    | <u>139,878</u>    |
| Allowance for doubtful accounts receivable | (240)            | (734)             |
| Net receivables                            | <u>\$ 92,506</u> | <u>\$ 139,144</u> |

During 2009, the Company recovered certain receivables reserved in 2008, resulting in \$1.8 million of income, which is included in selling, general and administrative expenses on the income statement. Bad debt expense related to receivables was \$2.5 million in 2008 and was negligible in 2007.

**(5) Inventories**

Inventories used in determining cost of sales were as follows:

| (Thousands of dollars)          | 2009              | 2008              |
|---------------------------------|-------------------|-------------------|
| Gross inventories @ FIFO:       |                   |                   |
| Finished goods                  | \$ 7,545          | \$ 2,643          |
| Work in progress                | 21,435            | 28,230            |
| Raw materials & component parts | 100,347           | 122,604           |
| Maintenance, tooling & supplies | 13,882            | 12,611            |
| Total gross inventories @ FIFO  | <u>143,209</u>    | <u>166,088</u>    |
| Less reserves:                  |                   |                   |
| LIFO                            | 29,961            | 32,926            |
| Valuation                       | 2,643             | 4,535             |
| Total inventories as reported   | <u>\$ 110,605</u> | <u>\$ 128,627</u> |

Gross inventories on a FIFO basis shown above that were accounted for on a LIFO basis were \$76.7 million and \$109.2 million at December 31, 2009 and 2008, respectively.

**(6) Property, Plant & Equipment**

The following is a summary of the Company's P. P. & E. balances at December 31:

| (Thousands of dollars)                   | 2009              | 2008              |
|------------------------------------------|-------------------|-------------------|
| Land                                     | \$ 6,735          | \$ 6,525          |
| Land improvements                        | 10,146            | 10,219            |
| Buildings                                | 92,467            | 75,756            |
| Machinery and equipment                  | 265,958           | 245,014           |
| Furniture and fixtures                   | 5,985             | 5,616             |
| Computer equipment and software          | 15,388            | 14,666            |
| Total property, plant and equipment      | <u>396,679</u>    | <u>357,796</u>    |
| Less accumulated depreciation            | (236,909)         | (227,717)         |
| Total property, plant and equipment, net | <u>\$ 159,770</u> | <u>\$ 130,079</u> |

Depreciation expense related to property, plant and equipment was \$17.1 million, \$15.6 million and \$13.7 million in 2009, 2008 and 2007, respectively.

## (7) Goodwill & Acquired Intangible Assets

### Goodwill

The changes in the carrying amount of goodwill during the years ended December 31, 2009 and 2008 are as follows (in thousands of dollars):

| (Thousands of dollars)              | Oil Field        | Power<br>Transmission | Total            |
|-------------------------------------|------------------|-----------------------|------------------|
| Balance as of 12/31/07              | \$ 9,447         | \$ 2,543              | \$ 11,990        |
| Foreign currency translation        | (19)             | (109)                 | (128)            |
| Balance as of 12/31/08              | 9,428            | 2,434                 | 11,862           |
| Goodwill acquired during the period | 28,577           | 4,489                 | 33,066           |
| Foreign currency translation        | 13               | 60                    | 73               |
| Balance as of 12/31/09              | <u>\$ 38,018</u> | <u>\$ 6,983</u>       | <u>\$ 45,001</u> |

### Intangible Assets

The Company amortizes identifiable intangible assets on a straight-line basis over the periods expected to be benefitted. All of the below intangible assets relate to the ILS and RMT acquisitions. The components of these intangible assets are as follows (in thousands of dollars):

|                                       | December 31, 2009           |                             |                  | Weighted<br>Average<br>Amortization<br>Period<br>(years) |
|---------------------------------------|-----------------------------|-----------------------------|------------------|----------------------------------------------------------|
|                                       | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net              |                                                          |
| Non-compete agreements and trademarks | \$ 2,064                    | \$ 258                      | \$ 1,806         | 7.2                                                      |
| Customer relationships and contracts  | 13,216                      | 1,043                       | 12,173           | 10.0                                                     |
|                                       | <u>\$ 15,280</u>            | <u>\$ 1,301</u>             | <u>\$ 13,979</u> | <u>7.0</u>                                               |

Amortization expense of intangible assets was approximately \$1.3 million for the year ended December 31, 2009. There was no intangible amortization expense in the years ended December 31, 2008 and 2007. Expected amortization expense by year is (in thousands of dollars):

|                             |                 |
|-----------------------------|-----------------|
| For the year ended 12/31/10 | \$ 1,672        |
| For the year ended 12/31/11 | 1,672           |
| For the year ended 12/31/12 | 1,573           |
| For the year ended 12/31/13 | 1,553           |
| For the year ended 12/31/14 | 1,441           |
| Thereafter                  | <u>\$ 6,068</u> |

### (8) Other Current Accrued Liabilities

The following is a summary of the Company's other current accrued liabilities balances at December 31:

| (Thousands of dollars)                  | 2009             | 2008             |
|-----------------------------------------|------------------|------------------|
| Customer prepayments                    | \$ 7,945         | \$ 12,925        |
| Litigation reserves                     | 6,637            | 6,000            |
| Deferred compensation & benefit plans   | 5,500            | 4,046            |
| Accrued professional services           | 548              | 1,097            |
| Hold back consideration                 | 1,605            | -                |
| Other accrued liabilities               | 1,912            | 1,272            |
| Total other current accrued liabilities | <u>\$ 24,147</u> | <u>\$ 25,340</u> |

### (9) Debt Obligations

The following is a summary of the Company's outstanding debt balances (in thousands of dollars):

|                                        | December 31,<br>2009 | December 31,<br>2008 |
|----------------------------------------|----------------------|----------------------|
| Long-term notes payable                | \$ 2,888             | \$ -                 |
| Less current portion of long-term debt | <u>(1,372)</u>       | <u>-</u>             |
| Long-term debt                         | <u>\$ 1,516</u>      | <u>\$ -</u>          |

Principal payments of long-term debt by year are as follows (in thousands of dollars):

|       |                 |
|-------|-----------------|
| 2011  | \$ 1,349        |
| 2012  | <u>167</u>      |
| Total | <u>\$ 1,516</u> |

The Company's current debt at December 31, 2009, primarily consists of assumed notes from the ILS acquisition, which are described below. The current portion of long-term debt reflects scheduled principal payments due on or before December 31, 2010.

On March 1, 2009, the Company assumed from ILS several notes payable, associated with prior acquisitions undertaken by ILS, with a remaining aggregate principal balance of \$3.9 million at interest rates ranging from 0% to 6% with a weighted average of 4.5%. On the outstanding principal balance as of December 31, 2009, the Company has secured letters of credit for \$1.5 million and the remaining \$1.4 million is secured by collateral consisting of equipment, inventory, and accounts receivable. The fair market value of the outstanding debt as of December 31, 2009 is not materially different than its carrying value.

In connection with the ILS acquisition, the Company also assumed a note payable to a bank in the amount of \$0.8 million, which was paid in full at closing. In connection with the RMT acquisition, the Company also assumed several notes payable to individuals and banks in the amount of \$1.5 million, which were paid in full at closing.

The Company has a three-year credit facility with a domestic bank (the "Bank Facility") consisting of an unsecured revolving line of credit that provides up to \$40.0 million of aggregate borrowing. This Bank Facility expires on December 31, 2010. Borrowings under the Bank Facility bear interest, at the Company's option, at either the greater of (i) the prime rate, (ii) the base CD rate plus an applicable margin or (iii) the Federal Funds Effective Rate plus an applicable margin or the London Interbank Offered Rate plus an applicable margin, depending on certain ratios as defined in the Bank Facility. As of December 31, 2009, no debt was outstanding under the Bank Facility and the Company was in compliance with all financial covenants under the terms of the Bank Facility. Deducting outstanding letters of credit of \$16.4 million, \$23.6 million of borrowing capacity was available at December 31, 2009.

**(10) Retirement Benefits**

The Company has a qualified noncontributory pension plan covering substantially all U.S. 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, as amended. In addition, the Company has two unfunded non-qualified deferred compensation pension plans for certain U.S. employees. The Pension Restoration Plan provides supplemental retirement benefits. The benefit is based on the same benefit formula as the qualified pension plan except that it does not limit the amount of a participant's compensation or maximum benefit. The Company also provides a Supplemental Executive Retirement Plan that credits an individual with 0.5 years of service for each year of service credited under the qualified plan. The benefits calculated under the non-qualified pension plans are offset by the participant's benefit payable under the qualified plan. The liabilities for the non-qualified deferred compensation pensions plans are included in "Other current accrued liabilities" and "Other liabilities" in the Consolidated Balance Sheet.

The Company reduced its U.S. employee base which resulted in a curtailment loss of \$1.5 million, which is recorded in cost of sales on the income statement.

The Company is also required by the French government to provide a lump sum benefit payable upon retirement to its French employees. A dedicated insurance policy is in place that can reimburse the Company for these retirement payments.

The Company sponsors two defined benefit postretirement 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. The Company accrues the estimated costs of the plans over the employee's service periods. The Company's postretirement health care plan is unfunded. For measurement purposes, the submitted claims medical trend was assumed to be 9.25% in 1997. Thereafter, the Company's obligation is fixed at the amount of the Company's contribution for 1997.

The Company also has qualified defined contribution retirement plans covering substantially all of its U.S. and Canadian employees. For U.S. employees, the Company makes contributions of 75% of employee contributions up to a maximum employee contribution of 6% of employee earnings. Employees may contribute up to an additional 18% (in 1% increments), which is not subject to match by the Company. For Canadian employees, the Company makes contributions of 3%-8% of an employee's salary with no individual employee match required. All obligations of the Company are funded through December 31, 2009. In addition, the Company provides an unfunded non-qualified deferred compensation defined contribution plan for certain U.S. employees. The Company's and individual's contributions are based on the same formula as the qualified contribution plan except that it does not limit the amount of a participant's compensation or maximum benefit. The contribution calculated under the non-qualified defined contribution plan is offset by the Company's and participant's contributions under the qualified plan. The Company's expense for these plans totaled \$3.3 million, \$3.5 million and \$3.3 million in the years ended December 31, 2009, 2008 and 2007, respectively. The liability for the non-qualified deferred defined contribution plan is included in "Other current accrued liabilities" in the Consolidated Balance Sheet.

**(10) Retirement Benefits (Continued)****Obligations and Funded Status  
At December 31**

| (Thousands of dollars)                         | Pension Benefits   |                    | Other Benefits    |                   |
|------------------------------------------------|--------------------|--------------------|-------------------|-------------------|
|                                                | 2009               | 2008               | 2009              | 2008              |
| <b>Changes in benefit obligation</b>           |                    |                    |                   |                   |
| Benefit obligation at beginning of year        | \$ 187,350         | \$ 171,445         | \$ 7,657          | \$ 7,926          |
| Service cost                                   | 4,769              | 4,933              | 145               | 152               |
| Interest cost                                  | 11,970             | 10,979             | 503               | 455               |
| Plan participants' contributions               | -                  | -                  | 880               | 946               |
| Plan change                                    | -                  | 3,143              | 640               | -                 |
| Actuarial loss (gain)                          | 13,844             | 5,583              | 471               | (21)              |
| Benefits paid                                  | (9,204)            | (8,733)            | (1,569)           | (1,801)           |
| Curtailments                                   | (1,136)            | -                  | (241)             | -                 |
| Other                                          | 1,154              | -                  | -                 | -                 |
| Benefit obligation at end of year              | <u>208,747</u>     | <u>187,350</u>     | <u>8,486</u>      | <u>7,657</u>      |
| <b>Change in plan assets</b>                   |                    |                    |                   |                   |
| Fair value of plan assets at beginning of year | 176,477            | 238,975            | -                 | -                 |
| Actual return on plan assets                   | 24,412             | (54,062)           | -                 | -                 |
| Employer contributions                         | 281                | 297                | 688               | 855               |
| Plan participants' contributions               | -                  | -                  | 881               | 946               |
| Benefits paid                                  | (9,204)            | (8,733)            | (1,569)           | (1,801)           |
| Other                                          | 664                | -                  | -                 | -                 |
| Fair value of plan assets at end of year       | <u>192,630</u>     | <u>176,477</u>     | <u>-</u>          | <u>-</u>          |
| Funded (unfunded) status at end of year        | <u>\$ (16,117)</u> | <u>\$ (10,873)</u> | <u>\$ (8,486)</u> | <u>\$ (7,657)</u> |

Amounts recognized in the balance sheet consist of:

| (Thousands of dollars)            | Pension Benefits   |                    | Other Benefits    |                   |
|-----------------------------------|--------------------|--------------------|-------------------|-------------------|
|                                   | 2009               | 2008               | 2009              | 2008              |
| Other current accrued liabilities | \$ (317)           | \$ (270)           | \$ (612)          | \$ (587)          |
| Postretirement benefits           | -                  | -                  | (7,874)           | (7,070)           |
| Other long-term liabilities       | (15,800)           | (10,603)           | -                 | -                 |
|                                   | <u>\$ (16,117)</u> | <u>\$ (10,873)</u> | <u>\$ (8,486)</u> | <u>\$ (7,657)</u> |

Amounts recognized in accumulated other comprehensive income consist of:

| (Thousands of dollars) | Pension Benefits |                  | Other Benefits  |                   |
|------------------------|------------------|------------------|-----------------|-------------------|
|                        | 2009             | 2008             | 2009            | 2008              |
| Prior service cost     | \$ 4,369         | \$ 5,850         | \$ 323          | \$ -              |
| Net loss (gain)        | 40,559           | 43,072           | (1,289)         | (1,709)           |
|                        | <u>\$ 44,928</u> | <u>\$ 48,922</u> | <u>\$ (966)</u> | <u>\$ (1,709)</u> |

**(10) Retirement Benefits (Continued)**

The accumulated benefit obligation for all defined benefit pension plans was \$193.1 million and \$174.1 million at December 31, 2009, and 2008, respectively.

**Components of Net Periodic Benefit Cost and Other Amounts Recognized in Other Comprehensive Income**

| (Thousands of dollars)             | Pension Benefits |                 |                   | Other Benefits |               |               |
|------------------------------------|------------------|-----------------|-------------------|----------------|---------------|---------------|
|                                    | 2009             | 2008            | 2007              | 2009           | 2008          | 2007          |
| <b>Net Periodic Benefit Cost</b>   |                  |                 |                   |                |               |               |
| Service cost                       | \$ 4,769         | \$ 4,933        | \$ 5,452          | \$ 145         | \$ 151        | \$ 174        |
| Interest cost                      | 11,970           | 10,979          | 9,725             | 503            | 455           | 458           |
| Expected return on plan assets     | (12,285)         | (16,664)        | (17,646)          | -              | -             | -             |
| Amortization of prior service cost | 795              | 649             | 566               | 54             | -             | -             |
| Amortization of net (gain) loss    | 4,566            | 181             | 102               | (217)          | (217)         | (227)         |
| Amortization of transition asset   | -                | (638)           | (926)             | -              | -             | -             |
| Curtailment                        | 1,542            | -               | -                 | (145)          | -             | -             |
| Net periodic benefit cost (income) | <u>\$ 11,357</u> | <u>\$ (560)</u> | <u>\$ (2,727)</u> | <u>\$ 340</u>  | <u>\$ 389</u> | <u>\$ 405</u> |

The estimated net loss and prior service cost for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$4.9 million and \$0.8 million, respectively. The estimated net gain and prior service cost for the defined benefit postretirement plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost over the next fiscal year are \$0.1 million and \$0.1 million, respectively.

**Additional Information****Assumptions****Weighted-average assumptions used to determine benefit obligations at December 31**

|                               | Pension Benefits |               | Other Benefits |       |
|-------------------------------|------------------|---------------|----------------|-------|
|                               | 2009             | 2008          | 2009           | 2008  |
| Discount rate                 | 5.25% - 5.80%    | 6.18% - 6.40% | 5.58%          | 6.25% |
| Rate of compensation increase | 2.0% - 4.5%      | 4.50%         | N/A            | N/A   |

**Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31**

|                                          | Pension Benefits |               |       | Other Benefits |       |       |
|------------------------------------------|------------------|---------------|-------|----------------|-------|-------|
|                                          | 2009             | 2008          | 2007  | 2009           | 2008  | 2007  |
| Discount rate                            | 6.00% - 6.40%    | 6.25% - 6.35% | 5.75% | 6.25%          | 6.20% | 5.75% |
| Expected long-term return on plan assets | 7.30%            | 7.30%         | 8.00% | N/A            | N/A   | N/A   |
| Rate of compensation increase            | 4.50%            | 4.50%         | 4.50% | N/A            | N/A   | N/A   |

## (10) Retirement Benefits (Continued)

For 2009, the Company assumed a long-term asset rate of return of 7.3%. In developing the 7.3% expected long-term rate of return assumption, the Company evaluated input from its third-party pension plan asset manager, including their review of asset class return expectations and long-term inflation assumptions. The Company also considered its historical 10-year and 15-year compounded return (period ended December 31, 2008), which were in-line to higher than the Company's long-term rate of return assumption, and analyzed expected long-term rate of return projections by asset class.

### Plan Assets

The Company's qualified pension plan assets at December 31, 2009 are as follows:

#### Fair Value Measurements at December 31, 2009 (in thousands)

| <u>Asset Category</u>                      | <u>Total</u>      | Quoted Prices in<br>Active markets for<br>Identical Assets<br>(Level 1) | Significant<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|--------------------------------------------|-------------------|-------------------------------------------------------------------------|--------------------------------------------------|----------------------------------------------------|
| Cash                                       | \$ 3,019          | \$ 3,019                                                                |                                                  |                                                    |
| Equity securities:                         |                   |                                                                         |                                                  |                                                    |
| Common stock                               | 56,307            | 56,307                                                                  |                                                  |                                                    |
| International stock - commingled funds (a) | 22,106            |                                                                         | \$ 22,106                                        |                                                    |
| International stock - mutual fund          | 10,823            | 10,823                                                                  |                                                  |                                                    |
| Fixed income securities:                   |                   |                                                                         |                                                  |                                                    |
| U.S. Treasuries                            | 8,905             | 8,905                                                                   |                                                  |                                                    |
| Mortgage-backed securities                 | 17,721            |                                                                         | 17,721                                           |                                                    |
| Collateralized mortgage obligations        | 5,141             |                                                                         | 5,141                                            |                                                    |
| Corporate bonds (b)                        | 21,556            |                                                                         | 21,556                                           |                                                    |
| Other types of investments:                |                   |                                                                         |                                                  |                                                    |
| Equity long/short hedge funds (c)          | 34,289            |                                                                         |                                                  | \$ 34,289                                          |
| Insurance policy (d)                       | 664               |                                                                         |                                                  | 664                                                |
| Real Estate (e)                            | 12,099            |                                                                         |                                                  | 12,099                                             |
| <b>Total</b>                               | <b>\$ 192,630</b> | <b>\$ 79,054</b>                                                        | <b>\$ 66,524</b>                                 | <b>\$ 47,052</b>                                   |

(a) This category represents International Equity Commingled Funds which invests in international stocks. The benchmark is the MSCI EAFE Index.

(b) This category represents investment grade bonds of U.S. issuers from diverse industries.

(c) This category includes hedge funds that invest both long and short in primarily U.S. common stocks. Management of the hedge funds has the ability to shift investments from value to growth strategies, from small to large capitalization stocks, and from a net long position to a net short position; however it is expected that the equity long/short hedge funds will have a net long position.

(d) This category includes a private insurance policy used for French retirement benefits.

(e) This category includes a RREEF America II Fund which consists of commingled private real estate.

**(10) Retirement Benefits (Continued)****Fair Value Measurements Using Significant Unobservable Inputs (Level 3)**

|                                                        | <b>Equity Long/Short<br/>Hedge Funds</b> | <b>Real Estate</b> | <b>Insurance<br/>Contracts</b> | <b>Total</b> |
|--------------------------------------------------------|------------------------------------------|--------------------|--------------------------------|--------------|
| Beginning balance at December 31, 2008                 | \$ 29,827                                | \$ 14,747          | \$ -                           | \$ 44,574    |
| Actual return on plan assets:                          |                                          |                    |                                |              |
| Relating to assets still held<br>at the reporting date | 4,462                                    | (2,648)            |                                | 1,814        |
| Relating to assets sold during<br>the period           |                                          |                    |                                | -            |
| Purchases, sales, and settlements                      |                                          |                    |                                |              |
| Other                                                  |                                          |                    | 664                            | 664          |
| Transfers in and/or out of Level 3                     |                                          |                    |                                | -            |
| Ending balance at December 31, 2009                    | \$ 34,289                                | \$ 12,099          | \$ 664                         | \$ 47,052    |

**Equity Long/Short Hedge Funds**

Hedge fund-of-funds are based on daily closing or institutional evaluation prices of underlying securities consistent with industry practices.

**Real Estate**

Real estate securities are valued based on recent market appraisals of underlying property as well as valuation methodologies to determine the most probable cash price in a competitive market.

**Insurance Contracts**

Insurance contracts are valued based upon underlying securities consistent with industry practices.

The Company invests in a diversified portfolio consisting of an array of assets classes that attempts to maximize returns while minimizing volatility. These asset classes include U.S. domestic equities, developed market equities, international equities, fixed income, real estate and hedged investments. Fixed income securities include medium-term government notes, corporate bonds and highly-rated mortgage-backed securities and collateralized mortgage obligations. Real estate primarily includes REIT investments focused on U.S. commercial warehouses. Hedged investments are primarily concentrated in funds focused on long/short investment strategies.

No equity or debt securities of the Company were held by the plan at December 31, 2009, or 2008.

The unqualified pension plans and the postretirement benefit plan of the Company are unfunded and thus had no plan assets as of December 31, 2009, and 2008.

## Cash Flows

## Contributions

The Company expects to make contributions of \$5.4 million to the pension plans and expects to make contributions of \$0.6 million to the postretirement plan in 2010.

## Estimated Future Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid during the fiscal years ending:

| (Thousands of dollars) | Pension<br>Benefits | Other<br>Benefits |
|------------------------|---------------------|-------------------|
| 2010                   | \$ 10,420           | \$ 629            |
| 2011                   | 11,167              | 644               |
| 2012                   | 11,891              | 659               |
| 2013                   | 12,435              | 681               |
| 2014                   | 13,275              | 694               |
| 2015 - 2019            | 77,102              | 3,582             |

**(11) Other Comprehensive Income**

The following table illustrates the related tax effect allocated to each component of other comprehensive income:

| (Thousands of dollars)                     | Pre-Tax<br>Amount  | Tax (Expense)/<br>Benefit | Net<br>Amount      |
|--------------------------------------------|--------------------|---------------------------|--------------------|
| <b>Year ended December 31, 2007</b>        |                    |                           |                    |
| Foreign currency translation adjustments   | \$ 5,057           | \$ -                      | \$ 5,057           |
| Defined benefit pension plans:             |                    |                           |                    |
| Amortization of net prior service cost     | 566                | (207)                     | 359                |
| Amortization of net loss                   | 102                | (37)                      | 65                 |
| Amortization of net transition asset       | (926)              | 339                       | (587)              |
| Net gain arising during period             | 11,265             | (4,123)                   | 7,142              |
| Total defined benefit pension plans        | 11,007             | (4,028)                   | 6,979              |
| Defined benefit postretirement plans:      |                    |                           |                    |
| Amortization of net gain                   | (227)              | 83                        | (144)              |
| Net gain arising during period             | 1,022              | (374)                     | 648                |
| Total defined benefit postretirement plans | 795                | (291)                     | 504                |
| Other comprehensive income                 | <u>\$ 16,859</u>   | <u>\$ (4,319)</u>         | <u>\$ 12,540</u>   |
| <b>Year ended December 31, 2008</b>        |                    |                           |                    |
| Foreign currency translation adjustments   | \$ (5,503)         | \$ -                      | \$ (5,503)         |
| Defined benefit pension plans:             |                    |                           |                    |
| Amortization of net prior service cost     | 649                | (238)                     | 411                |
| Amortization of net loss                   | 181                | (66)                      | 115                |
| Amortization of net transition asset       | (638)              | 234                       | (404)              |
| Net prior service cost                     | (3,143)            | 1,154                     | (1,989)            |
| Net loss arising during period             | (76,309)           | 28,034                    | (48,275)           |
| Total defined benefit pension plans        | (79,260)           | 29,118                    | (50,142)           |
| Defined benefit postretirement plans:      |                    |                           |                    |
| Amortization of net gain                   | (217)              | 80                        | (137)              |
| Net gain arising during period             | 21                 | (8)                       | 13                 |
| Total defined benefit postretirement plans | (196)              | 72                        | (124)              |
| Other comprehensive income                 | <u>\$ (84,959)</u> | <u>\$ 29,190</u>          | <u>\$ (55,769)</u> |
| <b>Year ended December 31, 2009</b>        |                    |                           |                    |
| Foreign currency translation adjustments   | \$ 3,525           | \$ -                      | \$ 3,525           |
| Defined benefit pension plans:             |                    |                           |                    |
| Amortization of net prior service cost     | 795                | (293)                     | 502                |
| Amortization of net loss                   | 4,566              | (1,682)                   | 2,884              |
| Net loss arising during period             | (1,717)            | 632                       | (1,085)            |
| Other                                      | 2,678              | (986)                     | 1,692              |
| Total defined benefit pension plans        | 6,322              | (2,329)                   | 3,993              |
| Defined benefit postretirement plans:      |                    |                           |                    |
| Amortization of net prior service cost     | 54                 | (20)                      | 34                 |
| Amortization of net gain                   | (217)              | 80                        | (137)              |
| Net loss arising during period             | (471)              | 174                       | (297)              |
| Net prior service cost                     | (640)              | 235                       | (405)              |
| Other                                      | 96                 | (35)                      | 61                 |
| Total defined benefit postretirement plans | (1,178)            | 434                       | (744)              |
| Other comprehensive income                 | <u>\$ 8,669</u>    | <u>\$ (1,895)</u>         | <u>\$ 6,774</u>    |

**(11) Other Comprehensive Income (continued)**

The following table illustrates the balances of accumulated other comprehensive income:

| (Thousands of dollars)        | Foreign<br>Currency<br>Translation | Defined<br>Benefit<br>Pension<br>Plans | Defined<br>Benefit<br>Postretirement<br>Plans | Accumulated<br>Other<br>Comprehensive<br>Income |
|-------------------------------|------------------------------------|----------------------------------------|-----------------------------------------------|-------------------------------------------------|
| <b>Balance, Dec. 31, 2007</b> | \$ 8,015                           | \$ 1,221                               | \$ 1,833                                      | \$ 11,069                                       |
| Current-period change         | (5,503)                            | (50,142)                               | (124)                                         | (55,769)                                        |
| <b>Balance, Dec. 31, 2008</b> | 2,512                              | (48,921)                               | 1,709                                         | (44,700)                                        |
| Current-period change         | 3,525                              | 3,993                                  | (744)                                         | 6,774                                           |
| <b>Balance, Dec. 31, 2009</b> | \$ 6,037                           | \$ (44,928)                            | \$ 965                                        | \$ (37,926)                                     |

**(12) Earnings per Share**

A reconciliation of the number of weighted shares used to compute basic and diluted net earnings per share for 2009, 2008 and 2007, are illustrated below:

|                                                                     | 2009              | 2008              | 2007              |
|---------------------------------------------------------------------|-------------------|-------------------|-------------------|
| Weighted average common shares outstanding for basic EPS            | 14,864,937        | 14,788,867        | 14,901,176        |
| Effect of dilutive securities: employee stock options               | 38,034            | 121,246           | 189,187           |
| Adjusted weighted average common shares outstanding for diluted EPS | <u>14,902,971</u> | <u>14,910,113</u> | <u>15,090,363</u> |

Options to purchase a total of 521,164, 167,870 and 202,302 shares of the Company's common stock were excluded from the calculation of fully diluted earnings per share for 2009, 2008 and 2007, respectively, because their effect on fully diluted earnings per share for the period were antidilutive.

**(13) Stock Option Plans**

The Company currently has two stock compensation plans. The 1996 Nonemployee Director Stock Option Plan and the 2000 Incentive Stock Compensation Plan provide for the granting of stock options to officers, employees and non-employee directors at an exercise price equal to the fair market value of the stock at the date of grant. The 2000 Incentive Stock Compensation Plan also provides for other forms of stock-based compensation such as restricted stock but none have been granted to date. Options granted to employees vest over two to four years and are exercisable up to ten years from the grant date. Upon retirement, any unvested options become exercisable immediately. Options granted to directors vest at the grant date and are exercisable up to ten years from the grant date.

The following table is a summary of the stock-based compensation expense recognized for the years ended December 31, 2009, 2008 and 2007:

| (Thousands of dollars)                       | 2009            | 2008            | 2007            |
|----------------------------------------------|-----------------|-----------------|-----------------|
| Stock-based compensation expense             | \$ 2,943        | \$ 3,584        | \$ 3,682        |
| Tax benefit                                  | (1,089)         | (1,326)         | (1,362)         |
| Stock-based compensation expense, net of tax | <u>\$ 1,854</u> | <u>\$ 2,258</u> | <u>\$ 2,320</u> |

**(13) Stock Option Plans (continued)**

The fair value of each option grant during the years ended December 31, 2009, 2008 and 2007 was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

|                                                     | 2009          | 2008            | 2007            |
|-----------------------------------------------------|---------------|-----------------|-----------------|
| Expected dividend yield                             | 1.73% - 2.80% | 1.33% - 2.20%   | 1.30% - 1.60%   |
| Expected stock price volatility                     | 46.8% - 56.3% | 41.00% - 49.70% | 41.10% - 46.20% |
| Risk free interest rate                             | 1.09% - 2.73% | 1.53% - 3.27%   | 3.71% - 4.85%   |
| Expected life of options                            | 3 - 7 years   | 2 - 6 years     | 3 - 6 years     |
| Weighted-average fair value per share at grant date | \$20.25       | \$19.72         | \$23.48         |

The expected life of options was determined based on the exercise history of employees and directors since the inception of the plans. The expected volatility is based upon the historical weekly and daily stock price for the prior number of years equivalent to the expected life of the stock option. The expected dividend yield was based on the dividend yield of the Company's common stock at the date of the grant. The risk free interest rate was based upon the yield of U.S. Treasuries which terms were equivalent to the expected life of the stock option.

A summary of stock option activity under the plans during year ended December 31, 2009, is presented below:

| Options                          | Shares         | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value (\$000's) |
|----------------------------------|----------------|---------------------------------|---------------------------------------------|-------------------------------------|
| Outstanding at January 1, 2009   | 548,639        | \$51.42                         |                                             |                                     |
| Granted                          | 190,500        | 51.34                           |                                             |                                     |
| Exercised                        | (24,625)       | 24.83                           |                                             |                                     |
| Forfeited or expired             | (5,499)        | 20.65                           |                                             |                                     |
| Outstanding at December 31, 2009 | <u>709,015</u> | <u>\$52.56</u>                  | <u>7.9</u>                                  | <u>\$14,664</u>                     |
| Exercisable at December 31, 2009 | <u>379,248</u> | <u>\$50.69</u>                  | <u>6.9</u>                                  | <u>\$8,567</u>                      |

As of December 31, 2009, there was \$4.7 million of total unrecognized compensation expense related to non-vested stock options. That cost is expected to be recognized over a weighted-average period of 2.8 years. The intrinsic value of stock options exercised in 2009, 2008 and 2007 was \$1.0 million, \$14.4 million and \$9.6 million, respectively.

**(14) Capital Stock**

The Company is authorized to issue 2,000,000 shares of preferred stock, the terms and conditions to be determined by the Board of Directors in creating any particular series. As of December 31, 2009, no shares of preferred stock had been issued.

# **(15) Income Taxes**

Earnings from continuing operations before income taxes for 2009, 2008 and 2007 consisted of the following:

| (Thousands of dollars)             | 2009             | 2008              | 2007              |
|------------------------------------|------------------|-------------------|-------------------|
| Domestic                           | \$ 17,880        | \$ 112,722        | \$ 86,650         |
| Foreign                            | 15,132           | 23,690            | 22,808            |
| Total earnings before income taxes | <u>\$ 33,012</u> | <u>\$ 136,412</u> | <u>\$ 109,458</u> |

The income tax provision for 2009, 2008 and 2007 consisted of the following:

| (Thousands of dollars)              | 2009             | 2008             | 2007             |
|-------------------------------------|------------------|------------------|------------------|
| Current:                            |                  |                  |                  |
| U.S. federal and state income taxes | \$ 7,286         | \$ 42,487        | \$ 23,892        |
| Foreign                             | 4,793            | 5,514            | 5,763            |
| Total current                       | <u>12,079</u>    | <u>48,001</u>    | <u>29,655</u>    |
| Deferred:                           |                  |                  |                  |
| U.S. federal and state income taxes | (1,186)          | (823)            | 7,579            |
| Foreign                             | (360)            | 1,209            | 439              |
| Total deferred                      | <u>(1,546)</u>   | <u>386</u>       | <u>8,018</u>     |
| Total                               | <u>\$ 10,533</u> | <u>\$ 48,387</u> | <u>\$ 37,673</u> |

Cash payments for income taxes totaled \$22.0 million, \$45.1 million and \$26.7 million for 2009, 2008 and 2007, respectively.

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

| (Thousands of dollars)                     | 2009             | 2008             | 2007             |
|--------------------------------------------|------------------|------------------|------------------|
| Tax provision computed at statutory rate   | \$ 11,554        | \$ 47,744        | \$ 38,310        |
| Tax effect of:                             |                  |                  |                  |
| Expenses for which no benefit was realized | 335              | 936              | 459              |
| Change in effective state tax rate         | (44)             | 115              | 53               |
| Tax credit                                 | (962)            | (237)            | (459)            |
| State taxes net of federal benefit         | 504              | 2,351            | 1,261            |
| Benefit of manufacturing deduction         | (481)            | (1,892)          | (1,105)          |
| Other, net                                 | (373)            | (630)            | (846)            |
| Total provision for taxes                  | <u>\$ 10,533</u> | <u>\$ 48,387</u> | <u>\$ 37,673</u> |

# (15) Income Taxes (continued)

The primary components of the deferred tax assets and liabilities and the related valuation allowances are as follows:

| (Thousands of dollars)                                | 2009       | 2008       |
|-------------------------------------------------------|------------|------------|
| Deferred income tax assets:                           |            |            |
| Pension costs                                         | \$ 7,523   | \$ 5,124   |
| Payroll and benefits                                  | 967        | 927        |
| Accrued warranty expenses                             | 1,328      | 1,144      |
| Postretirement benefits                               | 6,543      | 5,209      |
| Accrued liabilities                                   | 3,295      | 761        |
| Other, net                                            | 120        | 0          |
| Total deferred income tax assets                      | 19,776     | 13,165     |
| Less valuation allowance                              | (69)       | (75)       |
| Total deferred income tax assets                      | 19,707     | 13,090     |
| Noncurrent deferred income tax liabilities:           |            |            |
| Prepaid expenses                                      | (335)      | (318)      |
| Depreciation                                          | (18,387)   | (14,857)   |
| Inventories                                           | (730)      | (361)      |
| Other, net                                            | (5,515)    | (1,270)    |
| Total noncurrent deferred income tax liabilities, net | (24,967)   | (16,806)   |
| Total net deferred tax liability                      | \$ (5,260) | \$ (3,716) |
| Current deferred tax asset                            |            |            |
| Continuing operations                                 | \$ 5,198   | \$ 4,941   |
| Discontinued operations                               | 492        | 562        |
| Total current deferred tax asset                      | 5,690      | 5,503      |
| Non-current deferred tax liability                    |            |            |
| Continuing operations                                 | (10,950)   | (9,219)    |
| Discontinued operations                               | -          | -          |
| Total non-current deferred tax liability              | (10,950)   | (9,219)    |
| Total net deferred tax liability                      | \$ (5,260) | \$ (3,716) |

**(15) Income Taxes (continued)**

As of January 1, 2009, the Company had approximately \$1.4 million of total gross unrecognized tax benefits. Of this total, \$1.4 million (net of the federal benefit on state issues) represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the net effective income tax rate in any future period. As of December 31, 2009, the Company had approximately \$1.5 million of total gross unrecognized tax benefits. Of this total, \$1.5 million (net of the federal benefit on state issues) represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the net effective income tax rate in any future period. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

| (Thousands of dollars)                            | 2009     | 2008     | 2007     |
|---------------------------------------------------|----------|----------|----------|
| Balance at January 1,                             | \$ 1,368 | \$ 2,743 | \$ 3,383 |
| Gross increases- current year tax positions       | 593      | -        | 293      |
| Gross increases- tax positions from prior periods | 93       | 328      | 21       |
| Gross decreases- tax positions from prior periods | (372)    | (813)    | (648)    |
| Settlements                                       | (173)    | (890)    | (306)    |
| Balance at December 31,                           | \$ 1,509 | \$ 1,368 | \$ 2,743 |

The Company conducts business globally and, as a result, Lufkin Industries, Inc. and its subsidiaries file income tax returns in the U.S. federal and state jurisdictions, and various foreign jurisdictions. For U.S. federal purposes, tax years prior to 2006 are closed to assessment. Early in 2009, the Company settled an examination of the 2006 tax year with the IRS. Statutes for years prior to 2006 remain subject to review in certain U.S. state jurisdictions; however, the outcome of any future audit is not expected to have a material effect on the Company's results of operations. The Company is currently under examination by the state of Texas for the 2005-2006 tax years, and the Texas Comptroller has proposed adjustments to the Company. The Company is currently evaluating those proposed adjustments but does not anticipate the adjustments would result in a material change to its financial position. Settlements are expected in early 2010. The Company also remains subject to income tax examinations in the following material international jurisdictions: Canada (2005-2008), France (2007-2008), and Argentina (2003-2008). There are currently open tax exams in Argentina for tax years 2003 and 2007 and in France for 2007-2008. A tax examination in France for the 2006 tax year closed without any adjustments in late 2009.

The Company's continuing practice is to recognize interest and penalties related to income tax matters in administrative costs. The Company had \$32,000 accrued for interest and penalties at December 31, 2008. Interest and penalties of \$58,000 were accrued during the twelve months ended December 31, 2009.

## (16) Commitments and Contingencies

**Legal proceedings:** On March 7, 1997, a class action complaint was filed against Lufkin Industries, Inc. (the "Company") in the U.S. District Court for the Eastern District of Texas by an employee and a former employee of the Company who alleged race discrimination in employment. Certification hearings were conducted in Beaumont, Texas in February 1998 and in Lufkin, Texas in August 1998. In April 1999, the District Court issued a decision that certified a class for this case, which included all black employees employed by the Company from March 6, 1994, to the present. The case was administratively closed from 2001 to 2003 while the parties unsuccessfully attempted mediation. Trial for this case began in December 2003, and after the close of plaintiff's evidence, the court adjourned and did not complete the trial until October 2004. Although plaintiff's class certification encompassed a wide variety of employment practices, plaintiffs presented only disparate impact claims relating to discrimination in initial assignments and promotions at trial.

On January 13, 2005, the District Court entered its decision finding that the Company discriminated against African-American employees in initial assignments and promotions. The District Court also concluded that the discrimination resulted in a shortfall in income for those employees and ordered that the Company pay those employees back pay to remedy such shortfall, together with pre-judgment interest in the amount of 5%. On August 29, 2005, the District Court determined that the back pay award for the class of affected employees was \$3.4 million (including interest to January 1, 2005) and provided a formula for attorney fees that the Company estimates will result in a total not to exceed \$2.5 million. In addition to back pay with interest, the District Court (i) enjoined and ordered the Company to cease and desist all racially biased assignment and promotion practices and (ii) ordered the Company to pay court costs and expenses.

The Company reviewed this decision with its outside counsel and on September 19, 2005, appealed the decision to the U.S. Court of Appeals for the Fifth Circuit. On April 3, 2007, the Company appeared before the appellate court in New Orleans for oral argument in this case. The appellate court subsequently issued a decision on Friday, February 29, 2008 that reversed and vacated the plaintiff's claim regarding the initial assignment of black employees into the Foundry Division. The court also denied plaintiff's appeal for class certification of a class disparate treatment claim. Plaintiff's claim on the issue of the Company's promotional practices was affirmed but the back pay award was vacated and remanded for recomputation in accordance with the opinion. The District Court's injunction was vacated and remanded with instructions to enter appropriate and specific injunctive relief. Finally, the issue of plaintiff's attorney's fees was remanded to the District Court for further consideration in accordance with prevailing authority.

On December 5, 2008, the U.S. District Court Judge Clark held a hearing in Beaumont, Texas during which he reviewed the 5<sup>th</sup> U.S. Circuit Court of Appeals class action decision and informed the parties that he intended to implement the decision in order to conclude this litigation. At the conclusion of the hearing Judge Clark ordered the parties to submit positions regarding the issues of attorney fees, a damage award and injunctive relief. Subsequently, the Company reviewed the plaintiff's submissions which described the formula and underlying assumptions that supported their positions on attorney fees and damages. After careful review of the plaintiff's submission to the court the Company continued to have significant differences regarding legal issues that materially impacted the plaintiff's requests. As a result of these different results, the court requested further evidence from the parties regarding their positions in order to render a final decision. The judge reviewed both parties arguments regarding legal fees, and awarded the plaintiffs an interim fee, but at a reduced level from the plaintiffs original request. The Company and the plaintiffs reconciled the majority of the differences and the damage calculations which also lowered the originally requested amounts of the plaintiffs on those matters. Due to the resolution of certain legal proceedings on damages during first half of 2009 and the District Court awarding the plaintiffs an interim award of attorney fees and cost totaling \$5.8 million, the Company recorded an additional provision of \$5.0 million in the first half of 2009 above the \$6.0 million recorded in fourth quarter of 2008. The plaintiffs filed an appeal of the District Court's interim award of attorney fees with the U.S. Fifth Circuit Court of Appeals. The Fifth Circuit subsequently dismissed these appeals on August 28, 2009 on the basis that an appealable final judgment in this case had not been issued. The court commented that this issue can be reviewed with an appeal of final judgment.

On January 15, 2010, the U.S. District Court for the Eastern District of Texas notified the Company that it had entered a final judgment related to the Company's ongoing class-action lawsuit. The Court ordered Lufkin Industries to pay the plaintiffs \$3.3 million in damages, \$2.2 million in pre-judgment interest and 0.41% interest for any post-judgment interest. The Company had previously estimated the total liability for damages and interest to be approximately \$5.2 million. The Court also ordered the plaintiffs to submit a request for legal fees and expenses from January 1, 2009 through the date of the final judgment. The plaintiffs are required to submit this request within 14 days of the final judgment. On January 29, 2010, the plaintiffs filed a motion with the U.S. District Court for the Eastern District of Texas for a supplemental award of \$0.7 million for attorney's fees, costs and expenses incurred between January 1, 2009 and January 15, 2010, as allowed in the final judgment issued by the Court on January 15, 2010, related to the Company's ongoing class-action lawsuit. In the fourth quarter of 2009, the Company recorded a provision of \$1.0 million for these legal expenses and accrual adjustments for the final judgment award of damages.

On January 15, 2010, the plaintiffs filed a notice of appeal with the U.S. Fifth Circuit Court of Appeals of the District Court's final judgment. On January 21, 2010, The Company filed a notice of cross-appeal with the same court. In addition, the Company filed a motion with the District Court to stay the payment of damages referenced in the District Court's final judgment pending the outcome of the Fifth Circuit's decision on both parties' appeals. The District Court granted this motion to stay.

There are various other claims and legal proceedings arising in the ordinary course of business pending against or involving the Company wherein monetary damages are sought. For certain of these claims, the Company maintains insurance coverage while retaining a portion of the losses that occur through the use of deductibles and retention limits. Amounts in excess of the self-insured retention levels are fully insured to limits believed appropriate for the Company's operations. Self-insurance accruals are based on claims filed and an estimate for claims incurred but not reported. While the Company does maintain insurance above its self-insured levels, a decline in the financial condition of its insurer, while not currently anticipated, could result in the Company recording additional liabilities. It is management's opinion that the Company's liability under such circumstances or involving any other non-insured claims or legal proceedings would not materially affect its consolidated financial position, results of operations, or cash flow.

**Product warranties:** The change in the aggregate product warranty liability for the years ended December 31, 2009 and 2008, is as follows:

| (Thousands of dollars)       | 2009            | 2008            |
|------------------------------|-----------------|-----------------|
| Beginning balance            | \$ 3,586        | \$ 2,925        |
| Claims paid or accrued       | (3,793)         | (2,732)         |
| Additional warranties issued | 3,891           | 3,365           |
| Revisions in estimates       | 385             | 122             |
| Foreign currency translation | 151             | (94)            |
| Ending balance               | <u>\$ 4,220</u> | <u>\$ 3,586</u> |

**Operating leases:** Future minimum rental payments for operating leases having initial or remaining noncancelable lease terms in excess of one year are:

(Thousands of dollars)

|           |          |
|-----------|----------|
| 2010      | \$ 1,800 |
| 2011      | 1,143    |
| 2012      | 836      |
| 2013      | 744      |
| 2014      | 586      |
| All years | \$ 9,748 |

Expenditures for rentals and leases, including short-term rental contracts, were \$6.0 million, \$5.2 million and \$4.2 million for the years ended December 31, 2009, 2008 and 2007, respectively.

**Capital expenditures:** As of December 31, 2009, the Company had contractual commitments for capital expenditures of \$6.1 million that are expected to be paid in 2010.

# **(17) Business Segment Information**

The Company operates with two business segments: Oil Field and Power Transmission. The two operating segments are supported by a common corporate group. The accounting policies of the segments are the same as those described in the summary of major accounting policies. Corporate expenses and certain assets are allocated to the operating segments primarily based upon third party revenues. Sales by geographic region are determined by the shipping destination of a product or the site of service work. Inter-segment sales and transfers are accounted for as if the sales and transfers were to third parties, that is, at current market prices, as available. The following is a summary of key business segment and product group information:

| (Thousands of dollars)                                 | 2009       | 2008       | 2007       |
|--------------------------------------------------------|------------|------------|------------|
| Sales by segment:                                      |            |            |            |
| Oil Field                                              | \$ 349,168 | \$ 551,814 | \$ 397,354 |
| Power Transmission                                     | 172,191    | 189,380    | 158,452    |
| Total sales                                            | \$ 521,359 | \$ 741,194 | \$ 555,806 |
| Sales by geographic region:                            |            |            |            |
| United States                                          | \$ 290,924 | \$ 469,343 | \$ 318,668 |
| Europe                                                 | 50,362     | 60,463     | 49,350     |
| Canada                                                 | 19,039     | 33,354     | 31,677     |
| Latin America                                          | 94,972     | 97,310     | 80,604     |
| Middle East/North Africa                               | 40,310     | 56,149     | 52,849     |
| Other                                                  | 25,752     | 24,575     | 22,658     |
| Total sales                                            | \$ 521,359 | \$ 741,194 | \$ 555,806 |
| Earnings (loss) before income taxes:                   |            |            |            |
| Oil Field                                              | \$ 21,405  | \$ 116,150 | \$ 83,737  |
| Power Transmission                                     | 17,040     | 26,308     | 27,160     |
| Corporate & Other*                                     | (5,433)    | (4,479)    | 3,626      |
| Adjustment**                                           | -          | (1,567)    | (5,065)    |
| Total earnings (loss) before income taxes              | \$ 33,012  | \$ 136,412 | \$ 109,458 |
| Assets by segment:                                     |            |            |            |
| Oil Field                                              | \$ 293,140 | \$ 275,395 | \$ 226,697 |
| Power Transmission                                     | 128,789    | 126,912    | 130,008    |
| Corporate & Other*                                     | 118,850    | 127,300    | 121,361    |
| Adjustment**                                           | -          | -          | 12,327     |
| Total assets                                           | \$ 540,779 | \$ 529,607 | \$ 490,393 |
| Property, plant & equipment, net, by geographic region |            |            |            |
| United States                                          | \$ 121,419 | \$ 96,566  | \$ 82,643  |
| Europe                                                 | 14,827     | 11,194     | 10,947     |
| Canada                                                 | 9,072      | 9,731      | 13,796     |
| Latin America                                          | 14,211     | 12,280     | 9,516      |
| Other                                                  | 241        | 308        | 288        |
| Total P, P & E, net                                    | \$ 159,770 | \$ 130,079 | \$ 117,190 |
| Capital expenditures by segment                        |            |            |            |
| Oil Field                                              | \$ 27,384  | \$ 20,786  | \$ 12,830  |
| Power Transmission                                     | 12,168     | 7,755      | 5,159      |
| Corporate & Other*                                     | 273        | 1,011      | 826        |
| Total capital expenditures                             | \$ 39,825  | \$ 29,552  | \$ 18,815  |
| Depreciation/amortization by segment:                  |            |            |            |
| Oil Field                                              | \$ 11,561  | \$ 9,815   | \$ 8,578   |
| Power Transmission                                     | 5,951      | 5,151      | 4,704      |
| Corporate & Other*                                     | 945        | 733        | 726        |
| Total depreciation/amortization                        | \$ 18,457  | \$ 15,699  | \$ 14,008  |

**(17) Business Segment Information (Continued)**

Additional key segment information is presented below:

Year Ended December 31, 2009

| (Thousands of dollars)                         | <u>Oil Field</u>  | <u>Power<br/>Transmission</u> | <u>Corporate<br/>&amp; Other*</u> | <u>Adjustment**</u> | <u>Total</u>      |
|------------------------------------------------|-------------------|-------------------------------|-----------------------------------|---------------------|-------------------|
| Gross sales                                    | \$ 351,766        | \$ 175,476                    | \$ -                              | \$ -                | \$ 527,242        |
| Inter-segment sales                            | (2,598)           | (3,285)                       | -                                 | -                   | (5,883)           |
| Net sales                                      | <u>\$ 349,168</u> | <u>\$ 172,191</u>             | <u>\$ -</u>                       | <u>\$ -</u>         | <u>\$ 521,359</u> |
| Operating income (loss)                        | \$ 20,458         | \$ 16,966                     | \$ (6,000)                        | \$ -                | \$ 31,424         |
| Other income (expense), net                    | 947               | 74                            | 567                               | -                   | 1,588             |
| Earnings (loss) before<br>income tax provision | <u>\$ 21,405</u>  | <u>\$ 17,040</u>              | <u>\$ (5,433)</u>                 | <u>\$ -</u>         | <u>\$ 33,012</u>  |

Year Ended December 31, 2008

| (Thousands of dollars)                         | <u>Oil Field</u>  | <u>Power<br/>Transmission</u> | <u>Corporate<br/>&amp; Other*</u> | <u>Adjustment**</u> | <u>Total</u>      |
|------------------------------------------------|-------------------|-------------------------------|-----------------------------------|---------------------|-------------------|
| Gross sales                                    | \$ 557,669        | \$ 195,161                    | \$ -                              | \$ -                | \$ 752,830        |
| Inter-segment sales                            | (5,855)           | (5,781)                       | -                                 | -                   | (11,636)          |
| Net sales                                      | <u>\$ 551,814</u> | <u>\$ 189,380</u>             | <u>\$ -</u>                       | <u>\$ -</u>         | <u>\$ 741,194</u> |
| Operating income (loss)                        | \$ 117,535        | \$ 26,132                     | \$ (6,000)                        | \$ (1,567)          | \$ 136,100        |
| Other income (expense), net                    | (1,385)           | 176                           | 1,521                             | -                   | 312               |
| Earnings (loss) before<br>income tax provision | <u>\$ 116,150</u> | <u>\$ 26,308</u>              | <u>\$ (4,479)</u>                 | <u>\$ (1,567)</u>   | <u>\$ 136,412</u> |

Year Ended December 31, 2007

| (Thousands of dollars)                         | <u>Oil Field</u>  | <u>Power<br/>Transmission</u> | <u>Corporate<br/>&amp; Other*</u> | <u>Adjustment**</u> | <u>Total</u>      |
|------------------------------------------------|-------------------|-------------------------------|-----------------------------------|---------------------|-------------------|
| Gross sales                                    | \$ 399,955        | \$ 161,731                    | \$ -                              | \$ -                | \$ 561,686        |
| Inter-segment sales                            | (2,601)           | (3,279)                       | -                                 | -                   | (5,880)           |
| Net sales                                      | <u>\$ 397,354</u> | <u>\$ 158,452</u>             | <u>\$ -</u>                       | <u>\$ -</u>         | <u>\$ 555,806</u> |
| Operating income (loss)                        | \$ 82,629         | \$ 27,122                     | \$ -                              | \$ (5,065)          | \$ 104,686        |
| Other income (expense), net                    | 1,108             | 38                            | 3,626                             | -                   | 4,772             |
| Earnings (loss) before<br>income tax provision | <u>\$ 83,737</u>  | <u>\$ 27,160</u>              | <u>\$ 3,626</u>                   | <u>\$ (5,065)</u>   | <u>\$ 109,458</u> |

\* Corporate &amp; Other includes the litigation reserve.

\*\* Due to the discontinuation of the Trailer segment, certain items previously allocated to that segment have been reclassified to continuing operations. One adjustment is related to pension and postretirement charges associated with Trailer personnel that will continue to be a liability in future years. The other adjustment is for corporate allocations previously charged to Trailer as these expenses will continue in the future.

**(17) Business Segment Information (Continued)**

The following table reconciles total assets for the years ended December 31:

| (Thousands of dollars)              | 2009              | 2008              |
|-------------------------------------|-------------------|-------------------|
| Assets from continuing operations   | \$ 540,779        | \$ 529,607        |
| Assets from discontinued operations | 811               | 1,111             |
| Total assets                        | <u>\$ 541,590</u> | <u>\$ 530,718</u> |

**(18) Concentrations of Credit Risk**

The Company's concentration with respect to trade accounts receivable is limited. The large number of customers and diversified customer base across the two segments significantly reduces the Company's credit risk. The Company also has strict policies regarding the granting of credit to customers and does not offer credit terms to those customers that do not meet certain financial criteria and other guidelines. However, the recent downturn in the global economy has caused a higher level of credit risk. The Company is monitoring the payment practices of customers and is reviewing credit limits more frequently and conservatively than in prior periods. At December 31, 2009, 2008 and 2007, one customer represented 11.0%, 15.4% and 15.9%, respectively, of the consolidated Company sales.

**(19) Quarterly Financial Data (Unaudited)**

The following table sets forth unaudited quarterly financial data for 2009 and 2008:

| <u>Quarterly Financial Data (Unaudited)</u>  |                          |                           |                          |                           |
|----------------------------------------------|--------------------------|---------------------------|--------------------------|---------------------------|
| (Millions of dollars, except per share data) | <u>First<br/>Quarter</u> | <u>Second<br/>Quarter</u> | <u>Third<br/>Quarter</u> | <u>Fourth<br/>Quarter</u> |
| <b><u>2009</u></b>                           |                          |                           |                          |                           |
| Sales                                        | \$ 153.1                 | \$ 123.7                  | \$ 117.7                 | \$ 126.8                  |
| Gross profit                                 | 34.2                     | 27.0                      | 24.9                     | 26.4                      |
| Net earnings                                 | 9.1                      | 4.7                       | 5.1                      | 3.6                       |
| Basic earnings per share                     | 0.61                     | 0.32                      | 0.34                     | 0.24                      |
| Diluted earnings per share                   | 0.61                     | 0.32                      | 0.34                     | 0.24                      |
| <b><u>2008</u></b>                           |                          |                           |                          |                           |
| Sales                                        | \$ 141.1                 | \$ 174.5                  | \$ 195.1                 | \$ 230.5                  |
| Gross profit                                 | 40.5                     | 47.8                      | 55.8                     | 69.9                      |
| Net earnings                                 | 15.6                     | 21.2                      | 25.0                     | 26.6                      |
| Basic earnings per share                     | 1.06                     | 1.44                      | 1.68                     | 1.79                      |
| Diluted earnings per share                   | 1.05                     | 1.42                      | 1.66                     | 1.78                      |

## **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None

### **Item 9A. Controls and Procedures**

#### **Disclosure Controls and Procedures**

Based on their evaluation of the Company's disclosure controls and procedures as of December 31, 2009, the Chief Executive Officer of the Company, John F. Glick, and the Chief Financial Officer of the Company, Christopher L. Boone, have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934) are effective to ensure that information required to be disclosed in reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and effective to ensure that information required to be disclosed in such reports is accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, to allow timely decisions regarding disclosure.

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended December 31, 2009, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting and the Report of the Independent Registered Public Accounting Firm thereon are set forth in Part II, Item 8 of this report and are incorporated herein by reference.

### **Item 9B. Other Information**

None

## **PART III**

### **Item 10. Directors, Executive Officers of the Registrant and Corporate Governance**

The information required by Item 10 regarding directors is incorporated by reference from the information under the captions "Nominees for Director" and "Information About Current and Continuing Directors" in the Company's definitive Proxy Statement for the 2010 Annual Meeting of Stockholders (the "Proxy Statement"), which will be filed within 120 days after December 31, 2009. The information required by Item 10 regarding audit committee financial expert disclosure and the identification of the Company's audit committee is incorporated by reference from the information under the caption "Information About Current and Continuing Directors – Board Committees" in the Proxy Statement. The information required by Item 10 regarding the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is incorporated by reference from the information under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement. The information required by Item 10 regarding executive officers is incorporated by reference from the information under the caption "Information About Current Executive Officers" in the Proxy Statement.

The Company has adopted a written code of ethics, entitled the "Code of Ethics for Senior Financial Officers of the Company." The Company requires all of its senior financial officers, including the Company's principal executive officer, principal financial officer and principal accounting officer, to adhere to the Code of Ethics for Senior Financial Officers of the Company in addressing the legal and ethical issues encountered in conducting their work. The Company has also adopted a written Corporate Code of Conduct applicable to all salaried employees of the Company, including the senior financial officers. The Company has made available to stockholders the Code of Ethics for Senior Financial Officers of the Company and the Corporate Code of Conduct on its website at [www.lufkin.com](http://www.lufkin.com) or a copy can be obtained by writing to the Company Secretary, P.O. Box 849, Lufkin, Texas 75902. Any amendment to, or waiver from, the Code of Ethics for Senior Financial Officers of the Company and the Corporate Code of Conduct will be disclosed in a current report on Form 8-K within four business days of such amendment or waiver as required by the Marketplace Rules of the Nasdaq Stock Market, Inc.

### **Item 11. Executive Compensation**

The information required by Item 11 is incorporated by reference from the information under the captions "Executive Compensation", "Compensation Committee Report", "Stock Option Plans", "Compensation Committee Interlocks and Insider Participation", "Board Committees" and "Director Compensation" in the Proxy Statement.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information required by Item 12 related to security ownership of certain beneficial owners and management and related stockholder matters is incorporated by reference from the information under the caption "Security Ownership of Certain Beneficial Owners and Management" in the Proxy Statement. Information concerning securities authorized for issuance under the Company's equity compensation plans is set forth under the caption "Equity Compensation Plan Information" in Part II, item 5 of this report and is incorporated in Item 12 of this report by reference.

### **Item 13. Certain Relationships and Related Transactions and Director Independence**

During 2009, there were no transactions with management and others, no business relationships regarding directors or nominees for directors and no indebtedness of management required to be disclosed pursuant to this Item 13. The information required by Item 13 related to director independence is incorporated by reference from the information under the caption "Information About Current and Continuing Directors" in the Proxy Statement. The information required by Item 13 regarding related-person transactions is incorporated by reference to the information under the caption "Related Person Transactions" in the Proxy Statement.

### **Item 14. Principal Accountant Fees and Services**

The information required by Item 14 is incorporated by reference from the information under the caption "Report of the Audit Committee" and "Independent Public Accountants" in the Proxy Statement.

## PART IV

### **Item 15. Exhibits and Financial Statement Schedules**

- (a) Documents filed as part of the report  
1. Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm  
Consolidated Balance Sheets  
Consolidated Statements of Earnings  
Consolidated Statements of Shareholders' Equity & Comprehensive Income  
Consolidated Statements of Cash Flows  
Notes to Consolidated Financial Statements

2. Financial Statement Schedules

Schedule II- Valuation and Qualifying Accounts

All other financial statement schedules are omitted because of the absence of conditions under which they are required or because all material information required to be reported are included in the consolidated financial statements and notes thereto.

3. Exhibits

3.1

Fourth Restated Articles of Incorporation, as amended, included as Exhibit 4.1 to Lufkin Industries, Inc.'s (the "Company") registration statement on Form S-8 filed February 17, 2004 (File No. 333-112890), which exhibit is incorporated herein by reference.

3.2

Articles of Amendment to Fourth Restated Articles of Incorporation, included as Exhibit 3.1 to the Company's current report on Form 8-K of the registrant filed December 10, 1999, which exhibit is incorporated herein by reference.

3.3

Amended and Restated Bylaws, included as Exhibit 3.1 to the Company's current report on Form 8-K of the registrant filed October 9, 2007 (File No. 0-02612), which exhibit is incorporated herein by reference.

4.1

Form of Common Stock Certificate, included as Exhibit 4.1 to the Company's quarterly report on Form 10-Q of the registrant filed May 9, 2005 (File No. 0-02612), which exhibit is incorporated herein by reference.

\*10.1

1990 Stock Option Plan, included as Exhibit 4.3 to the Company's registration statement on Form S-8 dated August 23, 1995 (File No. 33-62021), which plan is incorporated herein by reference.

\*10.2

1996 Nonemployee Director Stock Option Plan, included as Exhibit 4.3 to the Company's registration statement on Form S-8 dated June 28, 1996 (File No. 333-07129), which plan is incorporated herein by reference.

\*10.3

Amended and Restated Incentive Stock Compensation Plan 2000, included as Exhibit 10.1 to the Company's current report on Form 8-K dated August 2, 2007 (File No. 0-02612), which exhibit is incorporated herein by reference.

- 10.4 Credit Agreement, dated December 30, 2002, between Lufkin Industries, Inc., JPMorgan Chase Bank and the lenders party thereto, included as Exhibit 10.1 to the Company's quarterly report on Form 10-Q of the registrant filed May 9, 2005 (File No. 0-02612), which exhibit is incorporated herein by reference.
- 10.5 Agreement and First Amendment to Credit Agreement, dated June 30, 2004, between Lufkin Industries, Inc. and JPMorgan Chase Bank, included as Exhibit 10.2 to the Company's quarterly report on Form 10-Q of the registrant filed May 9, 2005 (File No. 0-02612), which exhibit is incorporated herein by reference.
- 10.6 Agreement and Second Amendment to Credit Agreement, dated February 1, 2005, between Lufkin Industries, Inc. and JPMorgan Chase Bank, included as Exhibit to the Company's quarterly report on 10.3 Form 10-Q of the registrant filed May 9, 2005 (File No. 0-02612), which exhibit is incorporated herein by reference.
- 10.7 Agreement and Third Amendment to Credit Agreement between Lufkin Industries, Inc. and JPMorgan Chase Bank, National Association, included as Exhibit 10.3 to the Company's current report on Form 8-K of the registrant filed February 21, 2006 (File No. 0-02612), which exhibit is incorporated herein by reference.
- 10.8 Agreement and Fourth Amendment to Credit Agreement between Lufkin Industries, Inc. and JPMorgan Chase Bank, National Association, included as Exhibit 10.1 to the Company's current report on Form 8-K of the registrant filed November 30, 2007 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.9 Form of Employee Stock Option Agreement for the Company's 2000 Incentive Stock Compensation Plan, included as Exhibit 10.5 to the Company's current report on Form 8-K dated May 13, 2008 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.10 Form of Director Stock Option Agreement for the Company's 2000 Incentive Stock Compensation Plan, included as Exhibit 10.6 to the Company's current report on Form 8-K dated May 13, 2008 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.11 Thrift Plan Restoration Plan for Salaried Employees of Lufkin Industries, Inc., as amended, included as exhibit 10.13 to the Company's annual report on Form 10-K of the registrant filed March 1, 2007 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.12 Retirement Plan Restoration Plan for Salaried Employees of Lufkin Industries, Inc, as amended, included as exhibit 10.14 to the Company's annual report on Form 10-K of the registrant filed March 1, 2007 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.13 Lufkin Industries, Inc. Supplemental Retirement Plan, as amended, as amended, included as exhibit 10.15 to the Company's annual report on Form 10-K of the registrant filed March 1, 2007 (File No. 0-02612), which exhibit is incorporated herein by reference.

- \*10.14 Lufkin Industries, Inc. 2010 Variable Compensation Plan, included as Exhibit 10.1 to Form 8-K filed February 12, 2010 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.15 Amended and Restated Severance Agreement, dated January 21, 2008, between Lufkin Industries, Inc. and Mark E. Crews, included as Exhibit 10.1 to the Company's current report on Form 8-K filed on December 31, 2008 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.16 Amended and Restated Severance Agreement, dated February 12, 2008, between Lufkin Industries, Inc. and Terry L. Orr, included as Exhibit 10.2 to the Company's current report on Form 8-K filed on December 31, 2008 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.17 Amended and Restated Severance Agreement, dated March 1, 2008, between Lufkin Industries, Inc. and John F. Glick, included as Exhibit 10.3 to the Company's current report on Form 8-K filed on December 31, 2008 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.18 Amended and Restated Severance Agreement, dated May 7, 2008, between Lufkin Industries, Inc. and Christopher L. Boone, included as Exhibit 10.4 to the Company's current report on Form 8-K filed on December 31, 2008 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.19 Amended and Restated Severance Agreement, dated January 1, 2005, between Lufkin Industries, Inc. and Paul G. Perez, included as Exhibit 10.5 to the Company's current report on Form 8-K filed on December 31, 2008 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.20 Amended and Restated Severance Agreement, dated January 1, 2005, between Lufkin Industries, Inc. and Scott H. Semlinger, included as Exhibit 10.6 to the Company's current report on Form 8-K filed on December 31, 2008 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.21 Amended and Restated Employment Agreement, dated as of March 1, 2008, by and between Lufkin Industries, Inc. and John F. Glick included as Exhibit 10.7 to the Company's current report on Form 8-K filed on December 31, 2008 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.22 Amended and Restated Employment Agreement, dated as of August 18, 2006, by and between Lufkin Industries, Inc. and Paul G. Perez included as Exhibit 10.8 to the Company's current report on Form 8-K filed on December 31, 2008 (File No. 0-02612), which exhibit is incorporated herein by reference.
- \*10.23 Amended and Restated Employment Agreement, dated as of August 18, 2006, by and between Lufkin Industries, Inc. and Scott H. Semlinger included as Exhibit 10.9 to the Company's current report on Form 8-K filed on December 31, 2008 (File No. 0-02612), which exhibit is incorporated herein by reference.
- 18.1 Accountants' preferability letter regarding change in accounting principles.

- 21 Subsidiaries of the registrant
- 23 Consent of Independent Registered Public Accounting Firm
- 31.1 Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer
- 31.2 Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer
- 32.1 Section 1350 Certification of the Chief Executive Officer certification
- 32.2 Section 1350 Certification of the Chief Financial Officer certification

\* Management contract or compensatory plan or arrangement.

**SCHEDULE II**

Lufkin Industries, Inc.  
Valuation & Qualifying Accounts  
(in thousands of dollars)

| Description                         | Balance at<br>Beginning<br>of Year | Additions             |                                 |            | Balance at<br>End of<br>Year |
|-------------------------------------|------------------------------------|-----------------------|---------------------------------|------------|------------------------------|
|                                     |                                    | Charged<br>to Expense | Charged to<br>Other<br>Accounts | Deductions |                              |
| Allowance for Doubtful Receivables: |                                    |                       |                                 |            |                              |
| Year Ended December 31, 2009        | \$ 735                             | (1,844)               |                                 | 1,349      | \$ 240                       |
| Year Ended December 31, 2008        | 89                                 | 2,462                 | -                               | (1,816)    | 735                          |
| Year Ended December 31, 2007        | \$ 129                             | 12                    | -                               | (52)       | \$ 89                        |
| Inventory: Valuation Reserves:      |                                    |                       |                                 |            |                              |
| Year Ended December 31, 2009        | \$ 4,535                           | 100                   | -                               | (1,992)    | \$ 2,643                     |
| Year Ended December 31, 2008        | 1,579                              | 2,964                 | -                               | (8)        | 4,535                        |
| Year Ended December 31, 2007        | \$ 1,172                           | 446                   | -                               | (39)       | \$ 1,579                     |
| Inventory: LIFO Reserves:           |                                    |                       |                                 |            |                              |
| Year Ended December 31, 2009        | \$ 32,926                          | (2,965)               |                                 | -          | \$ 29,961                    |
| Year Ended December 31, 2008        | 25,184                             | 7,742                 | -                               | -          | 32,926                       |
| Year Ended December 31, 2007        | \$ 23,279                          | 1,905                 | -                               | -          | \$ 25,184                    |

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LUFKIN INDUSTRIES, INC.

BY /s/ Christopher L. Boone

Christopher L. Boone  
Signing on behalf of the registrant and as  
Vice President/Treasurer/Chief Financial Officer  
(Principal Financial and Accounting Officer)

Date: March 1, 2010

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

| Name                                               | Title                                                                                            | Date          |
|----------------------------------------------------|--------------------------------------------------------------------------------------------------|---------------|
| By <u>/s/ J. F. Glick</u><br>J. F. Glick           | President/Chief Executive Officer<br>(Principal Executive Officer)                               | March 1, 2010 |
| By <u>/s/ C. L. Boone</u><br>C. L. Boone           | Vice President/Treasurer/Chief Financial Officer<br>(Principal Financial and Accounting Officer) | March 1, 2010 |
| By <u>/s/ D. V. Smith</u><br>D. V. Smith           | Chairman of the Board of Directors                                                               | March 1, 2010 |
| By <u>/s/ J. F. Anderson</u><br>J.F. Anderson      | Director                                                                                         | March 1, 2010 |
| By <u>/s/ S. V. Baer</u><br>S. V. Baer             | Director                                                                                         | March 1, 2010 |
| By <u>/s/ J. D. Hofmeister</u><br>J. D. Hofmeister | Director                                                                                         | March 1, 2010 |
| By <u>/s/ J. T. Jongebloed</u><br>J. T. Jongebloed | Director                                                                                         | March 1, 2010 |
| By <u>/s/ J. H. Lollar</u><br>J. H. Lollar         | Director                                                                                         | March 1, 2010 |
| By <u>/s/ B. H. O'Neal</u><br>B. H. O'Neal         | Director                                                                                         | March 1, 2010 |
| By <u>/s/ R. R. Stewart</u><br>R. R. Stewart       | Director                                                                                         | March 1, 2010 |
| By <u>/s/ H. J. Trout, Jr.</u><br>H. J. Trout, Jr. | Director                                                                                         | March 1, 2010 |
| By <u>/s/ T. E. Wiener</u><br>T. E. Wiener         | Director                                                                                         | March 1, 2010 |

#### **CORPORATE OFFICERS:**

**J. F. Glick**  
President  
Chief Executive Office

**M. E. Crews**  
Vice President, General Manager –  
Oilfield Division

**T. L. Orr**  
Vice President, General Manager –  
Power Transmission Division

**S. H. Semlinger**  
Vice President, Manufacturing Technology

**P. G. Perez**  
Vice President, General Counsel,  
Corporate Secretary

**C. L. Boone**  
Vice President, Treasurer,  
Chief Financial Officer

#### **KEY LOCATIONS:**

**Corporate Office**  
P.O. Box 849  
Lufkin, TX 75902-0849  
936-634-2211  
www.lufkin.com

**Houston Sales**  
**Oilfield/Power Transmission**  
450 Gears Road, Suite 550  
Houston, TX 77067  
281-875-6500

**Lufkin Automation**  
11375 West Sam Houston Parkway  
Suite 800  
Houston, TX 77031  
281-495-1100

**Foundry Sales**  
P.O. Box 849  
Lufkin, TX 75902  
936-634-2211

**Oilfield Domestic Service**  
**Headquarters/Sales**  
P.O. Box 849  
Lufkin, TX 75902  
936-634-2211

**Gear Repair and Service**  
**Headquarters/Sales**  
711 Industrial Blvd.  
Lufkin, TX 75902  
936-634-2211

**Lufkin Industries, Inc. – Singapore**  
**Representative Office**  
83 Clemenceau Avenue  
#04-15/16, Suite 10, UE Square  
Singapore 239917  
65-6887-3807

**Lufkin Industries, Inc. – Sales Office**  
P.O. Box 667  
Worcester, WR4 OXR, United Kingdom  
44-1905-616-204

**Lufkin Industries Bahrain**  
Office 1, Bldg. 332  
Road 1309, Block 413  
Tashan, Kingdom of Bahrain  
973-1740-3524

**Lufkin France, S.A.S.**  
Avenue des Chavannes  
70220 Fougerolles, France  
(33) 3-84-49-64-00

**Lufkin France, S.A.S.**  
Aeroparc d'Entzheim  
Rue Icare – Le Neos  
67960 Entzheim, France  
(33) 3-90-29-76-20

**Lufkin Canada Sales & Services**  
1050 McDougall Place, 808-4th Ave. S.W.  
Calgary, Alberta T2P 3E8, Canada  
403-234-7692

**Lufkin Argentina S.A.**  
Av. Santa Fe 768 – 3er Piso  
C1059ABO – Capital Federal  
Buenos Aires, Argentina  
5411-4315-1641

**Lufkin Middle East**  
Road 281, No. 5  
New Maadi  
Cairo, Egypt  
202-754-8828

**Lufkin & Partners, LLC**  
Way 4886, Block 248, Building 5498  
Al-Khuwair, Muscat  
Sultanate of Oman  
968-2449-1090

**Lufkin Industries Australia Pty. Ltd.**  
Level 18, Riverside Centre  
123 Eagle Street  
Brisbane, QLD 4000, Australia  
61-7-3112-2759

**Lufkin Industries, Inc. – Sales Office**  
Via Dei Mille 50, Interno 6  
56038 Ponsacco, Pisa, Italy  
39-0587-734-472

**Lufkin Industries Romania SRL**  
154A Gheorghe Doja Street, 1st Floor  
Ploiesti, Prahova 100176  
Romania  
40-721-940-240

#### **COMMON STOCK TRANSFER AGENT:**

**Computershare Investor Services, LLC**  
250 Royall Street  
Canton, MA 02021  
888-294-8217

#### **AUDITORS:**

**Deloitte & Touche, LLP**  
1111 Bagby Street, Suite 4500  
Houston, TX 77002-4196  
713-982-2000

#### **INVESTOR RELATIONS COUNSEL:**

**Dennard Rupp Gray & Easterly, LLC**  
1800 West Loop South, Suite 200  
Houston, TX 77027  
713-529-6600

**LUFKIN**

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Lufkin, TX 75902-0849  
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