

The Energy Flows Through Us™
2010 ANNUAL REPORT



LUFKIN





*The Annual
Meeting of Shareholders
of Lufkin Industries, Inc.
will be held at the
Crown Colony Country Club,
900 Crown Colony Drive
Lufkin, Texas on
May 4, 2011, at 9:00 a.m. CDT.*



RUDOLPH THE RED NOSED PUMPING UNIT

For more than 40 years, Rudolph the Red Nosed Pumping Unit has been ushering in the holiday season in Lufkin, TX.

This full size, LUFKIN Mark 640 oil pumping unit is a fully operational unit painted red especially for the season. There are more than 1,000 7-watt lights on Rudolph.

Rudolph precedes a 38-foot LUFKIN Ultralight dump trailer decorated with lights and extras so it resembles a sleigh.

The working pumping unit is dismantled after the holiday season, repainted and sold to a Lufkin Industries customer to become a working pumping unit somewhere in the world.

OILFIELD PRODUCTS AND SERVICES

Lufkin is a leading global provider of artificial lift oilfield equipment and services, primarily consisting of highly adaptable pumping units, 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.



POWER TRANSMISSION PRODUCTS AND SERVICES

Lufkin is also a leading worldwide provider of power transmission equipment, primarily precision-made gears in weights of from 300 pounds to 250 tons and in power levels from 20 to 85,000 horsepower. These highly engineered products are used in industrial applications in a variety of industries, such as oil and gas, petrochemical, steel, plastics, sugar, rubber, marine and power generation. Lufkin's global service organization supports new equipment sales as well as an extensive after-market for installed power transmission equipment.



UNITED WAY

Lufkin Industries, Inc. is an active participant in the Angelina County United Way campaign. This was the 63rd year for the local agency that provides funds for 21 non-profit Angelina County organizations. The Founding Fathers of the Angelina County United Way included Mr. S. W. Henderson and Mr. W. W. Trout, both with strong ties to the Company.

In 2010, Lufkin Industries employees raised 139% of their goal by raising \$282,704. Ten percent of the total amount given by Lufkin Industries is set aside to help Lufkin employees in an emergency.

Lufkin Industries employees donate their time and talents to the local non-profit agencies, and we are proud of each and every one of our employees and their commitment to our community.



FINANCIAL HIGHLIGHTS

	December 31,				
(Thousands of dollars, except per share amounts)	2010	2009	2008	2007	2006
Sales from continuing operations	\$645,643	\$521,359	\$741,194	\$555,806	\$526,122
Operating Income from continuing operations	68,659	31,424	136,100	104,686	100,448
Net Earnings from continuing operations	43,531	22,479	88,025	71,785	71,272
Net earnings	43,823	22,026	88,239	74,211	72,994
Earnings per share:					
Basic*	\$1.46	\$0.74	\$2.99	\$2.49	\$2.46
Diluted*	\$1.45	\$0.74	\$2.96	\$2.46	\$2.42
Dividends per share*	\$0.50	\$0.50	\$0.50	\$0.44	\$0.31
Total assets	621,078	541,590	530,718	500,656	429,069
Working capital	260,621	253,744	296,925	224,733	181,957
Long-term notes payable, net of current portion	-	1,516	-	-	-
Shareholders' equity	485,960	435,679	413,937	384,653	328,140

*Years 2006-2009 adjusted for 2-for-1 Stock Split effective on June 1, 2010



ROMANIA

Lufkin Industries, Inc. announced in July 2010 its intention to construct a manufacturing facility near Ploiesti, Romania, just north of the capital Bucharest. Lufkin held a groundbreaking ceremony on October 6, 2010.

This facility is being built on an 82 acre site with an estimated cost of US\$126 million. The facility will initially employ just over 300 employees when completed in 2012. The Government of Romania, through the Ministry of Public Finance, has agreed to provide Lufkin with economic development incentives and financial assistance of 28 million Euros towards the construction costs, or approximately 30% of the plan cost.



JOHN F. "JAY" GLICK
President and Chief Executive Officer

"The demand for energy to fuel those economies began to recover, and with it, the demand for Lufkin products grew. Revenues in 2010 were the second highest in the company's history. "

DEAR FELLOW SHAREHOLDERS

During 2010, many of our markets began to recover from the recession that has mired much of the world since late 2008. Across the globe, economies slowly emerged, country by country, from the worst economic downturn since the Great Depression. The demand for energy to fuel those economies began to recover, and with it, the demand for Lufkin's products grew. Revenues in 2010 were the second highest in the company's history.

In 2009, during the early stages of the industry downturn, we believed the drop in oil prices was a temporary disruption in the long-term growth in global demand for petroleum products and other forms of energy. Consequently, we continued to invest in high-caliber people, acquisitions and product development. These investments were strategically aimed at extending the company's geographic reach, as well as broadening our product offering. We also invested in our existing production facilities, adding new machine tools to improve the efficiency and expand the capacity of our factories and service centers. Those investments enabled us to capitalize on the market opportunities we saw during 2010.

Financial Results

In 2010, our revenues grew by 24% to \$646 million. Growth was led by the Oilfield Division, where revenues increased 37% versus 2009. Activity in the Power Transmission Division was down 2% but relatively flat year-over-year when adjusted for the effect of the weaker Euro exchange rate versus the U.S. dollar. Earnings from continuing operations were \$44.2 million, or \$1.46 per share, excluding a pre-tax \$1.0 million, or \$0.02 per diluted share legal provision that was accrued in the third quarter. This represents a significant increase from the \$26.3 million, or \$0.89 per diluted share we earned in 2009, excluding the impact of a pre-tax \$6.0 million, or \$0.13 per diluted share litigation charge.

ODESSA, TX MULTI-FUNCTION SERVICE CENTER

Construction on Lufkin Industries, Inc's Multi-Function Service Center in Odessa, Texas was completed in April 2010. The service center will house the Oilfield Service, Automation and ILS operations. The service center also features a new training center for customers and employees.



Oilfield Division

Our 2010 Oilfield business benefitted from relatively stable oil prices. West Texas Intermediate traded within a \$75 to \$85 per barrel range until December, when prices began to rise slightly. This price stability, coupled with a forecast for a steady increase in global oil demand, created a very favorable investment climate for new oil production, which, in turn, drove demand for Lufkin's artificial lift products and services.

The uncertainty brought on by recent events in North Africa and the Middle East have pushed oil prices near \$100 per barrel. While it's too early to know the full consequences of the changes taking place in this region, a likely response will be greater exploration and production spending in more stable regions to mitigate supply risks.

We continued to expand our market penetration into international markets around the globe, but the real story for 2010 was the robust growth in North American oil production. Unconventional oil shale plays in the Bakken formation in North Dakota, the Eagle Ford play in South Texas and the Niobrara play in Wyoming were major growth areas in 2010, and we expect those basins to expand in scope over the next several years.

The BP Macondo blowout in the Gulf of Mexico in April 2010 had repercussions for the oil and gas industry that will likely be felt for years to come. The deep water drilling moratorium in the Gulf of Mexico that was imposed in the wake of the Macondo disaster was lifted in October, but as of February 2011, no new drilling permits had been issued. The resulting limited access to offshore reserves, coupled with better production techniques to improve the commercial viability of the shales and other unconventional oil plays, enhanced the attraction of onshore acreage and drove additional capital spending to the lower 48 and Canada.

During 2010, Lufkin enhanced its Automation products business with the opening of a new plant in Missouri City, Texas, near Houston. This facility houses an expanded manufacturing

operation that gives us the capacity to significantly increase the volume of automation products we supply to customers around the globe. It also houses our Automation engineering and product development groups. This facility will support growth in Automation technology well into the future. Lufkin's technically advanced well automation equipment helps our customers minimize operating costs and optimize production by monitoring and controlling production from rod-lift assisted wells.

We also opened our new Odessa Service Center in West Texas to support oil and gas customers in the Permian Basin. This service center allowed us to combine three separate operations under one roof, thereby improving operational efficiencies and the level of customer service offered to users of our rod pumps, gas and plunger lift, completion and automation products. The building houses a modern training center that hosts training sessions for Lufkin personnel as well as our customers in the region.

Lufkin Industries broke ground on a \$126 million manufacturing and service center in Ploiesti, Romania in the fourth quarter of 2010. This will become the Eastern Hemisphere headquarters for Lufkin's Oilfield Division. The Romanian government is providing state aid, which will offset roughly one-third of the cost of the project. The site will also support the Power Transmission Division's products in Eastern Europe and serve as a service and repair center for both divisions. Construction is on schedule. We expect to open the aftermarket service center in the second half of 2011 and begin manufacturing new products in the third quarter of 2012. The Romanian operation will be the cornerstone of our future growth strategies in Europe, Central Asia, the Middle East and North Africa.

Power Transmission Division

The Power Transmission Division weathered a difficult year during which many oil and gas projects were delayed. The division responded by developing new products for other markets. For

LUFKIN AUTOMATION

Lufkin Automation is a leader in the development, manufacture, sales and service of technically advanced, electronic well automation equipment and the premier supplier of artificial lift optimization and training with emphasis on increasing profits for oil and gas producers through minimized operating costs and optimum production.

Lufkin Automation will provide quality and value in engineered products and services to its customers, growth opportunities for its shareholders and employees, and will maximize its rate of return on capital investment.

Lufkin Automation moved into their new facility in Missouri City, Texas in November 2010.



example, the division supplied large, vertical pump drives for flood control applications for the City of New Orleans. In addition, Lufkin France developed a new line of pump drives for the nuclear power industry. The Power Transmission aftermarket group had a very successful year, registering record revenues in the service, repair, and remanufacture of gear units in a variety of applications, from the oil sands of Canada to offshore drilling rigs around the globe.

Throughout 2010, the markets we serve improved steadily, but the rate of improvement accelerated during the second half of the year. The intake of new orders during the fourth quarter made it the most robust quarter for bookings since the third quarter of 2008. This allowed us to begin 2011 with a strong backlog of orders on the books.

Investing in Our Future

The capital investments we have made during the past several years have positioned the company to capitalize on the growing demand for our products and services. But just as critical as facilities and machine tools are the investments we are making in people across our global footprint. To our long-serving, experienced team of professional managers in North America, Argentina and France, we have added talented managers, engineers and sales representatives who are contributing their international experience and strong technical knowledge, enabling Lufkin Industries to compete even more successfully in new, global markets. As a part of this effort, Lufkin's workforce is more culturally and linguistically diverse today. That diversity will ensure Lufkin's international efforts are closely tailored to the markets we will serve now and in the future.

In this exciting and challenging time, on behalf of Lufkin's management, Board of Directors, and our entire global team, I want to thank our shareholders for their confidence in Lufkin Industries.

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

WIND TURBINES

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, especially in North America. We have invested in manufacturing and repair facilities to enhance our capabilities to maintain, repair and refurbish the complex gearboxes driving each wind turbine.

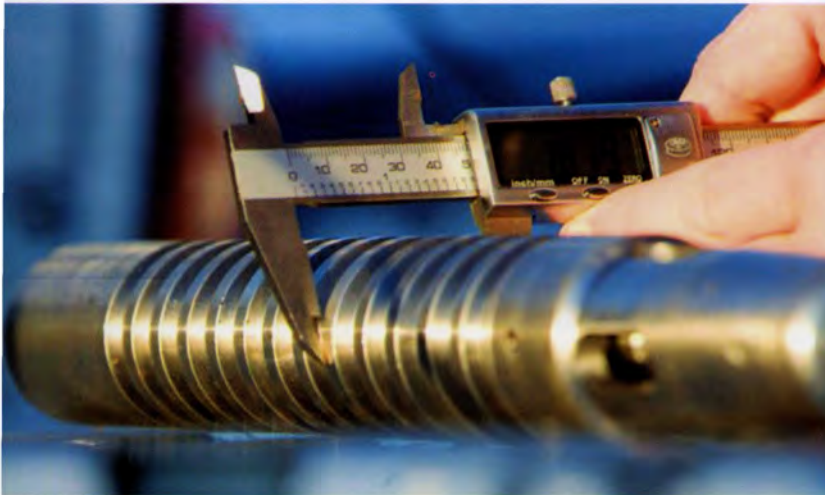
The new service center we opened in Bakersfield, California in August 2009 has positioned us well with our regional industrial customers and with wind turbine installations in the western U.S.

To the right: Testing of Wind Turbine Gear following overhaul and rebuild at Lufkin Gear Repair.



Western Desert of Egypt





LUFKIN – INTERNATIONAL LIFT SYSTEMS (ILS)

International Lift Systems (ILS) specializes in Gas Lift, Completion Products and Plunger Lift systems for the Domestic and International Oil and Gas Industry. Lufkin Industries acquired ILS in March 2009.

LUFKIN-ILS PROVIDES THE FOLLOWING SERVICES:

*Engineering
Application Design
Custom Manufacturing
Installation
Monitoring
Maintenance*

LUFKIN-ILS SERVICES ARE PROVIDED FOR THE FOLLOWING:

*Gas Lift Systems
Plunger Lift Systems
Hybrid Lift Systems
Completion Products*



OILFIELD

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

- Beam lift pumping equipment
- 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 and Argentina to serve the Americas, and 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 down time, 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

Lufkin – Petro Hydraulic Lift (PHL)

Petro Hydraulic Lift Systems (PHL) specializes in the development, manufacturing and distribution of its patented artificial lift system. PHL's products and services provide flexible solutions for the production of both oil and natural gas with installations documented to have increased production by as much as 200%. A combination of extensive field experience, product knowledge and service capabilities has made PHL a superior solution to better serve the energy industry.

Lufkin Industries acquired PHL in November 2010.

To the right: Hydraulic Power Unit for PHL.



producing characteristics of each well or reservoir. In addition to traditional oil well lifting applications used in maturing oil fields to counter natural production declines, Lufkin pumping units are also used to remove water from gas wells to enhance recovery.

In 2010, the Oilfield Division experienced a significant recovery in markets for traditional beam pumping and automation products and services. Revenues grew by almost 37 percent to \$477.9 million from depressed levels in 2009, driven largely by the rise of crude oil prices. Demand for Lufkin's products and services benefitted during 2010 from increases in oil-directed drilling and completion activity in the onshore shale plays such as the Bakken, traditional producing areas in the Permian Basin in West Texas and California as well as developing areas like the Eagle Ford shale in South Texas. Driven largely by stable commodity prices and oil-directed rig counts that rose steadily throughout 2010, Lufkin expects continued growth in the onshore U.S. market during 2011. Conversely, E&P spending for natural gas developments declined significantly in 2010 driven by weak commodity prices.

Activity in the Gulf of Mexico is expected to slowly recover in 2011 as new offshore drilling regulations are implemented by our customers. International markets in Canada, Latin America and the Middle East also recovered throughout 2010 and are expected to continue growing through the course of 2011 as the global economy improves, driving increased demand for oil and gas.

The Company broke ground in 2010 on the largest single capital investment in Lufkin's history -- construction of a \$126 million manufacturing and aftermarket facility in Ploiesti, Romania. The plant will be focused primarily on serving artificial lift markets in the Eastern Hemisphere: Africa, the Middle East, Russia and Asia. Construction began late in 2010, with manufacturing operations expected to begin in late 2012.

We increased domestic pumping unit manufacturing capacity throughout 2010 while continuing to reduce costs and improve operating efficiencies and utilization in a highly competitive market. Lufkin expects to see continued strong market demand for pumping units in 2011, countered by significant competition from imported equipment.

The acquisition of Petro Hydraulic Lift late in 2010, a Louisiana-based manufacturer of linear hydraulic pumping units, further expanded the breadth of Lufkin's artificial lift product offering. This hydraulically actuated surface lift unit reduces sucker rod stresses and provides another opportunity for integration of our automation technologies.

Lufkin's automation business rebounded strongly from the 2009 market downturn. Automation revenues grew by 62 percent in 2010, and we anticipate further strengthening in 2011 based on increased drilling activity in U.S. shale plays as well as growing international demand. Lufkin's systems automate the operation of beam lift pumping units to improve well performance using sophisticated proprietary software,

LUFKIN FOUNDRY

Lufkin Industries entered into the Foundry Industry in 1902 with the inception of Lufkin Foundry and Machine Company. Today, the Foundry is a full service manufacturer of low to medium volume ductile and gray iron castings for original equipment manufacturers.



REGEN Well Manager



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 2010. This accounted for 10 percent of the total automation revenue in 2010 and is anticipated to more than double in 2011. 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 the well's productive life.

The acquisition of International Lift Systems (ILS) in early 2009 added proven gas lift and plunger lift technologies to our artificial lift product line as well as a complimentary packer and completion tool product segment. ILS achieved significant success in 2010 with its efforts to expand into the international market.

Lufkin supports its product portfolio 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

ODESSA, TX MULTI-FUNCTION SERVICE CENTER

Production bay within the new multi-function service facility.



original equipment manufacturers' spare parts to maintain maximum up-time for oil and gas producers.

Lufkin operates a gray and ductile iron foundry capable of producing high-quality castings both for captive and commercial applications. Late 2010 saw increased activity in the heavy equipment and machine tool markets, providing optimism for increased commercial casting sales in 2011. Recently, the foundry has successfully developed and marketed low-cost disposable tooling for extremely low-volume applications and continues to leverage this offering across all market segments. 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 oil field and power transmission castings. This enables Lufkin to respond to tight customer delivery and quality requirements.



Gourndbreaking in Romania



LUFKIN FRANCE

Lufkin France, located in Fougerolles, is the cornerstone of Lufkin's operations in Europe, which include complete sales engineering technical support, manufacturing, gear repair and field service



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 and high-performance fluid film bearings are used across a wide spectrum of industrial applications.

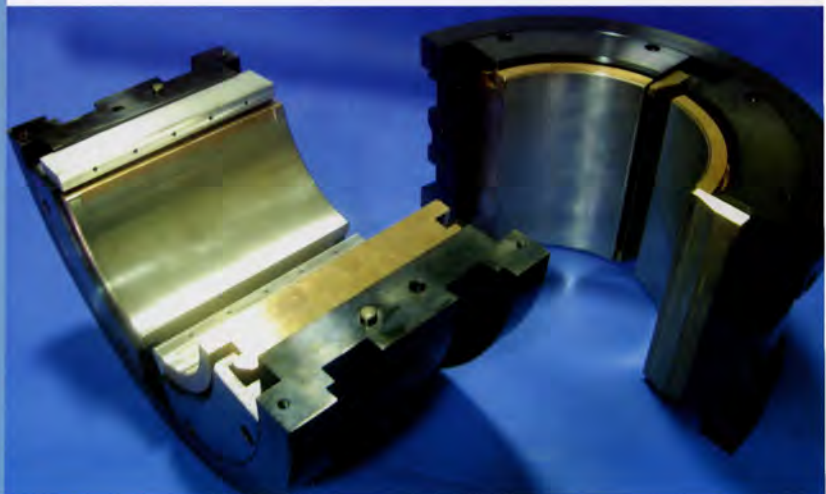
We differentiate ourselves in the industry by combining our industry-leading expertise in engineering, manufacturing technology and metallurgy to produce machinery with a proven history of reliability, industry-recognized superior performance and long service life. We deliver best-in-class customer service, 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 specializes in high-speed turbo-machinery units, low-speed high-torque units, custom-engineered fluid film bearings, and engineering analyses of turbo-equipment rotors. 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

LUFKIN ROTATING MACHINERY TECHNOLOGY (RMT)

Lufkin RMT, based in Wellsville, NY, 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.

Lufkin Industries acquired RMT in July 2009.



strategic applications for our high-speed units include electrical power generation, petrochemicals production, and liquefied natural gas (LNG) production and distribution.

The markets for our low-speed, high torque gear drives are primarily within the large-scale industrial and commodity production sectors. These include steel manufacture, marine propulsion, rubber and plastics manufacture, sugar cane processing, and hydro-electric power generation.

The Power Transmission Division reported 2010 sales of \$167.8 million, down 3% percent from 2009. New order intake, however, increased 24% to \$173.9 million from 2009. The weak global demand for energy experienced during 2009 gave way to an encouraging recovery beginning in the first quarter of 2010.

Emerging stability in the global economic climate in 2010 proved beneficial for several of the division's market sectors. Among these were gasoline refining, petrochemicals, power generation and marine propulsion. The economics of large-scale oil and gas projects, which had previously suffered from rapidly rising construction and equipment procurement costs from 2006 through 2008, began to improve. Major oil companies began to reactivate once-promising projects that had been suspended. Our confidence in the 2010 recovery was validated when numerous "drawing board" projects, which the division monitored closely throughout 2009, began to produce new orders beginning in late Q1 and early Q2.

The timing of gearbox and specialty bearing order placements was somewhat slower than expected, primarily due to protracted negotiations between the end users and the prime OEMs. Our new order intake began to ramp up sharply late in the first quarter and continued to gain momentum throughout the year.

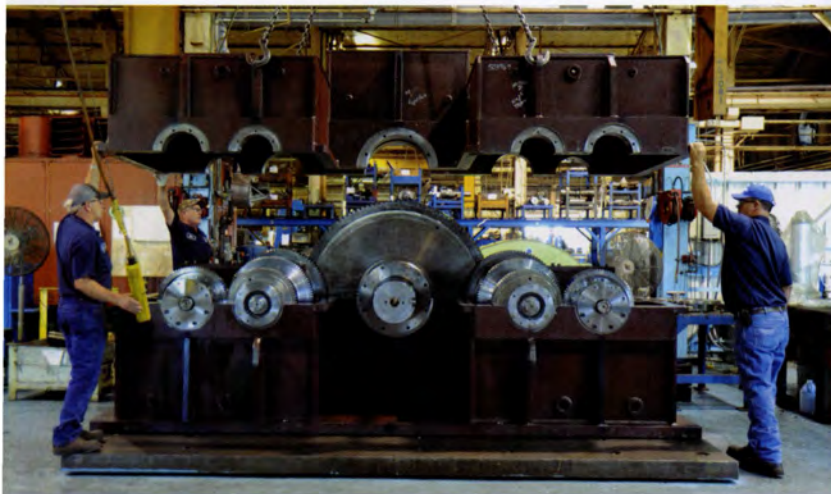
Within the oil and gas sector, LNG projects are among the most promising and show the most concentrated activity. These projects are located primarily offshore Eastern and Western Australia and the west coast of Africa. As of early 2011 there were approximately six world-class LNG projects in advanced stages of design, procurement or construction, and Lufkin expects to continue competing successfully for orders within this important segment. During 2010, we were awarded contracts to furnish high-speed gear drives and fluid film bearings for centrifugal compressors destined for the Queensland Curtis LNG project in Australia.

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

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 of choice for critical applications.

LUFKIN GEAR REPAIR

Lufkin Gear Repair provides global aftermarket and field service that targets the repair and refurbishment of gear installations worldwide, regardless of the manufacturer, while supporting the sales of new power transmission equipment.



Our on-going commitment to growth drives us to search for promising and profitable new markets. In the fourth quarter of 2010, we completed our portion of a major U.S. Corps of Engineers flood control project for the City of New Orleans, when we shipped the eleventh and final gearbox for the massive Gulf Intracoastal Waterway Pump Station. Our units will drive enormous pumps that will protect the city against the catastrophic floods that accompany hurricanes.

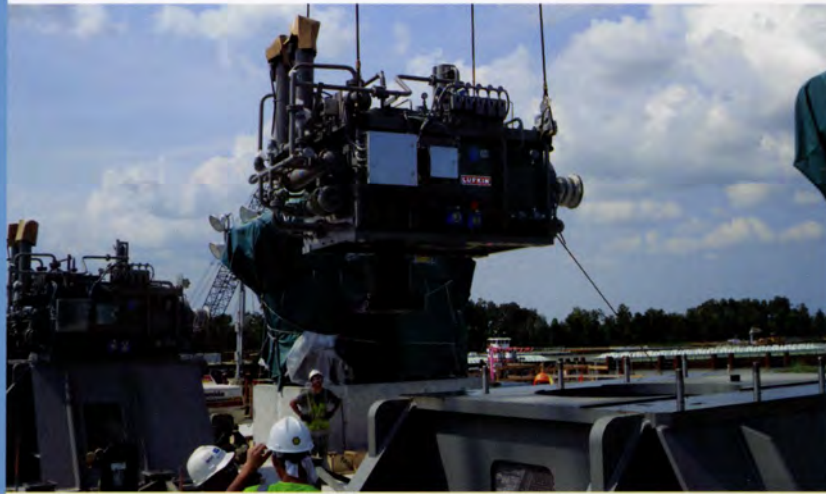
“Green” power generation is another new market where we have achieved significant gains. Our factory in France has designed and is currently manufacturing a large number of complex, high-reliability drives for cooling water pumps destined for two Asian nuclear power stations. This new product line has already positioned the division to compete successfully for similar projects in the growing nuclear power industry. We also won new business for specialty gear drives for hydro-electric 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, especially in North America. 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 we opened in Bakersfield, California in August 2009 has positioned us well with our regional industrial

LUFKIN FLOOD PUMP SPEED REDUCER

This is a 5,400 HP right angle flood pump speed reducer for the city of New Orleans West Gate Closure. Eleven gearboxes were designed to pump 8.5 million gallons of water per minute to protect the city against the catastrophic floods that accompany hurricanes.

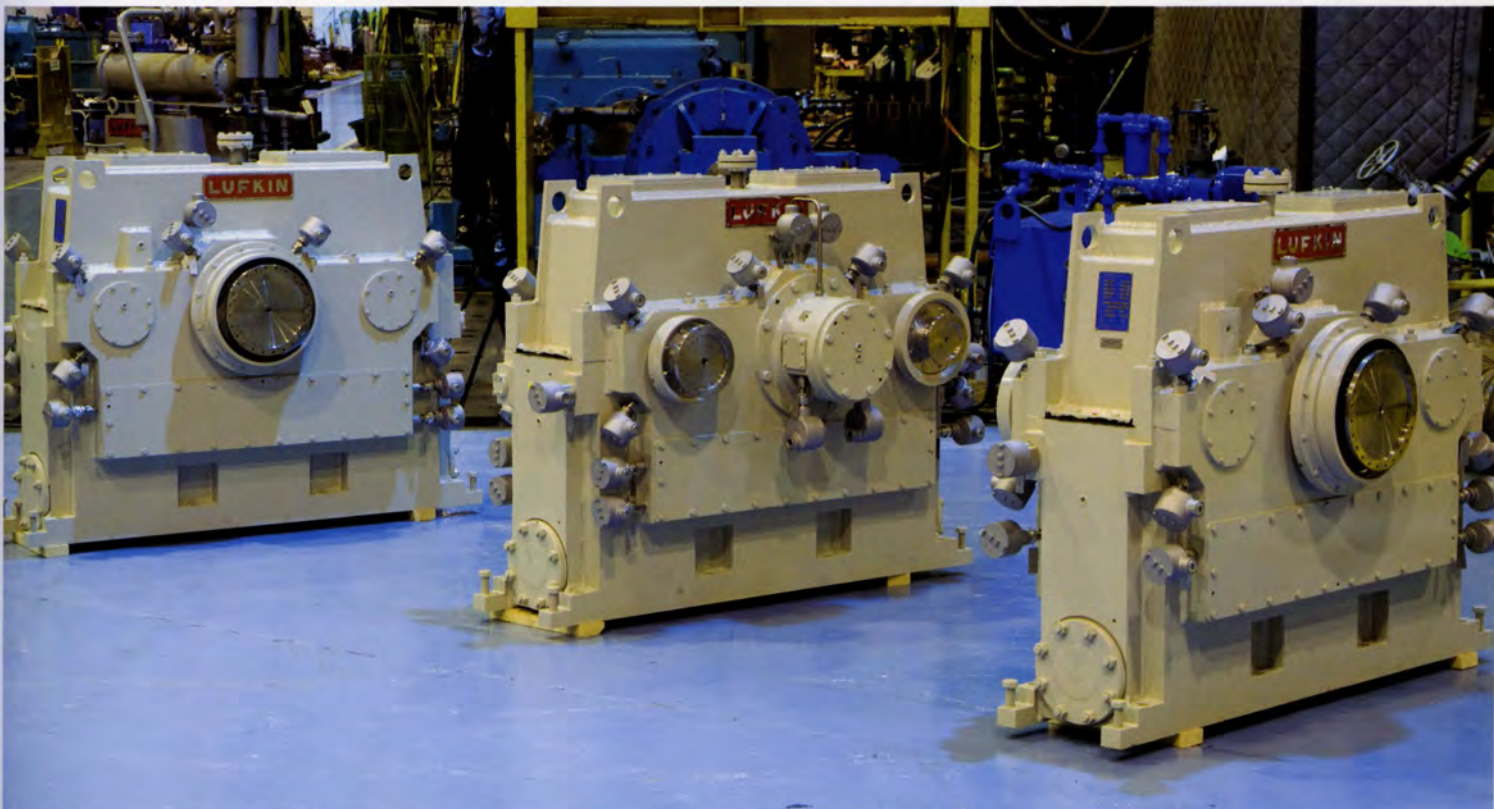


customers and with wind turbine installations in the western U.S. Broadening our global footprint even further, we plan to establish a regional service and repair center in the new Lufkin factory now under construction in Romania. This will serve as a platform for supporting our aftermarket expansion into Eastern Europe, Western Asia and the Middle East.

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.





Top Row (From Left to Right): Richard R. Stewart, John F. Anderson, J.F. Glick, Douglas V. Smith, John D. Hofmeister, John H. Lollar,
Bottom Row (From Left to Right): H. J. Trout, Jr., J.T. Jongebloed, Suzanne V. Baer, Thomas E. Wiener

2010 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

John H. Lollar

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

J.T. Jongebloed

Chairman - Nominating / Governance Committee
Member - Audit Committee
Board member since 2002

John F. Anderson

Member - Executive Committee, Pension Committee,
Compensation Committee
Board member since 2003

Suzanne V. Baer

Chairman - Audit Committee
Member - Pension Committee
Board member since 2005

Richard R. Stewart

Member - Audit Committee, Pension Committee
Board member since 2009

John D. Hofmeister

Member - Compensation Committee, Nominating /
Governance Committee
Board member since January 2010

LUFKIN INDUSTRIES, INC.

The following is a discussion of the Company's financial performance and other information. This report is part of the Company's Annual Report on Form 10-K, which has been filed with the Securities and Exchange Commission. Certain parts of this report are not required by the SEC, but are included to provide additional information. A complete copy of the Company's Annual Report on Form 10-K is available on the SEC's website at www.sec.gov or you can contact the Company's website at www.lufkin.com. The Company will also provide a copy of this report to any shareholder who requests it without charge upon written request.



FORM 10-K

Left to right (left to right): William B. Thomas, John A. Anderson, and John A. Anderson.
 Bottom row (left to right): John A. Anderson, John A. Anderson, and John A. Anderson.

JOHN A. ANDERSON, 1840-1910

William B. Thomas
 Chairman, Board of Directors
 President, Anderson Corporation
 Born in 1840, died 1910

John A. Anderson
 Chairman, Board of Directors
 President, Anderson Corporation
 Born in 1840, died 1910

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John A. Anderson
 Chairman, Board of Directors
 President, Anderson Corporation
 Born in 1840, died 1910

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 or free of charge on the Company's website at 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, a global supplier of oil field and power transmission products, is divided into two operating segments: Oil Field and Power Transmission.

On November 1, 2010 the Company completed the acquisition of the significant operating assets of Petro Hydraulic Lift Systems, LLC (“PHL”) and certain related companies, based in South Louisiana. PHL, specializes in the design, manufacture and leasing of hydraulic rod pumping units for oil and gas wells.

Financial information by industry segment and geographic area is incorporated herein by reference to Note 17 – “Business Segment Information” in the Notes to Consolidated Financial Statements set forth in Part II, Item 8 of this annual report on Form 10-K.

The Company employed approximately 3,000 people at December 31, 2010, including approximately 2,000 people that were paid on an hourly basis. Certain of the Company’s operations are subject to a union contract that expires in October 2011.

No customer represented over 10% of consolidated company sales as of December 31, 2010. An Oil Field customer and its related subsidiaries represented 11.0% and 15.4% of consolidated company sales in 2009 and 2008, respectively.

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- Five basic types of pumping units are manufactured: an air-balanced unit; a beam-balanced unit; a crank-balanced unit, a Mark II Unitorque unit; and a hydraulic unit. The basic differences between the five 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. The Company manufactures numerous sizes and combinations of Lufkin oil field pumping units within the five 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, which are purchased from both its own foundry and third-party foundries. Casting costs are subject to change, as a result of changes in raw material prices on scrap iron and pig iron in addition to changes in 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 2008 through 2010, 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. Raw material prices stayed relatively unchanged in 2010. As the global economy improves in 2011, 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 by Oil Field 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 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. In the fourth quarter of 2008, oil prices decreased significantly and stayed at reduced levels throughout 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, caused gross margins to decline in 2009. Activity levels increased moderately during the second half of 2009 and early 2010. As the global economy began to recover in 2010 and oil prices and drilling activity rose, demand levels increased to near 2008 levels. This trend is expected to continue in 2011, with higher drilling activity and lower surplus equipment inventory driving demand for new artificial lift equipment. Longer-term, the demand for artificial lift equipment is also expected to 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.

Competition:

The primary global competitor for artificial lift equipment is Weatherford International, but Chinese manufacturers of artificial lift equipment are also 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 equipment 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 as high-speed gearboxes. 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, in addition to 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 by Power Transmission 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 markets, 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. Order levels increased in the first half of 2010 as energy markets recovered, translating into higher sales in the second half of 2010. The pace of bookings in 2011 is expected to remain at this higher level, which should translate in to overall higher sales in 2011 compared to 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 the Company's website, 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 the SEC's website at 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 the Company's 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 the Company's supply of raw materials could adversely affect its results of operations.

The Company relies on various suppliers to supply the components utilized to manufacture its 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 the Company's suppliers. To date, these shortages have not caused a material disruption in availability or the Company's 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 may not be covered by insurance and 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 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, the Company 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 the Company may incur or for which the Company may be found responsible. Moreover, in the future, the Company may not be able to maintain insurance at levels of risk coverage or policy limits that it deems adequate or at premiums that it deems reasonable, 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 the Company's results of operations and financial condition. Litigation and claims for which the Company is not insured can occur, including employee claims, intellectual property claims, breach of contract claims, and warranty claims.

The Company may not be able to successfully integrate future acquisitions, which will cause it 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 the Company's 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 the Company's current labor contract could have a material adverse effect on its 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 the 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 the Company's 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 the Company's manufacturing operations or management information systems would have an adverse effect on its financial condition and results of operations.

While the Company owns numerous facilities domestically and internationally, its primary manufacturing facilities, located 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 owns and operates 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 Company's 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 its 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 effect 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 the Company's pension cost.

The Company's funding policy for its pension plan is to accumulate plan assets that, over the long-run, will approximate the present value of projected benefit obligations. The Company's 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. The Company's 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 the Company's 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 the Company's 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. While the financial markets experienced improvement in 2010, the Company may face challenges if conditions in the financial markets do not continue to improve in 2011. 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, which would establish an economy-wide cap-and-trade program to reduce U.S. emissions of greenhouse gases, including carbon dioxide and methane. Although it is not possible at this time to predict if or when any future federal laws or implementing regulations addressing greenhouse gas emissions may be adopted, and such laws or regulations that may be adopted 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 response to its endangerment findings, the EPA adopted regulations that require a reduction in emissions of greenhouse gases from motor vehicles. The EPA has asserted that the motor vehicle greenhouse gas emissions standards triggered the Clean Air Act construction and operating permit requirements for stationary sources, commencing when the motor vehicle standards took effect on January 2, 2011. The EPA also adopted rules which will 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.
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Corporate Facilities	33,000 sq. ft.
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Through the acquisitions of ILS and RMT in 2009 and PHL in 2010, the Company added three leased manufacturing facilities:

Lufkin ILS- Houston, TX	50,000 sq. ft.
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Lufkin RMT- Wellsville, NY	23,500 sq. ft.
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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.
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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.

The District Court's findings of fact and conclusions of law are set forth in its opinion, which is attached as an exhibit to this motion.

The Company's motion for summary judgment is hereby denied. The District Court's findings of fact and conclusions of law are set forth in its opinion, which is attached as an exhibit to this motion.

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The District Court's findings of fact and conclusions of law are set forth in its opinion, which is attached as an exhibit to this motion.

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 5th 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. 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.

On January 15, 2010, in its final judgment, 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 were required to submit this request within 14 days of the final judgment. On January 21, 2010, 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.

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. 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 September 28, 2010, the District Court granted plaintiffs' motion for supplemental attorney's fees, costs and expenses in the amount of \$0.7 million for the period of January 1, 2009 through January 15, 2010. In order to cover these cost, the Company recorded an additional provision of \$1.0 million in September 2010 for anticipated costs through the end of 2010.

On February 2, 2011 the United States Fifth Circuit Court of Appeals accepted the oral arguments from the plaintiffs and the Company on their respective appeals to the court. We anticipate the court's decision before the end of the second quarter of 2011.

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. (Removed and Reserved)

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, 2011, there were approximately 379 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 2010 and 2009, 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	2010			2009		
	Stock Price		Dividend	Stock Price		Dividend
	High	Low		High	Low	
First	\$ 40.85	\$ 29.80	\$ 0.125	\$ 20.63	\$ 13.48	\$ 0.125
Second	45.10	35.13	\$ 0.125	24.08	14.76	\$ 0.125
Third	44.97	36.22	\$ 0.125	26.91	18.19	\$ 0.125
Fourth	63.50	42.63	\$ 0.125	37.87	24.77	\$ 0.125

The Company has paid cash dividends for 71 consecutive years. Total dividend payments were \$15.0 million, \$14.9 million and \$14.8 million in 2010, 2009 and 2008, respectively.

Equity Compensation Plan Information

The following table sets forth securities of the Company authorized for issuance under equity compensation plans at December 31, 2010.

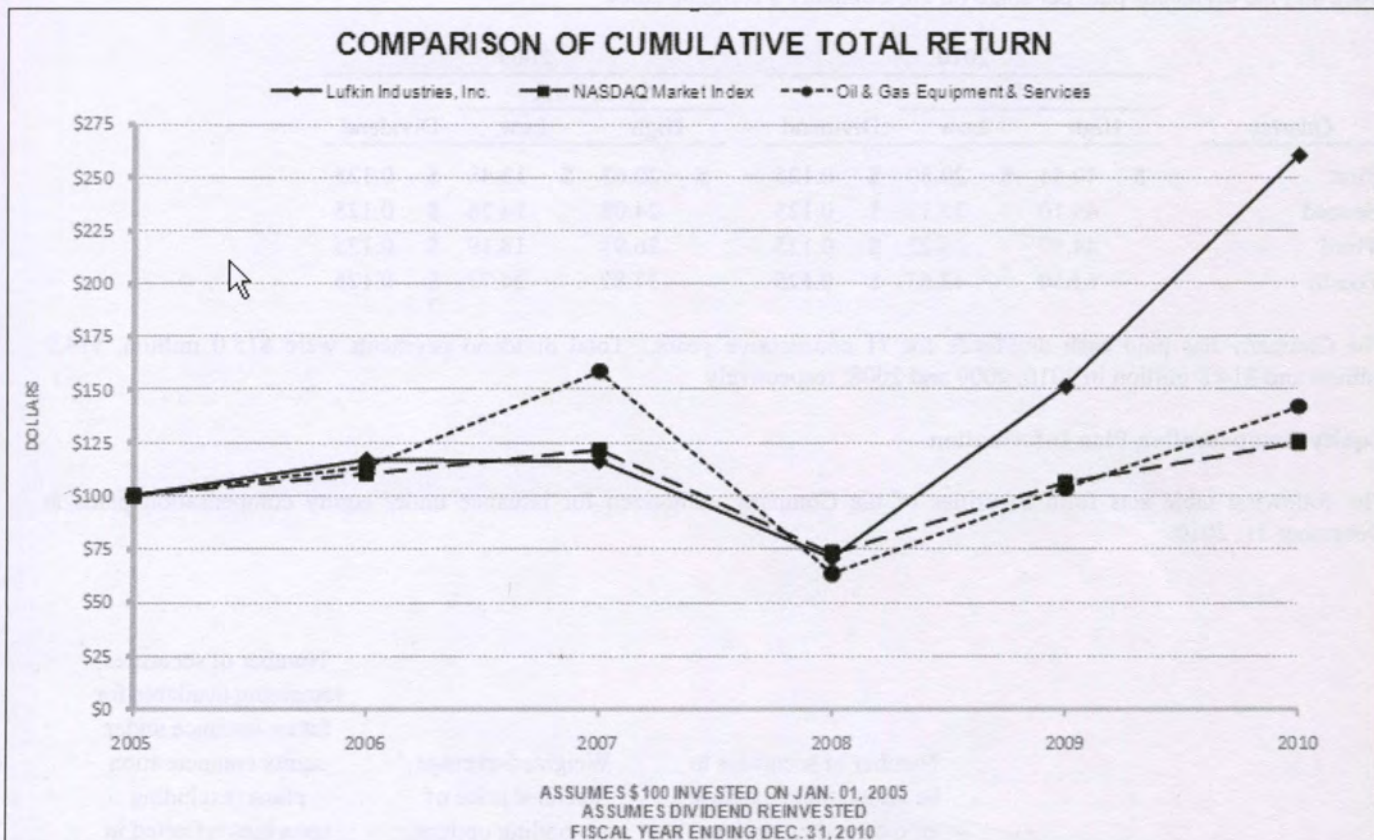
Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	1,321,637	\$33.26	1,135,936
Equity compensation plans not approved by security holders	-	-	-
Total	<u>1,321,637</u>	\$33.26	<u>1,135,936</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 the Company's cumulative, five-year total shareholder return with that of 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.



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)	2010	2009	2008	2007	2006
Sales	\$ 645.6	\$ 521.4	\$ 741.2	\$ 555.8	\$ 526.1
Earnings from continuing operations	43.5	22.5	88.0	71.8	71.3
Earnings per share from continuing operations:					
Basic	1.45	0.76	2.98	2.41	2.40
Diluted	1.44	0.76	2.96	2.38	2.36
Total assets	621.1	541.6	530.7	500.7	409.1
Cash dividends per share	0.50	0.50	0.50	0.44	0.31

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 its strategy, the Company has made capital investments in the Oil Field segment to increase manufacturing capacity and capabilities in its two main manufacturing facilities in Lufkin, Texas and Argentina. These investments have reduced production lead times, improved quality and reduced 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 and in November 2010 acquired the assets of Petro Hydraulic Lift Systems, which manufactured hydraulic pumping units. In July 2010, the Company announced its intention to construct a new multi-purpose manufacturing and aftermarket facility in Ploiesti Romania to support market expansion efforts in the Eastern Hemisphere. This facility will manufacture products for both the Oil Field and Power Transmission segments, with an initial focus on oil field products. This facility, which is being built on an 82 acre site, will have an estimated aggregate gross cost of \$126 million. When completed in 2012, the facility will initially employ just over 300 employees. The government of Romania, through the Ministry of Public Finance, has agreed to provide the Company with economic development incentives and financial assistance of 28 million Euros towards the construction costs, which accounts for approximately 30% of the total cost of the plant. The Company continues to look for investment opportunities to reduce manufacturing costs, expand geographically and add product offerings in the artificial lift space. On November 1, 2010 the Company completed the acquisition of the significant operating assets of Petro Hydraulic Lift Systems, LLC ("PHL") and certain related companies, based in South Louisiana. PHL, specializes in the design, manufacture and leasing of hydraulic rod pumping units for oil and gas wells.

In the Power Transmission segment, the Company continues to expand its gear repair network by opening and expanding facilities in various locations in the United States and Canada. The Company has made targeted capital investments in the United States 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. The Company intends to focus future capital investments for Oil Field and Power Transmission on international geographic expansion of manufacturing and service centers.

Trends/Outlook

Oil Field

Demand for the Company's 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 since 2004 increased the demand for pumping units and related service and products as a result of higher drilling activity, activation of idle wells and the upgrading of existing wells. In the fourth quarter of 2008, energy prices dramatically declined due to reductions in global demand. Planned new drilling and workover activity also reduced significantly as capital and operating budgets were reduced. 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 was more pronounced in North America than in international markets. 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.

During 2010, demand from North America increased steadily as the oil-directed rig count level surpassed 2008 levels. North America demand for artificial lift equipment has not increased as quickly as the oil-directed rig count due to fewer well completions per rig drilling due to the increased use of multi-stage horizontal frac technology, delays in completions due to unavailability of frac crews and improvements in drilling technology that extends the length of time wells remain free-flowing. Also, while order levels have continued to increase during 2010, the ability to raise prices remains a challenge. Most raw material prices have remained stable during 2010, but certain raw material associated with cast iron have recently increased. The Company expects 2011 demand to continue to increase over 2010 levels as these market issues are resolved and equipment sales start to catch up to the prior oil-directed rig count increases.

While the oil market is cyclical, 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, European, Russian and Middle Eastern markets. For this reason, the Company announced its intentions to construct a new multi-purpose manufacturing and aftermarket facility in Romania to support these markets. The new facility will be operational in 2012 and will cost approximately \$90 million net after Romanian government economic incentives. Additionally, the acquisitions of ILS and PHL were consistent with the Company's long-term growth strategy of integrating strategic assets to leverage the Company's position of industry leadership, providing 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 markets, 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 remained at these lower levels throughout the first half of 2010, new order and quotation activity, especially from the energy markets, increased during 2010 over levels seen in 2009. The pace of bookings in 2011 is expected to remain at this higher level, which should translate in to overall higher sales in 2011 compared to 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. 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.

Other

During 2010, 2009 and 2008, the Company booked pre-tax contingent liability provisions of \$1.0 million, \$6.0 million and \$6.0 million, respectively, for its ongoing class-action lawsuit. For additional information, please see Part I, Item 3 "Legal Proceedings" of this annual report on 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 2010 increased to \$645.6 million from \$521.4 million for 2009, or 23.8%. This increase in 2010 was primarily driven by higher sales of Oil Field products and services in the North American markets. In 2008, sales were \$741.2 million.

Gross margin for 2010 increased to 24.6% from 21.6% for 2009, due primarily to the favorable impact of higher plant utilization on fixed cost coverage in the Oil Field segment. Gross margin in 2008 was 28.9%. Additional segment data on gross margin is provided later in this section.

Higher selling, general and administrative expenses negatively impacted net earnings, with these expenses increasing to \$89.9 million during 2010 from \$75.1 million during 2009 and \$72.0 million during 2008. This increase in 2010 was primarily related to resources added from the ILS and RMT acquisitions, higher employee-related expenses in support of international expansion efforts and new product development. As a percentage of sales, selling, general and administrative expenses decreased to 13.9% during 2010 compared 14.4% during 2009, but increased compared to 9.7% during 2008. Operating income was also impacted by a litigation reserve of \$1.0 million during 2010, as compared to \$6.0 million each during 2008 and 2009, related to its ongoing class-action lawsuit.

The Company reported net earnings from continuing operations of \$43.5 million, or \$1.44 per share (diluted), for 2010, compared to net earnings from continuing operations of \$22.5 million, or \$0.76 per share (diluted), for 2009, and net earnings from continuing operations of \$88.0 million, or \$2.96 per share (diluted), for 2008.

Debt/equity (long-term debt net of current portion as a percentage of total equity) levels were back to 0.0% as of December 31, 2010 from 0.3% as of December 31, 2009. Cash balances at December 31, 2010, were \$88.6 million, down from \$100.9 million at December 31, 2009.

Year Ended December 31, 2010 Compared to Year Ended December 31, 2009:

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

Year Ended December 31	2010	2009	Increase/ (Decrease)	% Increase/ (Decrease)
Sales				
Oil Field	\$ 477,867	\$ 349,168	\$ 128,699	36.9
Power Transmission	167,776	172,191	(4,415)	(2.6)
Total	<u>\$ 645,643</u>	<u>\$ 521,359</u>	<u>\$ 124,284</u>	23.8
Gross Profit				
Oil Field	\$ 112,236	\$ 65,510	\$ 46,726	71.3
Power Transmission	46,282	47,034	(752)	(1.6)
Total	<u>\$ 158,518</u>	<u>\$ 112,544</u>	<u>\$ 45,974</u>	40.8

Oil Field

Oil Field sales increased to \$477.9 million, or by 36.9%, for the year ended December 31, 2010, from \$349.2 million for the year ended December 31, 2009. New pumping unit sales of \$254.4 million during 2010 were up \$66.2 million, or 35.2%, compared to \$188.2 million during 2009, primarily from higher U.S. demand. Pumping unit service sales of \$104.1 million during 2010 were up \$19.2 million, or 22.6%, compared to \$84.9 million during 2009. Automation sales of \$83.8 million during 2010 were up \$32.4 million, or 62.9%, compared to \$51.4 million during 2008. Commercial casting sales of \$11.3 million during 2010 were up \$1.9 million, or 20.4%, compared to \$9.3 million during 2009. Sales from Lufkin ILS of \$24.4 million during 2010 were up \$9.1 million, or 62.9%, compared to \$15.3 million in 2009, which represents 10 months of operations. Oil Field's backlog increased to \$131.4 million as of December 31, 2010, from \$43.3 million at December 31, 2009. This increase was caused primarily by higher orders for new pumping units as U.S. and international customers increased production due to higher oil prices.

Gross margin (gross profit as a percentage of sales) for the Oil Field segment increased to 23.5% for year ended December 31, 2010, compared to 18.8% for the year ended December 31, 2009, or 4.7 percentage points. This gross margin increase was related to the positive impact of higher plant utilization on fixed cost coverage.

Direct selling, general and administrative expenses for Oil Field increased to \$36.7 million, or by 37.4%, for the year ended December 31, 2010, from \$26.7 million for the year ended December 31, 2009. This increase was due to higher employee-related and legal expenses. Direct selling, general and administrative expenses as a percentage of sales increased only 0.1% to 7.7% for the year ended December 31, 2010, from 7.6% for the year ended December 31, 2008.

Power Transmission

Sales for the Company's Power Transmission segment decreased to \$167.8 million, or by 2.6%, for the year ended December 31, 2010, compared to \$172.2 million for the year ended December 31, 2009. New unit sales of \$114.2 million during 2010 were down \$17.6 million, or 13.3%, compared to \$131.8 million during 2009. Repair and service sales of \$48.8 million during 2010 were up \$10.5 million, or 27.3%, compared to \$38.4 million during 2009. Sales from Lufkin RMT increased to \$4.7 million during 2010, up from \$2.0 million during 2009. A portion of this increase is due to 2009 representing only 6 months of operations. Power Transmission backlog at December 31, 2010, increased to \$101.6 million from \$97.0 million at December 31, 2009, primarily from increased bookings of new units for the energy-related markets.

Gross margin for the Power Transmission segment increased to 27.6% for the year ended December 31, 2010, compared to 27.3% for the year ended December 31, 2009, or 0.3 percentage points. This gross margin increase was primarily from the favorable impact of higher production levels in manufacturing and repair on fixed cost coverage and an improved product mix.

Direct selling, general and administrative expenses for Power Transmission increased to \$27.5 million, or by 17.0%, for the year ended December 31, 2010, compared to \$23.5 million for the year ended December 31, 2009. Direct selling, general and administrative expenses as a percentage of sales increased to 16.4% for the year ended December 31, 2010, from 13.7% for the year ended December 31, 2009.

Corporate/Other

Corporate administrative expenses, which are allocated to the segments primarily based on budgeted sales levels, were \$25.6 million for the year ended December 31, 2010, an increase of \$0.7 million or 2.8%, from \$24.9 million for the year ended December 31, 2009.

Interest income, interest expense and other income and expense for the year ended December 31, 2010, decreased to \$2.2 million of expense compared to \$1.6 million of income for the year ended December 31, 2009, primarily from a decrease in gains of currency exchange and other interest from tax overpayments.

Pension expense, which is reported as a component of cost of sales, decreased to \$7.9 million for the year ended December 31, 2010, compared to \$10.7 million for the year ended December 31, 2009. This decrease in expense was primarily due to the impact of favorable demographic trends.

The net tax rate for the year ended December 31, 2010, was 35.5%, compared to 31.9% for the year ended December 31, 2009. The net tax rate in 2009 benefitted from adjustments to prior period tax filings in the U.S related to changes in tax laws.

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):

Year Ended December 31	2009	2008	Increase/ (Decrease)	% Increase/ (Decrease)
Sales				
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>	(29.7)
Gross Profit				
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>	(47.4)

*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.

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.

Liquidity and Capital Resources

The Company has historically relied on cash flows from operations and third-party borrowings 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, 2011, and the foreseeable future.

The Company's cash balance totaled \$88.6 million at December 31, 2010, compared to \$100.9 million at December 31, 2009. For the year ended December 31, 2010, net cash provided by operating activities was \$59.5 million, net cash used in investing activities totaled \$69.5 million and net cash used in financing activities amounted to \$2.3 million. Significant components of cash provided by operating activities included net earnings from continuing operations, adjusted for non-cash expenses, of \$75.0 million, partially offset by an increase in working capital of \$15.5 million. This working capital increase was primarily due to an increase in trade receivables and inventory balances of \$35.0 million and \$5.0 million, respectively, due to increased sales volumes during 2010, partially offset by an increase in accounts payable and accrued liabilities of \$27.2 million. Net cash used in investing activities included net capital expenditures totaling \$60.4 million and the ILS, RMT, and PHL acquisitions totaling \$9.9 million. Capital expenditures in 2010 were primarily for new facilities to support geographical and product line expansions in the Oil Field and Power Transmission segments. Capital expenditures for 2011 are projected to increase over 2010 spending levels, primarily for the new Romanian manufacturing facility, other new manufacturing and service 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. Significant components of net cash used by financing activities included dividend payments of \$15.0 million, or \$0.50, per share and debt repayments of \$2.9 million. Proceeds from stock option exercises of \$13.3 million partially offset financing cash outflows.

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 \$80.0 million of aggregate borrowing. This Bank Facility expires on December 31, 2013. 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, 2010, 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, \$63.6 million of borrowing capacity was available at December 31, 2010.

The following table summarizes the Company's expected cash outflows from financial contracts and commitments as of December 31, 2010. 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 six months) and are generally consistent from year to year.

(In thousands of dollars)		Payments due by period			
		Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Contractual obligations	Total				
Operating lease obligations	\$ 10,885	\$ 2,552	\$ 2,575	\$ 1,588	\$ 4,170
Contractual commitments for capital expenditures	5,820	5,820	-	-	-
Total	<u>\$ 16,705</u>	<u>\$ 8,372</u>	<u>\$ 2,575</u>	<u>\$ 1,588</u>	<u>\$ 4,170</u>

Since the Company has no significant tax loss carryforwards, the Company expects to make quarterly estimated tax payments in 2011 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 \$6.4 million and to its post-retirement health and life plans of approximately \$0.5 million in 2011. Contribution levels to these plans after 2011 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 8 of this Form 10-K, the Consolidated Balance Sheet at December 31, 2010 includes approximately \$1.8 million of liabilities associated with uncertain tax positions in the jurisdictions in which the Company 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 entered 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.

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 last-in, first-out (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 first-in, first-out (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 it is more-likely-than-not some or all of any deferred tax assets will expire before realization or that the future deductibility may not occur, 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 2010 results:

(Thousands of dollars)	Pension Benefits	Other Benefits
<u>Discount rate</u>		
Effect of change on net periodic benefit cost (income):		
.25 percentage point increase	\$ (634)	\$ (3)
.25 percentage point decrease	594	1
Effect of change on PBO/APBO:		
.25 percentage point increase	\$ (6,751)	\$ (167)
.25 percentage point decrease	7,097	175
<u>Long-term rate of return on plan assets</u>		
Effect of change on net periodic benefit cost (income):		
.25 percentage point increase	\$ (468)	\$ -
.25 percentage point decrease	468	-

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. Undue reliance should not be placed on 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. 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 the Company's 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 the Company's 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 materials, 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 prices of these raw materials have 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 the Company does not enter into long-term contracts with most of its suppliers, 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, 2010, this inter-company debt was comprised of a \$0.3 million receivable and a \$4.3 million payable from France and Canada, respectively. As of December 31, 2010, if the U.S. dollar strengthened by 10% over these currencies, the net income impact would be \$0.3 million of expense and if the U.S. dollar weakened by 10% over these currencies, the net income impact would be \$0.3 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, 2010, if the U.S. dollar strengthened or weakened by 10% over these currencies, the net income and expense impact would be negligible.

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, 2010. 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, 2010, 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, 2010, has been audited by Deloitte & Touche LLP, an independent registered accounting firm, as stated in their report which appears herein.

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Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets
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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, 2010 and 2009, 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, 2010. 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, 2010, 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, 2010 and 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, 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, 2010, 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, 2011

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

December 31, 2010 and 2009

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

	2010	2009
Assets		
Current Assets:		
Cash and cash equivalents	\$ 88,592	\$ 100,858
Receivables, net	127,298	92,506
Income tax receivable	3,547	4,303
Inventories	116,874	110,605
Deferred income tax assets	3,554	5,198
Other current assets	4,696	4,351
Current assets from discontinued operations	636	811
Total current assets	<u>345,197</u>	<u>318,632</u>
Property, plant and equipment, net	203,717	159,770
Goodwill, net	53,011	45,001
Other assets, net	19,153	18,187
Total assets	<u>\$ 621,078</u>	<u>\$ 541,590</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 26,972	\$ 19,993
Current portion of long-term debt	-	1,372
Accrued liabilities:		
Payroll and benefits	16,446	9,568
Warranty expenses	3,620	4,220
Taxes payable	6,763	4,562
Other	30,548	24,147
Current liabilities from discontinued operations	228	1,026
Total current liabilities	<u>84,577</u>	<u>64,888</u>
Long-term debt	-	1,516
Deferred income tax liabilities	11,953	10,950
Postretirement benefits	6,453	7,874
Other liabilities	32,098	20,647
Long-term liabilities from discontinued operations	37	37
Shareholders' equity:		
Common stock, \$1.00 par value per share; 60,000,000 shares authorized; 32,132,817 and 31,617,176 shares issued , respectively	32,133	31,618
Capital in excess par	74,811	55,617
Retained earnings	450,714	421,908
Treasury stock, 1,828,336 and 1,846,336 shares, respectively, at cost	(35,052)	(35,539)
Accumulated other comprehensive loss	(36,646)	(37,926)
Total shareholders' equity	<u>485,960</u>	<u>435,678</u>
Total liabilities and shareholders' equity	<u>\$ 621,078</u>	<u>\$ 541,590</u>

See notes to consolidated financial statements.

LUFKIN INDUSTRIES, INC. **CONSOLIDATED STATEMENTS OF EARNINGS**

Years ended December 31, 2010, 2009 and 2008
(Thousands of dollars, except per share data)

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Sales	\$ 645,643	\$ 521,359	\$ 741,194
Cost of sales	<u>487,125</u>	<u>408,815</u>	<u>527,120</u>
Gross profit	158,518	112,544	214,074
Selling, general and administrative expenses	89,859	75,120	71,974
Litigation reserve	<u>1,000</u>	<u>6,000</u>	<u>6,000</u>
Operating income	67,659	31,424	136,100
Interest income	54	899	1,737
Interest expense	(562)	(650)	(193)
Other income (expense), net	<u>294</u>	<u>1,339</u>	<u>(1,232)</u>
Earnings from continuing operations before income tax provision	67,445	33,012	136,412
Income tax provision	<u>23,914</u>	<u>10,533</u>	<u>48,387</u>
Earnings from continuing operations	43,531	22,479	88,025
Earnings (loss) from discontinued operations, net of tax	<u>292</u>	<u>(453)</u>	<u>214</u>
Net earnings	<u><u>\$ 43,823</u></u>	<u><u>\$ 22,026</u></u>	<u><u>\$ 88,239</u></u>
Basic earnings per share			
Earnings from continuing operations	\$ 1.45	\$ 0.76	\$ 2.98
Earnings (loss) from discontinued operations	<u>0.01</u>	<u>(0.02)</u>	<u>0.01</u>
Net earnings	<u><u>\$ 1.46</u></u>	<u><u>\$ 0.74</u></u>	<u><u>\$ 2.99</u></u>
Diluted earnings per share			
Earnings from continuing operations	\$ 1.44	\$ 0.76	\$ 2.96
Earnings (loss) from discontinued operations	<u>0.01</u>	<u>(0.02)</u>	<u>0.01</u>
Net earnings	<u><u>\$ 1.45</u></u>	<u><u>\$ 0.74</u></u>	<u><u>\$ 2.96</u></u>

See notes to consolidated financial statements.

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

Years Ended December 31, 2010, 2009 and 2008 (Thousands of dollars, except share data)	Common Stock		Capital In Excess of Par		Retained Earnings		Treasury Stock		Compre- hensive Income	Accumulated Other Compre- hensive Income (Loss)	Total
	Shares, net of Treasury	Common Stock									
Balance, Dec. 31, 2007	29,277,812	\$ 31,068	\$	33,699	\$ 341,315	\$	(32,498)		\$	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	(143,780)						(4,623)				(4,623)
Stock-based compensation				3,584							3,584
Exercise of stock options	587,558	516		10,857			1,286				12,659
Balance, Dec. 31, 2008	29,721,590	\$ 31,584	\$	48,140	\$ 414,748	\$	(35,835)		\$	(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	49,250	34		654			285				973
Balance, Dec. 31, 2009	29,770,840	\$ 31,618	\$	55,617	\$ 421,908	\$	(35,539)		\$	(37,926)	\$ 435,678
Comprehensive income:											
Net earnings					43,823				43,823		43,823
Other comprehensive income, net of tax:											
Foreign currency translation adjustments									(960)	(960)	(960)
Defined benefit pension plans									1,556	1,556	1,556
Defined benefit post-retirement plans									684	684	684
Total comprehensive income									<u>\$ 45,103</u>		
Cash dividends					(15,017)						(15,017)
Stock-based compensation				4,627							4,627
Exercise of stock options	533,641	515		14,567			487				15,569
Balance, Dec. 31, 2010	30,304,481	\$ 32,133	\$	74,811	\$ 450,714	\$	(35,052)		\$	(36,646)	\$ 485,960

See notes to consolidated financial statements.

LUFKIN INDUSTRIES, INC. **CONSOLIDATED STATEMENTS OF CASH FLOWS**

Years ended December 31, 2010, 2009 and 2008
(Thousands of dollars)

	2010	2009	2008
Cash flows from operating activities:			
Net earnings	\$ 43,823	\$ 22,026	\$ 88,239
Adjustments to reconcile net earnings to cash provided by operating activities:			
Depreciation and amortization	21,158	18,457	15,699
(Recovery) provision for losses on receivables	(86)	(1,840)	2,508
LIFO (income) expense	(1,185)	(2,964)	7,742
Deferred income tax provision/(benefit)	1,436	(913)	(3)
Excess tax benefit from share-based compensation	(2,344)	(259)	(4,140)
Share-based compensation expense	4,627	2,943	3,584
Pension expense (income)	7,861	10,665	(1,274)
Postretirement expense (income)	422	539	(48)
(Gain) loss on disposition of property, plant and equipment	(451)	(354)	27
(Loss) income from discontinued operations	(292)	453	(214)
Changes in:			
Receivables, net	(34,965)	58,461	(52,554)
Income tax receivable	(2,359)	(3,248)	1,409
Inventories	(4,986)	28,650	(46,151)
Other current assets	(357)	(1,376)	(2,144)
Accounts payable	6,550	(22,878)	24,201
Accrued liabilities	20,646	(6,531)	12,060
Net cash provided by continuing operations	59,498	101,831	48,941
Net cash used in discontinued operations	-	-	(1,813)
Net cash provided by operating activities	59,498	101,831	47,128
Cash flows from investing activities:			
Additions to property, plant and equipment	(60,363)	(39,825)	(29,552)
Proceeds from disposition of property, plant and equipment	1,021	923	219
(Increase) decrease in other assets	(265)	(1,216)	579
Acquisition of other companies	(9,857)	(51,658)	-
Net cash used in continuing operations	(69,464)	(91,776)	(28,754)
Net cash provided by discontinued operations	-	-	1,813
Net cash used in investing activities	(69,464)	(91,776)	(26,941)
Cash flows from financing activities:			
Payments of notes payable	(2,888)	(3,426)	-
Dividends paid	(15,017)	(14,866)	(14,806)
Excess tax benefit from share-based compensation	2,344	259	4,140
Proceeds from exercise of stock options	13,277	612	8,295
Purchases of treasury stock	-	11	(4,623)
Net cash used in financing activities	(2,284)	(17,410)	(6,994)
Effect of translation on cash and cash equivalents	(15)	457	(1,185)
Net (decrease) increase in cash and cash equivalents	(12,266)	(6,898)	12,008
Cash and cash equivalents at beginning of period	100,858	107,756	95,748
Cash and cash equivalents at end of period	\$ 88,592	\$ 100,858	\$ 107,756

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. The impact of subsequent events on these financial statements has been evaluated through the date of issuance.

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

In June 2010, the Company's Board of Directors approved a 2-for-1 stock dividend to be effected by issuing one additional share of the Company's common stock for every share of the Company's common stock outstanding on the stock dividend record date. The additional shares of the Company's common stock issued in connection with the stock dividend were distributed on June 1, 2010 to stockholders of record at the close of business on May 19, 2010. All prior period shares outstanding, earnings per share and prices per share have been adjusted to reflect the stock dividend.

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 translation adjustment 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 collectability 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.

The Company had \$20.3 million, \$22.7 million, and \$23.8 million in Bill-and-Hold sales outstanding as of December 31, 2010, 2009, and 2008, respectively.

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 (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

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 2010, the Company completed its annual impairment evaluation by comparing the fair value of each reporting unit to its carrying amount. No impairment was necessary.

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 all or a portion 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 U.S. income taxes have been provided is \$79.8 million at December 31, 2010, 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 U.S. income taxes (subject to adjustment for foreign tax credits) and foreign withholding taxes and such amounts could be significant. 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, debt obligations, 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, 2010 and 2009, 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 liability for 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 entered 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.

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. As a result of this acquisition, the Company 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 was paid on 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, 2010, the liabilities for these hold back payments were included in accrued liabilities and other liabilities of the Company's consolidated balance sheets.

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. During the second quarter of 2010, the Company made a one-time payment of \$0.3 million, as a result of the final valuation of working capital at the time of the acquisition.

On November 1, 2010 the Company completed the acquisition of the significant operating assets of Petro Hydraulic Lift Systems, LLC ("PHL") and certain related companies, based in South Louisiana. PHL, specializes in the design, manufacture and leasing of hydraulic rod pumping units for oil and gas wells.

The PHL acquisition has 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	\$ 8,015
Royalty consideration	<u>7,076</u>
Total consideration paid	<u>\$ 15,091</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 was \$7.8 million and has been recorded as goodwill in the accompanying December 31, 2010, 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>\$ 15,091</u>
Property, plant and equipment	4,135
Intangible assets	2,453
Inventory	675
Goodwill recorded	<u>\$ 7,828</u>

The Company also entered into a royalty agreement with the former owners of PHL. The agreement is for a ten year period beginning November 1, 2010, and is payable at a rate of 5% for the first five years and 8% for the subsequent five years. Royalties are payable quarterly and are based on product revenues. At December 31, 2010, the estimated present value for these royalty payments were included in the accrued liabilities and other liabilities section of the consolidated balance sheet.

Revenues and earnings to date for the PHL acquisition for all 2010 are not material. Pro forma schedules have not been included as the impact on the prior and current periods presented is not material.

The PHL preliminary purchase price allocation, which is 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 the Company's management. The final valuation for PHL, which is required to be completed by October 2011, is 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.

The sales amounts included in discontinued operations for 2010 and 2009 are related to the sale of certain tooling, equipment, and spare parts for scrap. As these assets were originally part of the trailer segment they have been included in the operating results of discontinued operations. In addition, the earnings for 2010 and losses for 2009 resulted from the settlement of certain litigation and warranty claims in those respective years.

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

	2010	2009	2008
Sales	\$ 2	\$ 36	\$ 7,135
Earnings (loss) before income tax provision	449	(724)	450
Income tax (provision) benefit	(157)	271	(236)
Earnings (loss) from discontinued operations, net of tax	\$ 292	\$ (453)	\$ 214

	December 31, 2010	December 31, 2009
Receivables, net	\$ -	\$ 17
Income tax receivable	568	302
Deferred income tax assets	68	492
Current assets from discontinued operations	636	811
Long-term assets from discontinued operations	-	-
Total assets from discontinued operations	\$ 636	\$ 811

Accounts payable	\$ 32	\$ 10
Accrued liabilities:		
Payroll and benefits	72	70
Warranty expenses	124	240
Other	-	706
Current liabilities from discontinued operations	228	1,026
Long-term liabilities	37	37
Total liabilities from discontinued operations	\$ 265	\$ 1,063

(4) Receivables

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

(Thousands of dollars)	2010	2009
Accounts receivable	\$ 126,671	\$ 87,497
Notes receivable	139	482
Other receivables	748	4,767
Gross receivables	127,558	92,746
Allowance for doubtful accounts receivable	(260)	(240)
Net receivables	<u>\$ 127,298</u>	<u>\$ 92,506</u>

Collections on previous bad debts related to receivables resulted in a recovery of \$0.1 million and \$1.8 million at December 31, 2010 and 2009, respectively. Bad debt expense related to receivables was \$2.5 million in 2008.

(5) Inventories

Inventories used in determining cost of sales were as follows:

(Thousands of dollars)	2010	2009
Gross inventories @ FIFO:		
Finished goods	\$ 7,757	\$ 7,545
Work in progress	26,680	21,435
Raw materials & component parts	99,440	100,347
Maintenance, tooling & supplies	14,156	13,882
Total gross inventories @ FIFO	148,033	143,209
Less reserves:		
LIFO	28,776	29,961
Valuation	2,383	2,643
Total inventories as reported	<u>\$ 116,874</u>	<u>\$ 110,605</u>

Gross inventories on a FIFO basis shown above that were accounted for on a LIFO basis were \$80.9 million and \$76.7 million at December 31, 2010 and 2009, respectively.

(6) Property, Plant & Equipment

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

(Thousands of dollars)	2010	2009
Land	\$ 19,775	\$ 6,735
Land improvements	10,449	10,146
Buildings	106,199	92,467
Machinery and equipment	289,579	265,958
Furniture and fixtures	6,839	5,985
Computer equipment and software	23,407	15,388
Total property, plant and equipment	456,248	396,679
Less accumulated depreciation	(252,531)	(236,909)
Total property, plant and equipment, net	<u>\$ 203,717</u>	<u>\$ 159,770</u>

Depreciation expense related to property, plant and equipment was \$19.4 million, \$17.1 million and \$15.6 million in 2010, 2009 and 2008, respectively.

(7) Goodwill & Acquired Intangible AssetsGoodwill

The changes in the carrying amount of goodwill during the years ended December 31, 2010 and 2009 are as follows (in thousands of dollars):

(Thousands of dollars)	Oil Field	Power Transmission	Total
Balance as of 01/01/09	\$ 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	38,018	6,983	45,001
Goodwill acquired during the period	7,839	331	8,170
Foreign currency translation	5	(165)	(160)
Balance as of 12/31/10	<u>\$ 45,862</u>	<u>\$ 7,149</u>	<u>\$ 53,011</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, RMT and PHL acquisitions. The components of these intangible assets are as follows (in thousands of dollars):

	December 31, 2010			Weighted Average Amortization Period (years)
	Gross Carrying Amount	Accumulated Amortization	Net	
Non-compete agreements and trademarks	\$ 2,550	\$ 619	\$ 1,931	6.3
Customer relationships and contracts	15,183	2,375	12,808	10.0
	<u>\$ 17,733</u>	<u>\$ 2,994</u>	<u>\$ 14,739</u>	<u>7.0</u>
	December 31, 2009			Weighted Average Amortization Period (years)
	Gross Carrying Amount	Accumulated 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 \$1.7 million and \$1.3 million at December 31, 2010 and 2009, respectively. There was no intangible amortization expense in the year ended December 31, 2008. Expected amortization expense by year is (in thousands of dollars):

For the year ended 12/31/11	\$	2,017
For the year ended 12/31/12		1,885
For the year ended 12/31/13		1,857
For the year ended 12/31/14		1,707
For the year ended 12/31/15		1,670
Thereafter	\$	5,603

(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)	2010	2009
Customer prepayments	\$ 11,999	\$ 7,945
Litigation reserves	6,493	6,637
Deferred compensation & benefit plans	6,548	5,500
Acquisition hold back & royalty consideration	2,132	1,605
Other accrued liabilities	3,376	2,460
Total other current accrued liabilities	<u>\$ 30,548</u>	<u>\$ 24,147</u>

(9) Debt Obligations

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

	December 31, 2010	December 31, 2009
Long-term notes payable	\$ -	\$ 2,888
Less current portion of long-term debt	-	(1,372)
Long-term debt	<u>\$ -</u>	<u>\$ 1,516</u>

In the fourth quarter 2010 the Company elected to pre-pay the outstanding debt balances of the assumed notes from the 2009 ILS acquisition, which matured between 2011 and 2012.

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 \$80.0 million of aggregate borrowing. The Bank Facility expires on December 31, 2013. 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, 2010, 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, \$63.6 million of borrowing capacity was available at December 31, 2010.

(10) Retirement Benefits

The Company has a qualified noncontributory pension plan covering substantially all U.S. employees. The benefits provided by this plan are measured by length of service, compensation and other factors, and are currently funded by trusts established under the plan. Funding of retirement costs for the plan 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 Supplemental Executive Retirement Plan 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 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 matching by the Company. For Canadian employees, the Company makes contributions of 3%-8% of an employee's salary with no individual employee matching required. All obligations of the Company are funded through December 31, 2010. 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 \$3.8 million, \$3.3 million and \$3.5 million in the years ended December 31, 2010, 2009 and 2008, 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	
	2010	2009	2010	2009
Changes in benefit obligation				
Benefit obligation at beginning of year	\$ 208,747	\$ 187,350	\$ 8,486	\$ 7,657
Service cost	5,655	4,769	92	145
Interest cost	11,584	11,970	350	503
Plan participants' contributions	-	-	770	880
Plan change	-	-	-	640
Actuarial loss (gain)	11,116	13,844	(1,325)	471
Benefits paid	(9,767)	(9,204)	(1,412)	(1,569)
Curtailments	-	(1,136)	-	(241)
Other	(76)	1,154	-	-
Benefit obligation at end of year	<u>227,259</u>	<u>208,747</u>	<u>6,961</u>	<u>8,486</u>
Change in plan assets				
Fair value of plan assets at beginning of year	192,630	176,477	-	-
Actual return on plan assets	21,896	24,412	-	-
Employer contributions	339	281	642	688
Plan participants' contributions	-	-	770	881
Benefits paid	(9,767)	(9,204)	(1,412)	(1,569)
Other	(44)	664	-	-
Fair value of plan assets at end of year	<u>205,054</u>	<u>192,630</u>	<u>-</u>	<u>-</u>
Unfunded status at end of year	<u>\$ (22,205)</u>	<u>\$ (16,117)</u>	<u>\$ (6,961)</u>	<u>\$ (8,486)</u>

Amounts recognized in the balance sheet consist of:

(Thousands of dollars)	Pension Benefits		Other Benefits	
	2010	2009	2010	2009
Other current accrued liabilities	\$ (354)	\$ (317)	\$ (508)	\$ (612)
Postretirement benefits	-	-	(6,453)	(7,874)
Other long-term liabilities	(21,851)	(15,800)	-	-
	<u>\$ (22,205)</u>	<u>\$ (16,117)</u>	<u>\$ (6,961)</u>	<u>\$ (8,486)</u>

Amounts recognized in accumulated other comprehensive income consist of:

(Thousands of dollars)	Pension Benefits		Other Benefits	
	2010	2009	2010	2009
Prior service cost	\$ 3,872	\$ 4,369	\$ 284	\$ 323
Net loss (gain)	39,500	40,559	(1,933)	(1,289)
	<u>\$ 43,372</u>	<u>\$ 44,928</u>	<u>\$ (1,649)</u>	<u>\$ (966)</u>

(10) Retirement Benefits (Continued)

The accumulated benefit obligation for all defined benefit pension plans was \$211.7 million and \$193.1 million at December 31, 2010, and 2009, respectively.

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

(Thousands of dollars)	Pension Benefits			Other Benefits		
	2010	2009	2008	2010	2009	2008
Net Periodic Benefit Cost						
Service cost	\$ 5,654	\$ 4,769	\$ 4,933	\$ 92	\$ 145	\$ 151
Interest cost	11,585	11,970	10,979	350	503	455
Expected return on plan assets	(12,752)	(12,285)	(16,664)	-	-	-
Amortization of prior service cost	785	795	649	51	54	-
Amortization of net (gain) loss	3,712	4,566	181	(291)	(217)	(217)
Amortization of transition asset	-	-	(638)	-	-	-
Curtailement	-	1,542	-	-	(145)	-
Net periodic benefit cost (income)	<u>\$ 8,984</u>	<u>\$ 11,357</u>	<u>\$ (560)</u>	<u>\$ 202</u>	<u>\$ 340</u>	<u>\$ 389</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 \$3.6 million and \$0.9 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 \$0.2 million and \$0.1 million, respectively.

Additional Information

Assumptions

Weighted-average assumptions used to determine benefit obligations at December 31

	Pension Benefits		Other Benefits	
	2010	2009	2010	2009
Discount rate	5.19% - 5.26%	5.25% - 5.80%	4.97%	5.58%
Rate of compensation increase	5.12% - 5.21%	2.00% - 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		
	2010	2009	2008	2010	2009	2008
Discount rate	5.26% - 5.80%	6.00% - 6.40%	6.25% - 6.35%	5.58%	6.25%	6.20%
Expected long-term return on plan assets	6.80%	7.30%	7.30%	N/A	N/A	N/A
Rate of compensation increase	5.12%	4.50%	4.50%	N/A	N/A	N/A

(10) Retirement Benefits (Continued)

For 2010, the Company assumed a long-term asset rate of return of 6.8%. In developing the 6.8% 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, 2009), 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, 2010 are as follows:

Fair Value Measurements at December 31, 2010 (in thousands)

Asset Category	Total	Quoted Prices in Active markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash	\$ 7,897	\$ 7,897		
Equity securities:				
Common stock	62,304	62,304		
International stock - commingled funds (a)	25,290		\$ 25,290	
International stock - mutual fund	11,427	11,427		
Fixed income securities:				
U.S. Treasuries	13,502	13,502		
Mortgage-backed securities	13,076		13,076	
Collateralized mortgage obligations	3,865		3,865	
Corporate bonds (b)	17,082		17,082	
Other types of investments:				
Equity long/short hedge funds (c)	36,305			\$ 36,305
Insurance policy (d)	643			643
Real Estate (e)	13,663			13,663
Total	\$ 205,054	\$ 95,130	\$ 59,313	\$ 50,611

(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)**

	Equity Long/Short Hedge Funds	Real Estate	Insurance Contracts	Total
Beginning balance at December 31, 2009	\$ 34,289	\$ 12,099	\$ 664	\$ 47,052
Actual return on plan assets:				
Relating to assets still held at the reporting date	2,016	1,564		3,580
Relating to assets sold during the period				-
Purchases, sales, and settlements				
Other			(21)	(21)
Transfers in and/or out of Level 3				-
Ending balance at December 31, 2010	\$ 36,305	\$ 13,663	\$ 643	\$ 50,611

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, 2010 or 2009.

The unqualified pension plans and the postretirement benefit plan of the Company are unfunded and thus had no plan assets as of December 31, 2010 and 2009.

Cash Flows

Contributions

The Company expects to make contributions of \$6.4 million and \$0.5 million to the pension plans and the postretirement plan, respectively, in 2011.

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 Benefits	Other Benefits
2011	\$ 10,605	\$ 520
2012	11,425	520
2013	12,039	527
2014	12,862	527
2015	13,644	531
2016 - 2020	79,861	2,623

(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 Amount	Tax (Expense)/ Benefit	Net Amount
Year ended December 31, 2008			
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 loss	<u>\$ (84,959)</u>	<u>\$ 29,190</u>	<u>\$ (55,769)</u>
Year ended December 31, 2009			
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>
Year ended December 31, 2010			
Foreign currency translation adjustments	\$ (960)	\$ -	\$ (960)
Defined benefit pension plans:			
Amortization of net prior service cost	785	(290)	495
Amortization of net loss	3,712	(1,371)	2,341
Net loss arising during period	(2,030)	750	(1,280)
Other	-	-	-
Total defined benefit pension plans	2,467	(911)	1,556
Defined benefit postretirement plans:			
Amortization of net prior service cost	51	(19)	32
Amortization of net gain	(291)	108	(183)
Net gain arising during period	1,325	(490)	835
Net prior service cost	-	-	-
Other	-	-	-
Total defined benefit postretirement plans	1,085	(401)	684
Other comprehensive income	<u>\$ 2,592</u>	<u>\$ (1,312)</u>	<u>\$ 1,280</u>

(11) Other Comprehensive Income (Continued)

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

(Thousands of dollars)	Foreign Currency Translation	Defined Benefit Pension Plans	Defined Benefit Postretirement Plans	Accumulated Other Comprehensive Loss
Balance, Dec. 31, 2008	\$ 2,512	\$ (48,921)	\$ 1,709	\$ (44,700)
Current-period change	3,525	3,993	(744)	6,774
Balance, Dec. 31, 2009	6,037	(44,928)	965	(37,926)
Current-period change	(960)	1,556	684	1,280
Balance, Dec. 31, 2010	<u>\$ 5,077</u>	<u>\$ (43,372)</u>	<u>\$ 1,649</u>	<u>\$ (36,646)</u>

(12) Earnings per Share

A reconciliation of the number of weighted shares used to compute basic and diluted net earnings per share for 2010, 2009 and 2008, are illustrated below:

	2010	2009	2008
Weighted average common shares outstanding for basic EPS	29,978,034	29,729,874	29,577,734
Effect of dilutive securities: employee stock options	328,328	76,068	242,492
Adjusted weighted average common shares outstanding for diluted EPS	<u>30,306,362</u>	<u>29,805,942</u>	<u>29,820,226</u>

Options to purchase a total of 125,543, 1,042,328 and 335,560 shares of the Company's common stock were excluded from the calculation of fully diluted earnings per share for 2010, 2009 and 2008, 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, 2010, 2009 and 2008:

(Thousands of dollars)	2010	2009	2008
Stock-based compensation expense	\$ 4,627	\$ 2,943	\$ 3,584
Tax benefit	(1,712)	(1,089)	(1,326)
Stock-based compensation expense, net of tax	<u>\$ 2,915</u>	<u>\$ 1,854</u>	<u>\$ 2,258</u>

(13) Stock Option Plans (Continued)

The fair value of each option grant during the years ended December 31, 2010, 2009 and 2008 was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	2010	2009	2008
Expected dividend yield	0.94% - 1.60%	0.87% - 1.40%	0.67% - 1.10%
Expected stock price volatility	51.20% - 57.80%	23.40% - 28.15%	20.50% - 24.85%
Risk free interest rate	0.53% - 2.96%	0.55% - 1.37%	0.77% - 1.64%
Expected life of options	2 - 6 years	3 - 7 years	2 - 6 years
Weighted-average fair value per share at grant date	\$17.05	\$10.13	\$9.86

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, 2010, is presented below:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000's)
Outstanding at January 1, 2010	1,418,028	\$26.28		
Granted	439,500	45.58		
Exercised	(533,641)	24.88		
Forfeited or expired	(2,250)	29.34		
Outstanding at December 31, 2010	<u>1,321,637</u>	<u>\$33.26</u>	<u>8.1</u>	<u>\$38,501</u>
Exercisable at December 31, 2010	<u>507,963</u>	<u>\$28.45</u>	<u>6.8</u>	<u>\$17,241</u>

As of December 31, 2010, there was \$7.1 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 2.7 years. As of December 31, 2009 and 2008 the weighted average grant date fair value was \$51.34 and \$56.89, respectively. The intrinsic value of stock options exercised in 2010, 2009 and 2008 was \$11.4 million, \$1.0 million and \$14.4 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, 2010 and 2009, no shares of preferred stock had been issued.

(15) Income Taxes

Earnings from continuing operations before income taxes for 2010, 2009 and 2008 consisted of the following:

(Thousands of dollars)	2010	2009	2008
United States	\$ 50,278	\$ 17,880	\$ 112,722
Foreign	17,167	15,132	23,690
Total earnings before income taxes	<u>\$ 67,445</u>	<u>\$ 33,012</u>	<u>\$ 136,412</u>

The income tax provision for 2010, 2009 and 2008 consisted of the following:

(Thousands of dollars)	2010	2009	2008
Current:			
U.S. federal and state income taxes	\$ 15,815	\$ 7,286	\$ 42,487
Foreign	6,663	4,793	5,514
Total current	<u>22,478</u>	<u>12,079</u>	<u>48,001</u>
Deferred:			
U.S. federal and state income taxes	2,819	(1,186)	(823)
Foreign	(1,383)	(360)	1,209
Total deferred	<u>1,436</u>	<u>(1,546)</u>	<u>386</u>
Total	<u>\$ 23,914</u>	<u>\$ 10,533</u>	<u>\$ 48,387</u>

Cash payments for income taxes totaled \$18.8 million, \$22.0 million and \$45.1 million for 2010, 2009 and 2008, 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)	2010	2009	2008
Tax provision computed at statutory rate	\$ 23,606	\$ 11,554	\$ 47,744
Tax effect of:			
Expenses for which no benefit was realized	279	335	936
Change in effective state tax rate	13	(44)	115
Tax credit	(1,065)	(962)	(237)
State taxes net of federal benefit	1,813	504	2,351
Benefit of manufacturing deduction	(1,127)	(481)	(1,892)
Other, net	395	(373)	(630)
Total provision for taxes	<u>\$ 23,914</u>	<u>\$ 10,533</u>	<u>\$ 48,387</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)	2010	2009
Deferred income tax assets:		
Pension costs	\$ 10,138	\$ 7,523
Payroll and benefits	1,313	967
Accrued warranty expenses	1,078	1,328
Postretirement benefits	6,356	6,543
Accrued liabilities	2,526	3,295
Other, net	706	120
Total deferred income tax assets	22,117	19,776
Less valuation allowance	(389)	(69)
Total deferred income tax assets	21,728	19,707
Noncurrent deferred income tax liabilities:		
Prepaid expenses	(644)	(335)
Depreciation	(21,004)	(18,387)
Inventories	(1,486)	(730)
Other, net	(6,924)	(5,515)
Total noncurrent deferred income tax liabilities, net	(30,058)	(24,967)
Total net deferred tax liability	\$ (8,330)	\$ (5,260)
Current deferred tax asset		
Continuing operations	\$ 3,554	\$ 5,198
Discontinued operations	69	492
Total current deferred tax asset	3,623	5,690
Non-current deferred tax liability		
Continuing operations	(11,953)	(10,950)
Discontinued operations	-	-
Total non-current deferred tax liability	(11,953)	(10,950)
Total net deferred tax liability	\$ (8,330)	\$ (5,260)

(15) Income Taxes (Continued)

As of January 1, 2010, 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. As of December 31, 2010, the Company had approximately \$1.8 million of total gross unrecognized tax benefits. Of this total, \$1.8 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)	2010	2009	2008
Balance at January 1,	\$ 1,509	\$ 1,368	\$ 2,743
Gross increases- current year tax positions	372	593	-
Gross increases- tax positions from prior periods	233	93	328
Gross decreases- tax positions from prior periods	(262)	(372)	(813)
Settlements	(14)	(173)	(890)
Balance at December 31,	<u>\$ 1,838</u>	<u>\$ 1,509</u>	<u>\$ 1,368</u>

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 2007 are closed to assessment. Statutes for years prior to 2007 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. In early 2010, the Company settled the examination by the State of Texas for the 2005 – 2006 tax years. This settlement did not have a material impact on the Company's financial statements. The Company also remains subject to income tax examinations in the following material international jurisdictions: Canada (2005-2009), France (2009), and Argentina (2003– 2009). In 2010, the Company also settled two international exams in Argentina for tax years 2004-2008 and in France for tax years 2006-2008. These settlements did not have a material impact on the financial statements.

The Company's continuing practice is to recognize interest and penalties related to income tax matters in administrative costs. The Company had \$131,000 accrued for interest and penalties at December 31, 2009. Interest and penalties of \$30,000 were accrued during the twelve months ended December 31, 2010.

(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 5th 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. 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.

On January 15, 2010, in its final judgment, 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 were required to submit this request within 14 days of the final judgment. On January 21, 2010, 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.

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. 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 September 28, 2010, the District Court granted plaintiffs' motion for supplemental attorney's fees, costs and expenses in the amount of \$0.7 million for the period of January 1, 2009 through January 15, 2010. In order to cover these cost, the Company recorded an additional provision of \$1.0 million in September 2010 for anticipated costs through the end of 2010.

On February 2, 2011 the United States Fifth Circuit Court of Appeals accepted the oral arguments from the plaintiffs and the Company on their respective appeals to the court. We anticipate the court's decision before the end of the second quarter of 2011.

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, 2010 and 2009, is as follows:

(Thousands of dollars)	2010	2009
Beginning balance	\$ 4,220	\$ 3,586
Claims paid or accrued	(3,213)	(3,793)
Additional warranties issued	3,244	3,891
Revisions in estimates	(678)	385
Foreign currency translation	47	151
Ending balance	<u>\$ 3,620</u>	<u>\$ 4,220</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)

2011	\$ 2,552
2012	1,457
2013	1,118
2014	917
2015	671
All years	\$ 4,170

Expenses for rentals and leases, including short-term rental contracts, were \$7.8 million, \$6.0 million and \$5.2 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Capital expenditures: As of December 31, 2010, the Company had contractual commitments for capital expenditures of \$5.8 million that are expected to be paid in 2011.

(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)	2010	2009	2008
Sales by segment:			
Oil Field	\$ 477,867	\$ 349,168	\$ 551,814
Power Transmission	167,776	172,191	189,380
Total sales	\$ 645,643	\$ 521,359	\$ 741,194
Sales by geographic region:			
United States	\$ 390,129	\$ 290,924	\$ 469,343
Europe	46,799	50,362	60,463
Canada	33,668	19,039	33,354
Latin America	103,390	94,972	97,310
Middle East/North Africa	43,913	40,310	56,149
Other	27,744	25,752	24,575
Total sales	\$ 645,643	\$ 521,359	\$ 741,194
Earnings (loss) before income taxes:			
Oil Field	\$ 57,690	\$ 21,405	\$ 116,150
Power Transmission	10,937	17,040	26,308
Corporate & Other*	(1,182)	(5,433)	(4,479)
Adjustment**	-	-	(1,567)
Total earnings (loss) before income taxes	\$ 67,445	\$ 33,012	\$ 136,412
Assets by segment:			
Oil Field	\$ 376,324	\$ 293,140	\$ 275,395
Power Transmission	134,004	128,789	126,912
Corporate & Other	110,114	118,850	127,300
Adjustment**	-	-	-
Total assets	\$ 620,442	\$ 540,779	\$ 529,607
Property, plant & equipment, net, by geographic region			
United States	\$ 145,842	\$ 121,419	\$ 96,566
Europe	33,051	14,827	11,194
Canada	8,655	9,072	9,731
Latin America	15,924	14,211	12,280
Other	245	241	308
Total P, P & E, net	\$ 203,717	\$ 159,770	\$ 130,079
Capital expenditures by segment			
Oil Field	\$ 43,938	\$ 27,384	\$ 20,786
Power Transmission	8,445	12,168	7,755
Corporate & Other	7,980	273	1,011
Total capital expenditures	\$ 60,363	\$ 39,825	\$ 29,552
Depreciation/amortization by segment:			
Oil Field	\$ 13,484	\$ 11,561	\$ 9,815
Power Transmission	6,752	5,951	5,151
Corporate & Other	922	945	733
Total depreciation/amortization	\$ 21,158	\$ 18,457	\$ 15,699

(17) Business Segment Information (Continued)

Additional key segment information is presented below:

Year Ended December 31, 2010

(Thousands of dollars)	<u>Oil Field</u>	<u>Power Transmission</u>	<u>Corporate & Other*</u>	<u>Adjustment**</u>	<u>Total</u>
Gross sales	\$ 479,732	\$ 171,155	\$ -	\$ -	\$ 650,887
Inter-segment sales	(1,865)	(3,379)	-	-	(5,244)
Net sales	<u>\$ 477,867</u>	<u>\$ 167,776</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 645,643</u>
Operating income (loss)	\$ 57,749	\$ 10,911	\$ (1,001)	\$ -	\$ 67,659
Other (expense) income, net	(59)	26	(181)	-	(214)
Earnings (loss) before income tax provision	<u>\$ 57,690</u>	<u>\$ 10,937</u>	<u>\$ (1,182)</u>	<u>\$ -</u>	<u>\$ 67,445</u>

Year Ended December 31, 2009

(Thousands of dollars)	<u>Oil Field</u>	<u>Power Transmission</u>	<u>Corporate & 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, net	947	74	567	-	1,588
Earnings (loss) before 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 Transmission</u>	<u>Corporate & 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 (expense) income, net	(1,385)	176	1,521	-	312
Earnings (loss) before income tax provision	<u>\$ 116,150</u>	<u>\$ 26,308</u>	<u>\$ (4,479)</u>	<u>\$ (1,567)</u>	<u>\$ 136,412</u>

* Corporate & 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)	2010	2009
Assets from continuing operations	\$ 620,442	\$ 540,779
Assets from discontinued operations	636	811
Total assets	<u>\$ 621,078</u>	<u>\$ 541,590</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. No customer represented over 10% of consolidated company sales as of December 31, 2010. At December 31, 2009 and 2008, one customer represented 11.0% and 15.4%, respectively, of the consolidated Company sales.

(19) Quarterly Financial Data (Unaudited)

The following table sets forth unaudited quarterly financial data for 2010 and 2009:

<u>Quarterly Financial Data (Unaudited)</u>				
(Millions of dollars, except per share data)	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
<u>2010</u>				
Sales	\$ 127.1	\$ 152.9	\$ 172.1	\$ 193.5
Gross profit	28.6	37.3	43.3	49.2
Net earnings	6.0	10.6	12.6	14.3
Basic earnings per share	0.21	0.35	0.42	0.47
Diluted earnings per share	0.20	0.35	0.42	0.47
<u>2009</u>				
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	0.31	0.16	0.17	0.12
Diluted earnings per share	0.31	0.16	0.17	0.12

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, 2010, 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, as amended (the Exchange Act)) 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 required disclosure.

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended December 31, 2010, 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 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 2011 Annual Meeting of Stockholders (the "Proxy Statement"), which will be filed within 120 days after December 31, 2010. 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 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 annual report of Form 10-K and is incorporated in Item 12 of this report by reference.

Item 13. Certain Relationships and Related Transactions and Director Independence

Since January 1, 2010, there have been 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 Accounting 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 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.
- *10.5 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.
- *10.6 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.
- *10.7 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.
- *10.8 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.
- *10.9 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.
- *10.10 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.
- *10.11 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.
- *10.12 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.
- *10.13 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.
- *10.14 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.

- *10.15 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.
- *10.16 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.
- *10.17 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.
- *10.18 Severance Agreement, dated as of September 20, 2010, between Lufkin Industries, Inc. and Brian J. Gifford included as Exhibit 10.1 to the Company's current report on Form 8-K filed on October 1, 2010 (File No. 0-02612), which exhibit is incorporated herein by reference.
- *10.19 Amended and Restated Credit Agreement dated as of December 31, 2010, between Lufkin Industries, Inc. and JPMorgan Chase Bank, N.A. included as Exhibit 10.1 to the Company's current report on Form 8-K filed on January 4, 2011 (File No. 0-02612), which exhibit is incorporated herein by reference.
- 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 Beginning of Year	Additions		Deductions	Balance at End of Year
		Charged to Expense	Charged to Other Accounts		
Allowance for Doubtful Receivables:					
Year Ended December 31, 2010	\$ 240	(93)		113	\$ 260
Year Ended December 31, 2009	735	(1,844)	-	1,349	240
Year Ended December 31, 2008	\$ 89	2,462	-	(1,816)	\$ 735
Inventory: Valuation Reserves:					
Year Ended December 31, 2010	\$ 2,643	(224)	-	(36)	\$ 2,383
Year Ended December 31, 2009	4,535	100	-	(1,992)	2,643
Year Ended December 31, 2008	\$ 1,579	2,964	-	(8)	\$ 4,535
Inventory: LIFO Reserves:					
Year Ended December 31, 2010	\$ 29,961	(1,185)		-	\$ 28,776
Year Ended December 31, 2009	32,926	(2,965)	-	-	29,961
Year Ended December 31, 2008	\$ 25,184	7,742	-	-	\$ 32,926

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, 2011

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> J. F. Glick	President/Chief Executive Officer (Principal Executive Officer)	March 1, 2011
By <u>/s/ C. L. Boone</u> C. L. Boone	Vice President/Treasurer/Chief Financial Officer (Principal Financial and Accounting Officer)	March 1, 2011
By <u>/s/ D. V. Smith</u> D. V. Smith	Chairman of the Board of Directors	March 1, 2011
By <u>/s/ J. F. Anderson</u> J.F. Anderson	Director	March 1, 2011
By <u>/s/ S. V. Baer</u> S. V. Baer	Director	March 1, 2011
By <u>/s/ J. D. Hofmeister</u> J. D. Hofmeister	Director	March 1, 2011
By <u>/s/ J. T. Jongebloed</u> J. T. Jongebloed	Director	March 1, 2011
By <u>/s/ J. H. Lollar</u> J. H. Lollar	Director	March 1, 2011
By <u>/s/ R. R. Stewart</u> R. R. Stewart	Director	March 1, 2011
By <u>/s/ H. J. Trout, Jr.</u> H. J. Trout, Jr.	Director	March 1, 2011
By <u>/s/ T. E. Wiener</u> T. E. Wiener	Director	March 1, 2011

CORPORATE OFFICERS:

J. F. Glick

President
Chief Executive Officer

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

B. J. Gifford

Vice President of Human Resources

CORPORATE OFFICE:

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

WORLD WIDE WEB:

For information on Lufkin Industries Inc.'s products
and services, and the latest industry news visit
www.lufkin.com.

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 & Lascar, LLC
1800 West Loop South, Suite 200
Houston, TX 77027
713-529-6600



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