



*The Energy Flows Through Us™*



**2012**

ANNUAL REPORT

**LUFKIN**



## ABOUT LUFKIN

Founded in 1902, Lufkin Industries (NASDAQ: LUFK) is a global provider of artificial lift products, services and automation solutions for the oil and gas industry, including beam pumping, gas lift and plunger lift systems. Its Power Transmission segment also serves the energy and industrial sectors with engineered gearing solutions. Lufkin has vertically integrated all vital technologies required to design, manufacture and market its products.

## Operational Divisions

### 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 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.



## Financial Highlights

(Thousands of dollars, except per share amounts)

|                                                    | 2012               | 2011        | 2010      | 2009      | 2008      |
|----------------------------------------------------|--------------------|-------------|-----------|-----------|-----------|
| Sales from continuing operations                   | <b>\$1,281,200</b> | \$ 932,135  | \$645,643 | \$521,359 | \$741,194 |
| Operating Income from continuing operations        | <b>140,052</b>     | 107,478     | 67,659    | 31,424    | 136,100   |
| Net Earnings from continuing operations            | <b>81,857</b>      | 65,971      | 43,531    | 22,479    | 88,025    |
| Earnings per share from continuing operations:     |                    |             |           |           |           |
| Basic*                                             | <b>\$ 2.48</b>     | \$ 2.17     | \$ 1.45   | \$ 0.76   | \$ 2.98   |
| Diluted*                                           | <b>2.45</b>        | 2.14        | 1.44      | 0.76      | 2.96      |
| Dividends per share*                               | <b>0.50</b>        | 0.50        | 0.50      | 0.50      | 0.50      |
| Total assets                                       | <b>\$1,435,219</b> | \$1,096,705 | \$621,078 | \$541,590 | \$530,718 |
| Working capital                                    | <b>379,489</b>     | 293,730     | 260,620   | 253,744   | 296,925   |
| Long-term notes payable,<br>net of current portion | <b>300,454</b>     | 332,500     | —         | 1,516     | —         |
| Shareholders' equity                               | <b>813,971</b>     | 507,533     | 485,960   | 435,678   | 413,937   |

\*Years 2008–2009 adjusted for 2-for-1 Stock Split effective on June 1, 2010.

# OUR PEOPLE ARE OUR STRENGTH

People, technology and  
new acquisitions fuel  
record growth in 2012.



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

## Dear Fellow Shareholder,

Lufkin Industries followed a record 2011 with another record year in 2012. Revenues grew 37% and new business bookings grew 38%, to \$1.3 billion, while net earnings increased 24% to \$81.9 million. We finished the year with our highest order backlog ever of \$324 million, up 19% from 2011.

In the process of delivering another record year, our Company faced the challenges of a rapid rise in demand for our products—particularly, our rod lift and automation products. Despite difficulties we and others in the industry encountered as we ramped up manufacturing capacity to satisfy this spike in demand, our employees rose to the challenge, and we exited the year with a strong fourth quarter.

Driving the strong growth in 2012 was the resurgence in U.S. land drilling that has accompanied the development of tight shale plays. The use of unconventional drilling and completion methods has allowed the U.S. to begin regaining control of its energy future. Lufkin's products are playing a major role in extracting oil from these unconventional plays.

According to Spears and Associates, an industry research group, the artificial lift market grew 23% year-over-year in 2012. Perhaps more important for Lufkin Industries, rod lift—our core product—raised its share of the total artificial lift market from 25% in 2011 to 31% in 2012, reflecting producers' preference for rod lift in these unconventional plays. We expect this trend to continue in North America and to spread to international markets as unconventional oil is developed in those regions as well.

In order to satisfy the robust demand for Lufkin's products, we added new capacity to our existing manufacturing organization. The 400 employees that

joined the Company were vital to the increase in output, but the significant increase in our factory workforce also presented challenges as we strived to train so many new workers and to manage and overcome the productivity hurdles that typically accompany such rapid growth. This impacted profit margins both in our Oilfield Division and more significantly in our Power Transmission Division, although margins began to strengthen again later in the year.

### OILFIELD DIVISION

The use of automation technology to optimize production from artificial lift wells continued to build in 2012, resulting in a record year for automation products. Adoption of this technology is fueled by the improved reliability and production rates, along with the reduced operating costs they deliver to our customers.

In addition, the companies we acquired at the end of February 2012—Zenith Oilfield Technology, Datac Instrumentation and Realflex Technologies—contributed to this success. These acquisitions brought both new markets and new capabilities to our portfolio, and they are driving the development of the next generation of automation products. The first generation of the new I-Well Manager, incorporating the Datac SCADA (supervisory control and data acquisition) technology are scheduled for roll-out in the second quarter of 2013.

The acquisition of Quinn's Oilfield Supply of Canada in late 2011 also contributed to Lufkin's financial performance during 2012. We have only begun to penetrate the international markets for down-hole pumps, but early results suggest we are likely to realize stronger growth for this product in the future.

Long lead times due to capacity constraints were the chief barrier to further growth in our down-hole pump

business in 2012. To address this, we launched a capital project to expand capacity in our Red Deer, Alberta facility. With the added capacity that is scheduled to be in place in late 2013, we are well positioned to support the global demand for down-hole pumps that we expect to see in the near term.

We largely completed our new Romania facility; by year end, virtually all of the construction work on the new manufacturing center and offices was complete, and most of the machine tools were in place. As 2013 got under way, we began trial manufacturing runs to calibrate our machine tools to turn out products to Lufkin's precise specifications. We also opened new service centers in the U.S. in 2012 to better support customers in the Bakken and Eagle Ford plays—which combined with the Permian Basin generated the lion's share of growth last year.

Although the U.S. oil demand underpinned our success in 2012, we look to international markets to drive growth in 2013 in our Oilfield segment. We have made headway in developing new markets for Lufkin's products in Romania, and more broadly, in the Eastern Hemisphere countries that will be served from Romania.

International sales momentum is expected to increase as we go through the year, with Latin America, the Arabian Gulf and North Africa leading the way. Although business was interrupted with one of our most important Latin America markets—Argentina—due to labor unrest in 2012, we are hopeful that this market will be less volatile in 2013.

In the U.S., with the oil-directed land drilling rig count hovering above 1,330 in early March 2013, we expect continued strength in drilling in the Eagle Ford Shale in South Texas, the Permian Basin in West Texas and the Bakken play in North Dakota and Montana, along with a drilling recovery in California.

To meet the needs of our customers globally and to capture our share of that 18% increase in demand for artificial lift products that Spears and Associates is forecasting for 2013, margin-enhancing productivity improvements and overall capacity expansion will continue to be our main focus.

#### POWER TRANSMISSION DIVISION

2012 was a challenging year for our Power Transmission Division. Although we delivered 5% growth in revenues, we experienced factory performance issues in the first half of the year that dampened growth and pulled down margins, and we saw a number of sizeable orders we expected to book in 2012 experience delays.

Even so, we began to see productivity recover in the second half, and we realized strong performance from our Lufkin France operations. Lufkin France continues to make inroads with European compressor and pump

manufacturers, expanding Lufkin's presence in the turbo gear markets in the Eastern Hemisphere.

Energy project customers represented 63% of our new bookings in Power Transmission, and we expect that trend to continue this year, particularly in the oil and gas and petrochemical segments.

Overall, we are very encouraged by the opportunities we see in 2013 in both divisions, but most particularly on the Oilfield side. The current oil price environment should support strong levels of drilling in the U.S. shale plays and in most international oil provinces around the world.

Industry surveys indicate that global exploration and production spending is expected to increase about 10% in 2013, with international dollars expected to increase by about 13%. The continued weakness in U.S. natural gas prices could drive more E&P spending abroad, as producers seek better returns on investment—which could drive new business for our operations in France and Romania.

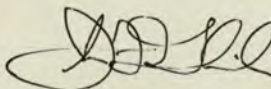
Included in our capital budget for 2013 are the installation of a chrome-plating facility in our Quinn's operation to expand capacity in Canada and the addition of a new high-speed test stand in our Lufkin France operation—along with several smaller machine tool additions to de-bottleneck capacity constraints in our manufacturing facilities.

In addition to the substantial capacity ramp-up expected this year, we are continually striving to expand and enhance our supply chain that feeds the raw materials and casting to our factories in both the Oilfield and Power Transmission divisions, using our global buying power to obtain reliable sources of high-quality materials at the best prices possible.

Our expanded facilities worldwide—combined with our unmatched reputation for engineering excellence, product reliability, on-time delivery, and our portfolio of next-generation automation products that allows operators to produce their wells more efficiently and cost effectively—leave Lufkin Industries well positioned to be globally competitive and give our Company the opportunity to win a growing share of the expanding global market for artificial lift products and services.

On behalf of the management team and our board of directors, we thank you for your investment in Lufkin Industries.

Sincerely,



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

## GLOBAL HIGHLIGHTS

### NORTH AMERICA

New tight oil developments in shale plays drove expansion in artificial lift. Lufkin expanded its network of service centers to provide unmatched field support to our North American customers. Lufkin's products and services are playing a vital role in the revival of onshore oil production in North America and helping the United States become less dependent on imported oil.

### LATIN AMERICA

While 2012 was a year of challenges in Latin America, particularly in Argentina, this region is poised for growth in energy production. Much of the production in Latin America will be from mature fields, or tight shale formations, and will require artificial lift. We expect stronger demand in 2013 for rod lift, gas lift and automation products.



## EUROPE

Europe continues to be an important market for our products, and is a growing support base for manufacturing and technical service to our customers. Our operations in France continue to expand the reach of our Power Transmission products. Lufkin's new operation in Romania will provide the hub for manufacturing, engineering, and technical support for our artificial lift and automation products to customers in the Middle East, North Africa, Europe, Central Asia, and the FSU.

## MIDDLE EAST

The Middle East remains a region of significant promise for artificial lift. Maturing fields and an infrastructure for processing hydrocarbons will necessitate continued investment in oil and gas development. Again, Lufkin is well positioned with its highly trained sales, service and technical support teams in Oman, Kuwait and Bahrain supplemented by a very effective network of representatives strategically located throughout the region.

## NORTH AFRICA

After a period of political change in this region, we expect growth in oil exploration and production to gather pace. Our operations in Egypt performed very well during the Arab Spring. Our staff is well trained and provides our customers in the region with excellent service and technical support.





## OILFIELD DIVISION

**Lufkin** is a vertically integrated global leader in artificial lift systems for the efficient production of crude oil, condensate and natural gas. Our goals are to increase production, optimize reservoir performance, maximize equipment life, reduce required manpower, minimize down time and reduce operating costs for our clients. To achieve these goals, the Oilfield Division provides an extensive array of Artificial Lift products and expertise, which includes:

- Rod lift pumping equipment
- Gas lift and plunger lift systems
- Down-hole reciprocating rod pumps and progressing cavity pumps (PCP)
- Automation and control systems including SCADA (Supervisory Control and Data Acquisition) software
- Down-hole gauges for Electrical Submersible Pumps, PCP, plunger lift and rod lift applications
- Installation, maintenance and repair services
- Foundry castings
- Well optimization engineering services

Nearly 90 years ago, Lufkin engineers designed and patented the first counter-balanced pumping unit from our foundry in Lufkin, Texas. Today, Lufkin's Oilfield Division, which now includes that original foundry as well as manufacturing facilities in Argentina, Canada, Egypt and Romania, delivers pumping units and a broad range of artificial lift products globally. We also have an international network of sales representative offices in more than 40 countries as well as service centers featuring original equipment manufacturer (OEM) parts to serve our global clients.

The North American onshore oilfield market operated at near record levels in 2012, with an increased focus on the recovery of oil and natural gas liquids using horizontal and directional drilling and high pressure well fracturing methods to enhance production and reserve recovery primarily from unconventional shale plays.



## SHALE PLAYS IN NORTH AMERICA

The demand for our premier rod lift pumping units grew in 2012, with revenue increasing 25% to \$506 million, as drilling and completion activity was focused in several key shale plays in North America.

Drilling and development programs in the Eagle Ford play in South Texas, the Bakken shale play in North Dakota and Montana and the Cline/Wolfcamp/Spraberry plays in the Permian Basin drove strong bookings and sales growth in 2012 across all of Lufkin's product lines.

Pumping unit bookings to the Bakken play increased in 2012 by 17% year over year, with Lufkin providing significant numbers of pumping units to the major operators in this play. Lufkin delivered over 1,000 new pumping units to the Bakken area last year and also

provided a significant share of the pumping units to operators in the Eagle Ford play.

The Company anticipates significant increases in Oilfield product and service bookings in the Cline Shale play in West Texas during 2013—a developing horizontal play—as well as in other traditional Permian Basin plays, along with strong ongoing activity in the Eagle Ford play.

Lufkin's gas-focused businesses—Pentagon Optimization Services, Lufkin Hydraulic Lift and International Lift Systems—were all negatively affected by low natural gas prices and our customers' investment focus on liquids recovery projects during 2012. Futures prices suggest a gradual improvement in natural gas pricing in the U.S. starting in late 2013.

## OILFIELD DIVISION

# GLOBAL EXPANSION

Lufkin has invested heavily in the facilities and people required to effectively serve international markets.



Lufkin's new manufacturing and aftermarket facility in Ploiesti, Romania—which will enable Lufkin to more efficiently and cost effectively serve expanding Eastern Hemisphere markets—is in the final stages of completion in early 2013. The main manufacturing plant is equipped with the most modern and state-of-the-art machine tools to allow rapid deliveries and higher throughput. The Romanian facility will be capable of manufacturing the full range of pumping unit sizes and has easy access to road, rail and sea transportation hubs to allow greatly reduced transport costs and reduction in lead times.

Development of the shale gas markets in both Western and Eastern Europe is expected to gain momentum, as they provide European governments with lower energy costs and a greater security of gas supplies despite continuing environmental resistance in certain European countries. Lufkin's facility in Romania is strategically located to serve these key future markets as well as new and traditional artificial lift markets in the Middle East and Asia.

The Company expects commissioning and acceptance of the major machine tools in Romania to be completed during the second quarter of 2013. At the end of 2012, this facility employed over 180 personnel across all disciplines, and we expect to have over 250 personnel by mid-2013, expanding to over 300 by the end of 2013. The Romania plant also includes a state-of-the-art aftermarket facility to provide installation, repair, preventative maintenance, asset management and well optimization services for all of Lufkin's product lines.

In addition, we expanded our Eastern Hemisphere presence last year by locating key personnel in Russia, Indonesia and Libya to provide business acquisition and service support in these geographic markets. Lufkin formed a joint venture in Libya to supply equipment, maintenance and service for the existing fields. Although the recent unrest in Libya significantly affected activity in 2012, we expect increased stability in this region this year, and we expect this new venture to be fully operational in 2013.

Lufkin's regional expansion in Latin America continued in 2012 with new operations started in Colombia and Mexico. The Colombian operation is expected to benefit

from ongoing strong activity in traditional artificial lift plays as well as incremental activity driven by new shale plays. Mexico should benefit from an increased focus on restoring shut-in production and optimizing producing wells in existing fields.

Lufkin's operations in Argentina faced numerous challenges in 2012 associated with labor disruptions and the nationalization of oil producer YPF. However, as YPF continues to stabilize, and development of new shale plays gathers momentum, we also expect incremental market growth opportunities in Argentina.



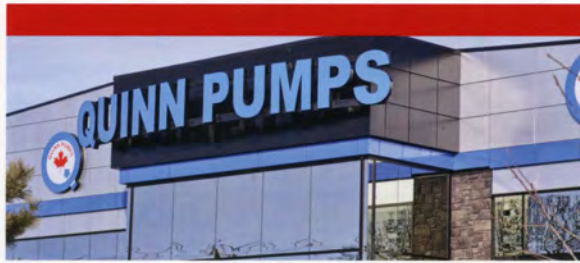
# KEY ACQUISITIONS

Lufkin's focus in 2012 was to begin capturing the value of recent acquisitions by integrating technology, people and processes.

Over the last two years Lufkin Oilfield Division has acquired six companies, and our focus in 2012 was to integrate all of the newly acquired technologies into our customer offerings, expand international market positions and grow revenues profitably.

Lufkin's Automation experienced another record revenue year in 2012. This product line provides sophisticated well automation software and hardware to optimize well production and minimize operating costs for rod lift pumping systems, progressing cavity pumps and plunger lift systems. Sales of variable speed drives (VSD) were particularly strong, as operators heavily employed this technology for shale play wells.





Lufkin closed on three key acquisitions during 2012 that expanded the capabilities of our Automation product line. Datac Instrumentation and Realflex Technologies, based in Ireland provided Lufkin with state-of-the-art SCADA software systems and well management systems. Zenith Oilfield Technology, based in Scotland, provided real-time down-hole sensing and production optimization systems for ESP, PCP and rod lift systems. The capabilities these companies brought to Lufkin allow us to offer our customers a sophisticated information backbone,

advanced applications and decision making tools for efficiently monitoring production from artificial lifted wells.

Automation is an integral part of Lufkin's system-wide approach to artificial lift optimization. Lufkin will continue to invest in new technologies in this area to help our clients reduce the overall costs of production in mature fields.

Lufkin's International Lift Systems (ILS) product line acquired a proprietary gas lift valve technology, the Eagle Gas Lift Valve, to expand its product portfolio. Quinn Pumps, the Canadian down-hole pump manufacturer we purchased in late 2011, also acquired a small rod lift pump company based in Enid, Oklahoma to expand its footprint in the Mid-Continent region.

As a result of these and other strategic acquisitions we have made over the last four years, Lufkin is better prepared to offer fully integrated, cradle-to-grave artificial lift product solutions and well optimization services.

## OILFIELD DIVISION



# INCREASED PRODUCTION CAPACITY

Lufkin continues to invest in its manufacturing and aftermarket capabilities to better serve our customers.

In addition to the new facility in Romania, the Company continued to retool and add new manufacturing capacity to its Lufkin, Texas factory through significant machine tool investments and better operational performance. State-of-the-art CNC gear shapers, horizontal boring machines, lathes and beam processing equipment were commissioned during 2012 to reduce costs and improve throughput. Operational headcount increased by an additional 14% in Lufkin.



We opened new service centers in Pleasanton, Texas; Pecos, Texas; and Williston, North Dakota to provide additional aftermarket capabilities for the Quinn's, Automation and pumping unit product lines.

A new chrome plating facility is also under construction in Red Deer, Alberta, to provide significant new capacity for the Quinn's reciprocating rod pump and GrenCo

progressive cavity pump product lines. This facility is expected to be fully operational during the fourth quarter of 2013.

Our Field Services product line also experienced increased demand in 2012 and has expanded in key oil and gas producing areas globally. Lufkin's focus on comprehensive quality includes installation, maintenance and repair services using OEM parts. Field Services are led by our highly trained, safety award-winning personnel. Our service philosophy parallels that of our clients—safely reducing the total cost of ownership of artificial lift products and optimizing production.

Our gray and ductile iron foundry has been part of Lufkin since 1902. Having dedicated foundry facilities is a significant competitive advantage for meeting tight customer delivery requirements and is critical to ensuring quality throughout the manufacturing process. The foundry produces castings for rod lift pumping units in sizes from 100 pounds to 15 tons. Our reputation for quality is the reason our foundry services are sought by commercial clients, themselves renowned for innovative engineering and enduring quality.

As we enter 2013, the oil and gas industry is expected to show continued growth both domestically and internationally. Although U.S. onshore was the growth leader in 2012, we expect international markets to lead Oilfield growth in 2013—particularly in Latin America, the Arabian Gulf and North Africa. Lufkin is ready for this growth—with strong management, an experienced and talented workforce, outstanding artificial lift technologies, a solid strategic plan and expanded manufacturing capacity.

**OILFIELD DIVISION**

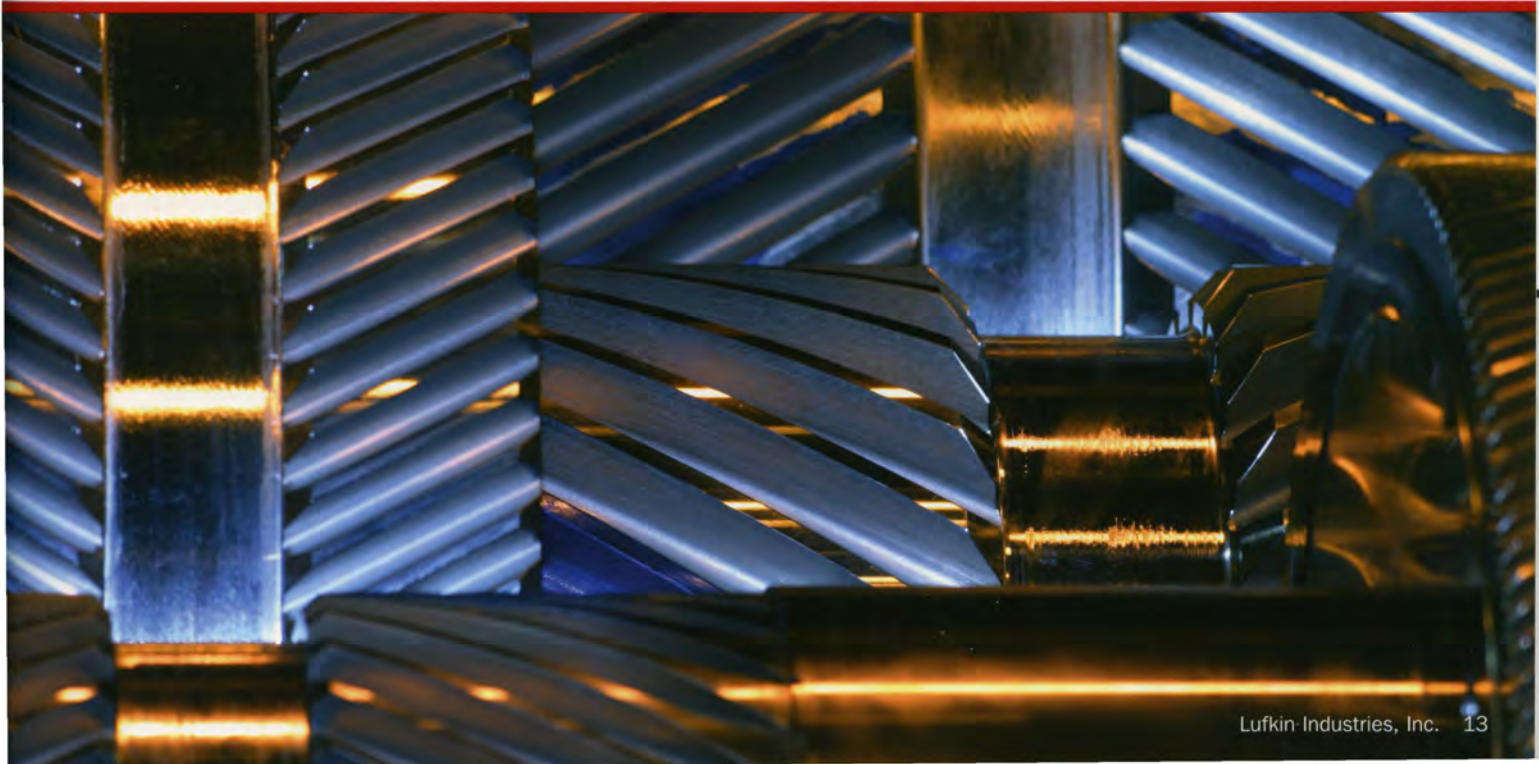
## POWER TRANSMISSION DIVISION

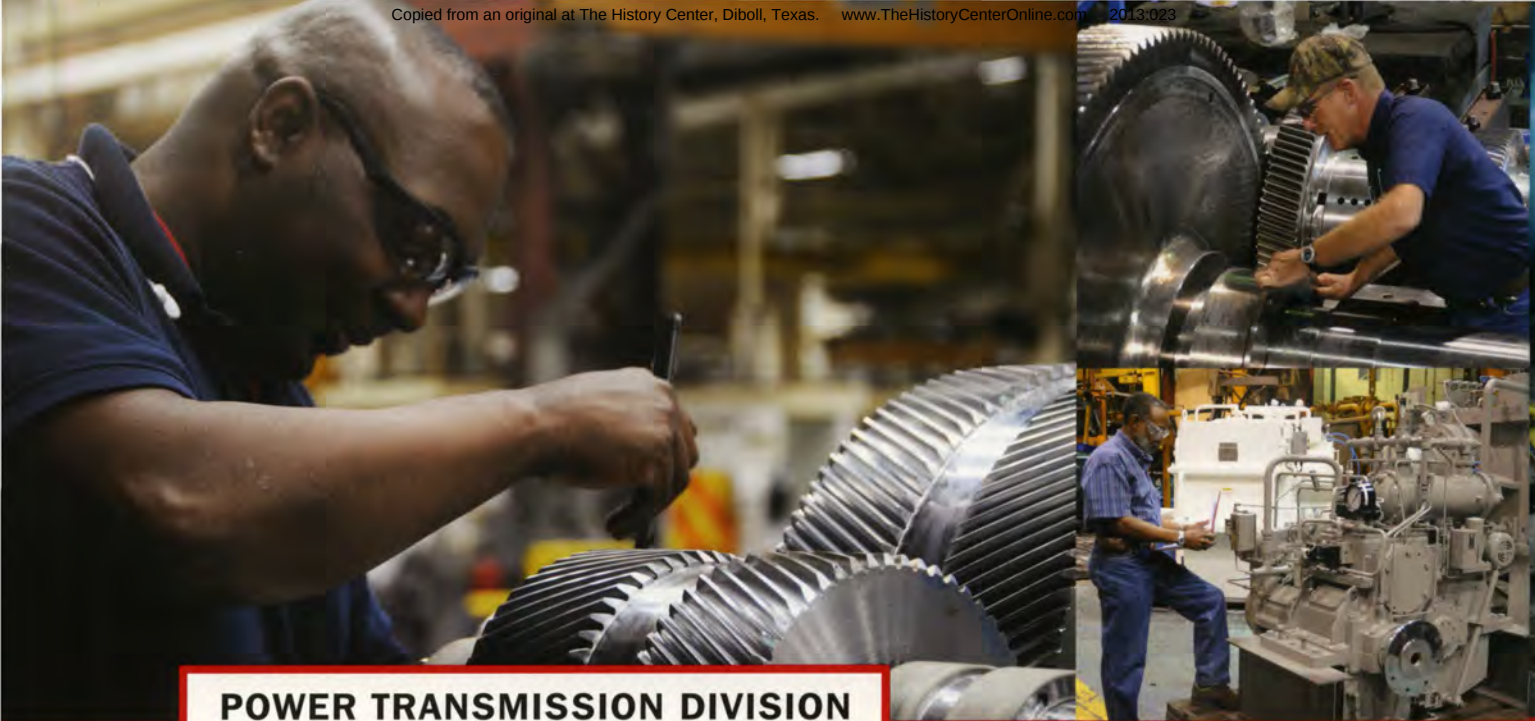
### 2012 REVIEW

Power Transmission targets investments in RMT Bearing Factory and expansion of our French High Speed Testing Operation to align for future business growth.

Lufkin Industries is one of the world's leading suppliers of mechanical power transmission products and services. Our highly engineered precision high-speed turbo-machinery gear drives, low-speed high-torque gear drives and custom-engineered high-performance fluid film bearings are used across a wide spectrum of industrial applications.

We differentiate ourselves by combining our industry-leading expertise in engineering, metallurgy and manufacturing technology 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 and our various strategically located service centers. We are the only turbo gear manufacturer that offers this full range of global support.





## POWER TRANSMISSION DIVISION

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

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

During 2012, the Power Transmission Division reported sales of \$205.6 million, up 5% percent from \$195.6 million in 2011. New order intake was flat at \$198.1 million. Demand for energy is expected to continue rising in 2013 with growth coming primarily from China, India, Brazil, other parts of Asia, and the Middle East.

Active oil and gas markets include large upstream development projects, mostly in West Africa and South America. The projects involve power generation gearboxes and mechanical drive applications for turbo compressors and pumps, mostly on floating production, storage and offloading facilities or other offshore production facilities. We are also seeing significant domestic activity in midstream applications for natural gas transportation and gas liquids processing. Power generation activity remained strong throughout 2012 with orders for large projects, including one for the rebuilding of the Iraqi electric infrastructure.

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.

RMT has built a strong reputation in the industry for 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



Lufkin RMT Bearing Facility, Wellsville, NY

for advanced technology products in critical applications. Lufkin gearbox and RMT bearing product lines have achieved significant synergies with regard to client bases, technical expertise and innovative solutions.

Our operations in France continues to gain market share in both the oil & gas and power generation sectors. As a result, significant capital investments have been approved to expand the French facility capacity and capability including the construction of a new high performance test stand scheduled to be completed in Q4 2013. Significant achievements for the European manufacturing plant included certification for nuclear products and services, the successful qualification as a supplier for new load gear products to serve the local OEM market, increased market share with European and Asian turbine and compressor manufacturers, and the development of a new epicyclic load gear for the power generation markets.

The Power Transmission division has expanded its engineering center beyond the Lufkin, Texas and France factories into Bucharest, Romania and Houston, Texas. There have been numerous new product developments that have positioned Lufkin on the frontier such as the new compact high torque QST/TST drives for the sugar industry, standardization of high power/high speed compressor drives, and the highly sophisticated integrally geared turbo expander and compressor gearboxes that utilized both Lufkin gearing and patented RMT bearing and seal technology.

Significant investments were also made in our RMT Bearing Manufacturing and Service & Repair operations. In December 2012 we relocated our operation into a larger modern facility that will allow for an increase in both manufacturing capacity as well as an expansion of the turbo machinery and gearbox repair businesses. This Gearbox Repair facility will better position Lufkin for increased growth in the North East United States.

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.

## BOARD MEMBERS



**Douglas V. Smith**  
Chairman of the Board  
Chairman—Executive Committee  
Board member since 1993



**John F. Glick**  
President  
Chief Executive Officer  
Board member since 2007



**Howard J. Trout, Jr.**  
Chairman—Pension Committee  
Member—Executive Committee,  
Nominating and Governance  
Committee  
Board member since 1980



**Thomas E. Wiener**  
Member—Executive Committee,  
Pension Committee, Nominating  
and Governance Committee  
Board member since 1987



**John H. Lollar**  
Chairman—Compensation  
Committee  
Member—Audit Committee  
Board member since 1997



**James T. Jongebloed**  
Member—Audit Committee,  
Nominating and Governance  
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**  
Chairman—Nominating and  
Governance Committee  
Member—Compensation Committee  
Board member since 2010

## 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 this filing in this report have been omitted, such as the cover page and exhibits. A complete copy of the Company's Annual Report on Form 10-K is available on the SEC's website at [www.sec.gov](http://www.sec.gov) or free of charge on the Company's website at [www.lufkin.com](http://www.lufkin.com). The Company will also provide to any shareholder a copy of this report without charge upon written request. Please mail your requests to Investor Relations, P.O. Box 1649, Lufkin, Texas 75902.

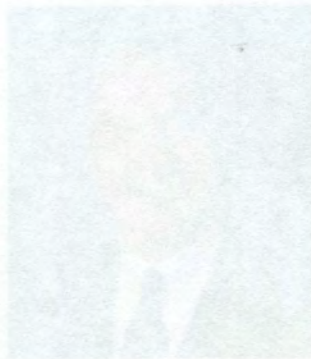
# LUFKIN

**FORM 10-K**

## BOARD MEMBERS



**Douglas V. Smith**  
Chairman of the Board  
President—Arkansas Genealogical  
Board member since 1989



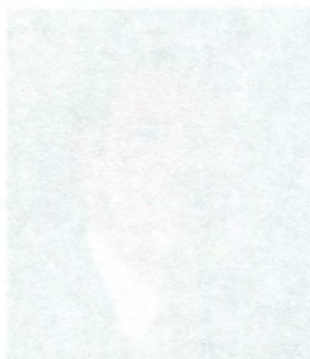
**John F. Silva**  
President  
Chief Executive Officer  
Board member since 2002



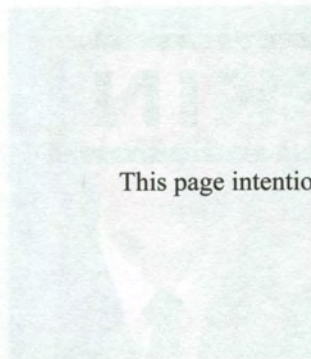
**Raymond J. Stolt, Jr.**  
Chairman—Finance Committee  
Member—Executive Committee,  
Technology and Governance  
Committee  
Board member since 1993



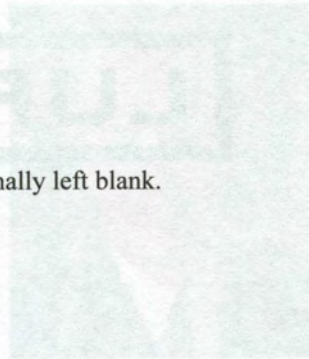
**Thomas F. Woods**  
Member—Executive Committee,  
Finance Committee, Technology  
and Governance Committee  
Board member since 1997



**John M. Wynn**  
Chairman—Executive Committee,  
Technology  
Member—Audit Committee  
Board member since 2007



**Steven T. Jamieson**  
Member—Audit Committee,  
Technology and Governance  
Committee  
Board member since 2009

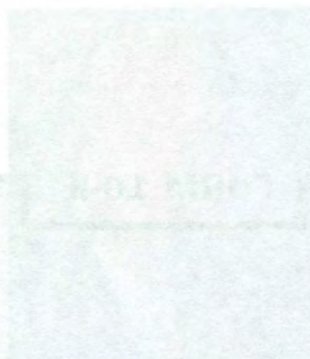


**John F. Anderson**  
Member—Executive Committee,  
Finance Committee,  
Technology Committee  
Board member since 2003

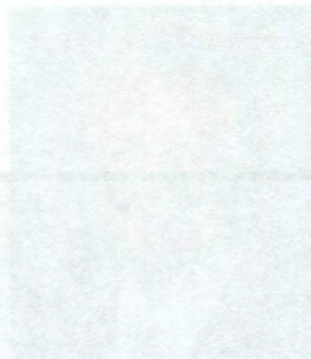


**Suzanne V. Baer**  
Chairman—Audit Committee  
Member—Executive Committee  
Board member since 2009

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**Thomas J. Smith**  
Member—Executive Committee,  
Technology Committee  
Board member since 2008



**John F. Smith**  
Chairman—Executive Committee,  
Technology Committee  
Board member since 2007



## PART I

### Item 1. Business

#### **Our Business**

Lufkin Industries, Inc. ("we" or the "Company") is a global supplier of artificial lift products, technology, services and solutions, including automated control equipment and analytical products for artificial lift equipment, to the oil and gas industry. In addition, the Company designs, manufactures and services power transmission products for use in energy infrastructure and industrial applications. Since being founded in 1902, the Company has expanded its product portfolio through in-house research and development as well as through acquisitions of businesses with complementary product lines and technologies. Through this evolution, the Company has become a global supplier to the oil and natural gas industry and other select industrial sectors, with offices and facilities in more than a dozen countries and decades of experience in oilfields around the world. The Company's most important asset is its reputation with its customers, which is based on the reliability of its products and the enhanced efficiency those products bring to its customers' operations. The combination of high performance products and experienced personnel has allowed the Company to expand its customer base and its geographical footprint.

Growth in oil and gas production requires both the successful drilling of new wells and improved recovery from existing wells. Artificial lift is a production process used in oil wells and, to a lesser extent, natural gas wells to supplement a reservoir's natural pressure in order to bring more hydrocarbons to the surface. Most wells that are initially free-flowing will eventually require artificial lift as they mature due to a natural decline in reservoir pressure over time. This decline typically occurs more rapidly in unconventional oil and natural gas reservoirs than it does in conventional reservoirs. As global demand for energy has increased, and readily-accessible oil and natural gas reserves have declined, producers have increasingly focused on enhanced recovery from existing fields to boost production by extending the life of reserves utilizing artificial lift technology. The Company's goal is to become the preferred source for artificial lift solutions.

Growing economies are creating the need for large-scale energy infrastructure projects such as refineries and power plants. These energy infrastructure projects require a variety of products capable of high performance under extreme operating conditions. The Company designs, manufactures and services custom gearboxes that perform under such conditions in both energy infrastructure and industrial applications. The Company believes that its reputation for engineering skill and reliability in its Power Transmission segment, as well as its global presence, will allow it to continue to grow its business as demand for energy infrastructure projects increases around the world.

The Company's business consists of two operating segments: Oilfield and Power Transmission.

#### ***Oilfield***

The Company's Oilfield segment manufactures and services artificial lift products, including reciprocating rod, gas, plunger and hydraulic lift equipment, progressive cavity pumps ("PCPs") and related well-site products. In 2012, the Oilfield segment accounted for approximately 84% of the Company's revenues and approximately 97% of the Company's operating income. The Company is a leading supplier to the oil and gas industry of beam pumping units for rod lift applications. The Company's iconic pumping units are among the most recognized in the industry and have a reputation for quality and reliability. Approximately 76% of North American oil and gas operators have used the Company's products in their operations. There has been a resurgence in rod lift unit sales in recent years as a result of the increased development of oil and liquids-rich plays in the United States, such as the Bakken and Eagle Ford Shale formations, as well as more mature fields in the Permian Basin and California. According to Spears & Associates ("Spears"), a leading industry research consultant, rod lift sales represented approximately 31% of the \$10.9 billion artificial lift market in 2012 compared to approximately 25% in 2011 and 20% in 2010, and grew more than any other artificial lift technology. In addition, Spears anticipates that the artificial lift market will grow an additional 18% over 2012 levels in 2013.

The Oilfield segment also designs, manufactures, installs and services automated control equipment and analytical products for artificial lift equipment. These products, referred to as "automation solutions," help lower production costs and optimize well efficiency for our customers. The Company's automation solutions offerings are enhanced by the use of Supervisory Control and Data Acquisition ("SCADA"), which provides the critical communication link among our products. The data acquisition and communication capabilities of SCADA permit the analysis of well production data in real time, which in turn enables the Company's product solutions to optimize well performance.

Building on the Company's decades-long success with rod lift equipment, the Company has recently pursued a strategy of expanding its artificial lift products and services portfolio and the geographic scope of its Oilfield segment through a series of strategic acquisitions. Additionally, the Company is developing the industry's leading automation solutions across all artificial lift technologies. In furtherance of these objectives, since the beginning of 2010, the Company has acquired:

- the hydraulic rod pumping unit business of Petro Hydraulic Lift Systems, LLC;
- Pentagon Optimization Services, Inc. ("Pentagon"), a diversified Canadian well optimization company that assembles and services plunger lift equipment; and
- The reciprocating down-hole pump and PCP business of Quinn's Oilfield Supply Ltd. ("Quinn's").
- Datac Instrumentation Limited ("Datac"), a provider of technology that enables artificial lift equipment to transmit and receive performance data as well as remote terminal unit technology;
- RealFlex Technologies Limited ("Realflex"), a provider of real-time server software packages for process control systems; and
- Zenith Oilfield Technology Limited ("Zenith"), a leading provider of down-hole monitoring, data gathering and control systems for artificial lift applications, including real time optimization and control systems for PCPs and electric submersible pumps ("ESPs"), as well as artificial lift completion systems for ESPs.

These acquisitions have enabled the Company to expand its product portfolio, customer base and geographic footprint, accelerate its automation solutions strategy and provide its products and services with industry-leading technological capabilities, including the collection and evaluation of down-hole well performance data in real time.

The Company's next generation of automation solutions will permit our customers to dynamically manage artificial lift equipment and thereby optimize performance through the collection of real time, down-hole well data, the analysis of that data by surface automation systems and the automatic adjustment of operating parameters based on that data to more efficiently produce a reservoir. We are designing these automation solutions to be capable of interfacing with artificial lift technologies, including ESPs, manufactured by any of the major artificial lift equipment vendors. We believe that our vendor-neutral, integrated approach to automation is unique and will allow the Company to develop a relationship with customers who have traditionally relied on other vendors for their artificial lift needs. However, we also believe that our automation solutions will continue to be more reliable and perform at optimal levels when used in combination with our own products, and we intend to leverage our automation solutions to enhance sales of our artificial lift equipment.

### ***Oilfield Products***

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

**Pumping Units.** The Oilfield segment manufactures five basic types of pumping units: an air-balanced unit; a beam-balanced unit; a crank-balanced unit, a Mark II Unitorque unit and a hydraulic unit. The basic differences among the five types of units 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 pumping units within the five basic types. In addition, the Company manufactures and services down-hole reciprocating pumps that work with the surface equipment to bring liquids from the reservoir to the surface.

**Pumping Unit Service.** Through its network of service centers, the Oilfield segment transports and repairs pumping units. The service centers also refurbish and sell used pumping units.

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

**Gas Lift/Plunger Lift.** The Oilfield segment designs, manufactures, installs and services gas lift and plunger lift equipment.

**Progressive Cavity Pumps.** The Oilfield segment designs, manufactures, installs and services PCP equipment.

**Foundry Castings.** As part of the Company's vertical integration strategy, the Oilfield segment operates an iron foundry to produce castings for new pumping units. In order to maximize utilization of this facility, we also produce castings for third parties when capacity and demand permit.

### ***Power Transmission***

The Company's Power Transmission segment designs, manufactures and services custom engineered speed increasing and reducing gearboxes for energy infrastructure and industrial applications. In 2012, the Power Transmission segment accounted for approximately 16% of the Company's revenues and approximately 3% of the Company's operating income. The Company's speed-increasing gearboxes convert lower speed and higher torque input to higher speed and lower torque output,

while speed-reducing gearboxes convert higher speed and lower torque input to lower speed and higher torque output. The Company's high-speed or turbo gears are used in petrochemical production, refining, offshore oil production, oil and gas transmission, natural gas liquefaction and electrical power generation. The Company is one of the only producers of high-horsepower, high-speed gearboxes for these demanding applications. The Company's low-speed industrial gears are used in metals processing, tire and rubber production, sugar processing, marine propulsion and mining. We believe that the Company's power transmission products in both high-speed and low-speed applications benefit from an excellent reputation for quality and reliability.

### ***Power Transmission Products***

The Power Transmission segment designs, manufactures and services speed increasing and reducing gearboxes for industrial applications. The Company produces numerous sizes and designs of gearboxes depending on the end use. While there are standard designs, the majority of the gearboxes we manufacture are custom-designed and manufactured in collaboration with the customer for the customer's particular 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. 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.** In addition to producing parts for aftermarket service, the Company manufactures capital spares for customers in conjunction with the production of new gearboxes in order to minimize the customer's downtime if repair or replacement is required in the future.

**Gearbox Repair & Service.** The Power Transmission segment provides on and off-site repair and service for its own products and those manufactured by other companies. Repair work is performed in dedicated facilities due to the quick turn-around times required.

**Lufkin RMT.** We acquired Rotating Machinery Technology, Inc. ("RMT") in 2009. RMT specializes in the analysis, design and manufacture of precision, custom-engineered tilting-pad bearings and related components for high-speed turbo machinery operating in critical duty applications. RMT also services, repairs and upgrades turbo-expander process units for air and gas separation.

Financial information by industry segment and geographic area is incorporated herein by reference to Note 15 – "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.

### ***Other Business Data***

#### ***Raw Materials***

The Company purchases a variety of raw materials in manufacturing its products for both the Oilfield and Power Transmission segments. The principal raw materials are structural and plate steel, round alloy steel, steel forgings and iron castings, which are purchased from both the Company's 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, the Company does not enter into long-term contracts for raw materials and generally has not experienced shortages of raw materials. During 2012, the Company did not experience any significant material shortages. Raw material prices in North America have remained relatively stable over the last several years and the Company does not anticipate any raw material or component part shortages in the short-term. However, the Company has experienced significant inflation in raw materials in Argentina as a result of local economic disruptions. Raw material prices may continue to increase and availability may decrease with little notice.

## **Competition**

The primary global competitor for artificial lift equipment is Weatherford International Ltd., but Chinese manufacturers of artificial lift equipment also participate in the domestic and international markets both as direct competitors and by supplying wholesale equipment to our other competitors. 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. There are also various other manufacturers of certain types of artificial lift equipment, such as Dover and Robbins & Myers. While we believe that the Company is one of the larger manufacturers of artificial lift equipment in the world, manufacturers of other types of equipment like electric submersible pumps, such as Schlumberger Limited and Baker Hughes Incorporated, have a significant share of the total artificial lift market. Weatherford International is the Company's single largest competitor in the service market, although small independent operators also provide significant competitive pressures. Additionally, we believe that other large competitors such as Halliburton Company and National Oilwell Varco, Inc. may be considering entering or expanding their presence in the artificial lift markets.

In the Oilfield segment, due to 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.

We believe that the market for the gearboxes manufactured by our Power Transmission segment is also very competitive. 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. Although price is an important factor, we believe that potential customers also emphasize proven designs, workmanship and engineering in sourcing these products. Accordingly, the Company outsources very little of the design and manufacturing processes for its Power Transmission products.

## **Markets Served and Customers**

Demand for artificial lift equipment primarily depends on the level of onshore drilling and workover activity as well as the depth and fluid conditions of that drilling. Drilling activity is driven by our customers' current perceptions of the level and stability of the price of oil, commodity prices and our customers' access to operating cash flow and other sources of capital. The higher energy prices experienced since 2010 has increased drilling activity and, accordingly, the demand for artificial lift equipment and related service and products. 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 continued in 2012, with higher drilling activity and lower surplus equipment inventory driving demand for new artificial lift equipment. Drilling activity slowed in the fourth quarter of 2012 as customers had substantially depleted their capital budgets earlier in the year. While drilling activity is expected to be slower in the first quarter of 2013 as a result of this slowdown, activity levels are expected to ramp up during the subsequent quarters of 2013. Long-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 Latin American, Russian and Middle Eastern markets.

Our Power Transmission segment 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 competitive conditions. Favorable conditions for one market may be unfavorable for another market. Generally, if global industrial capacity utilization is 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. Demand for RMT products generally follows demand for high-speed gearboxes.

Our Oilfield segment customers include independent oil and natural gas production companies, integrated oil companies and foreign national oil companies, and our customers for the Power Transmission segment include owners and operators of chemical plants, refineries, manufacturers and other similar industrial concerns. No single customer represented over 10% of the Company's consolidated revenues for years ended December 31, 2012, 2011 or 2010.

## **Employees**

The Company had approximately 4,400 employees at December 31, 2012, including approximately 2,500 employees that were paid on an hourly basis. Certain of the Company's employees are subject to a collective bargaining agreement that expires in October 2014. The Company considers its relations with its foreign and domestic employees to be satisfactory, except that the Company has experienced work stoppages by its Argentina employees, which do not target the Company specifically, as a result of the general strikes by Argentinian workers in response to political and economic instability in that country.

The nature of the products manufactured and serviced by the Company generally requires skilled labor. Our ability to increase capacity could be limited by our ability to hire and train qualified personnel. Additionally, because our main U.S. manufacturing facilities are unionized, a prolonged labor disruption could have a significant impact on the Company's ability to maintain production levels. The Company has experienced significant wage inflation and occasional work stoppages at the Oilfield segment's Argentina plant due to local economic disruptions.

### ***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 it believes would be reasonably likely to have a material adverse effect on its business, an accident or unknown or unexpected environmental claim with respect to one or more of the Company's current businesses or a business or property that one of its predecessors owned or used 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 believe that future costs of environmental compliance will have a material adverse effect on its business, results of operations or financial condition.

### **Available Information**

The Company makes available, free of charge, through the Company's website, [www.lufkin.com](http://www.lufkin.com), its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended. Access to these electronic filings is available as soon as reasonably practicable after the Company files such material with, or furnishes it to, the Securities and Exchange Commission. You may also request printed copies of these documents free of charge by writing to the Corporate 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](http://www.sec.gov).

## **Item 1A. Risk Factors.**

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

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

The Oilfield segment is materially dependent on the level of oil and natural 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 natural gas prices have been subject to significant fluctuation in recent years in response to changes in the supply and demand for oil and natural 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 natural gas exploration and production activity;
- worldwide economic conditions, particularly economic conditions in North America;
- oil and natural 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 and iron in the manufacture of its products. The price of these raw materials has a significant impact on the cost of producing products. Steel and iron 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 it, 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 and bearings 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, its margins, results of operations, cash flow and financial condition could be adversely affected.

***Raw material shortages or interruptions 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 and typically does not have long-term contracts with these suppliers. The availability of raw materials is a function of the availability of steel and iron and the alloy materials that are utilized by the Company's suppliers. To date, shortages have not caused a material disruption in raw material availability or in the Company's manufacturing operations. However, material disruptions may occur in the future. Raw material shortages and allocations may result in work slowdowns or stoppages, inefficient operations and a build-up of inventory. 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, results of operations and financial condition.

***The Company's customers' industries are undergoing continuing consolidation that may impact its results of operations.***

Some of the Company's largest customers have consolidated and are using their size and purchasing power in an effort to achieve economies of scale and pricing concessions. This consolidation may result in reduced capital spending by such customers or the acquisition of one or more of the Company's other primary customers, which may lead to decreased demand for the Company's products and services. The Company cannot assure you that it will be able to maintain its level of sales to any customer that has consolidated or replace that revenue with increased business activities with other customers. As a result, this consolidation activity could have a significant negative impact on the Company's results of operations or financial condition. The Company is unable to predict what effect consolidations may have on prices, capital spending by its customers, its selling strategies, its competitive position, its ability to retain customers or its ability to negotiate favorable agreements.

***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 its insurance and that could adversely affect its results of operations.***

The products that the Company manufactures and the services that it provides are complex, and the failure of its equipment to operate properly or to meet specifications may greatly increase its 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 its 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 has and expects to continue to consider opportunities to acquire related businesses. For an acquisition to be successful, the Company must successfully integrate it, achieve cost efficiencies and manage 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 disputes or the expiration of the Company's current collective bargaining agreement could have a material adverse effect on its business.***

The Company's main U.S. manufacturing facilities are unionized, and the collective bargaining agreement with respect to those facilities will expire in October 2014. The Company also has unionized labor in other international operations. The Company cannot assure that 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 result in a disruption of operations and higher wage expenses, which could have a material adverse effect upon the Company's 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, train and retain skilled personnel in the areas of management, product engineering, manufacturing, 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. Additionally, during periods of high demand, workers can be in short supply and the hiring of workers in large numbers can distract management and increase overhead costs. 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 exists in the industries in which the Company operates and competitors may offer 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 its business, financial condition and results of operations.

***A deterioration in future expected profitability or cash flows could result in an impairment of the Company's goodwill.***

The Company performs an annual assessment of the recoverability of goodwill and indefinite lived intangibles. Additionally, the Company assesses goodwill and indefinite lived intangibles for impairment whenever events or changes in circumstances indicate that such carrying values may not be recoverable. The Company relies on discounted cash flow analysis, which requires significant judgments and estimates about the Company's future operations, to develop its estimates of fair value. If these projected cash flows change materially, the Company may be required to record impairment losses relative to goodwill or indefinite lived intangibles which could be material to its results of operations in any particular reporting period.

***The Company has foreign operations that would be adversely impacted in the event of political instability, economic instability, legal sanctions or changes in global trade policies.***

The Company has operations in certain international areas, including parts of the Middle East and Latin America, that are subject to local or regional political instability, economic instability or legal sanctions (such as restrictions against countries that the U.S. government may deem to sponsor terrorism) as well as changes in global trade policies. The Company's operations may be restricted or prohibited in any country in which one or more of these risks occur. With respect to any particular country, these risks include:

- civil unrest, acts of terrorism, force majeure, war or other armed conflict;
- inflation and currency fluctuations, devaluations and conversion restrictions;
- disruption of oil and natural gas exploration and production activities;
- governmental action to expropriate and nationalize the Company's assets in such country or deprive the Company of contract rights;
- restriction of the movement and exchange of funds;
- inhibition of the Company's ability to collect receivables;

- enactment of additional or stricter U.S. government or international sanctions; and
- limitation of the Company's access to markets for periods of time.

The occurrence of any of these risks could result in the loss of our personnel or assets, disrupt financial and commercial markets or increase (perhaps prohibitively) the cost of continuing the Company's operations in the affected region, which could have a material adverse effect on the Company's business, results of operations and financial condition.

***The Company is subject to the U.S. Foreign Corrupt Practices Act and other anti-corruption laws, as well as other laws and regulations governing its operations. If the Company fails to comply with these laws, it could be subject to civil or criminal penalties, other remedial measures, and legal expenses, which could adversely affect its business, financial condition and results of operations.***

The U.S. Foreign Corrupt Practices Act and similar worldwide anti-bribery laws generally prohibit companies and their intermediaries from making improper payments to government officials for the purpose of obtaining or retaining business. Given the industries in which the Company participates, the Company operates in parts of the world that have experienced governmental corruption to some degree, and in which strict compliance with anti-bribery laws may conflict with local customs and practices. The Company's training and compliance program cannot protect it from reckless or criminal acts committed by its employees or agents. Violations of these laws, or allegations of such violations, could disrupt the Company's business and result in a material adverse effect on its results of operations, financial condition, and cash flows.

The Company is also subject to other laws and regulations governing its operations, including regulations administered by the U.S. Department of Commerce's Bureau of Industry and Security, the U.S. Department of Treasury's Office of Foreign Asset Control, and various non-U.S. government entities, including applicable export control regulations, economic sanctions on countries and persons, and customs requirements, which the Company refers to collectively as "Trade Control laws." Trade Control laws are complex and constantly changing, and compliance with them increases the Company's cost of doing business. There is no assurance that the Company's compliance policies and programs will be completely effective in ensuring its compliance with Trade Control laws. If the Company is not in compliance with Trade Control laws, it may be subject to criminal and civil penalties, and other sanctions and remedial measures, and legal expenses, which could have an adverse impact on its business, financial condition, results of operations and liquidity. Likewise, any investigation of any potential violations of Trade Control laws by U.S. or foreign authorities could also have an adverse impact on the Company's reputation, business, financial condition and results of operations.

***The Company's 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.

***The Company may be subject to litigation if another party claims that it has infringed upon its intellectual property rights.***

The tools, techniques, methodologies, programs and components the Company uses to provide its services and products may infringe upon the intellectual property rights of others. Infringement claims generally result in significant legal and other costs and may distract management from running the Company's core business. Royalty payments under licenses from third parties, if available, would increase the Company's costs. Additionally, an infringement claim could require the Company to seek and pay for a license for a particular technology, discontinue use of that technology or seek to develop an alternative technology. If a license were not available the Company might not be able to continue providing a particular service or product, which could adversely affect its financial condition, results of operation and cash flows. Additionally, developing non-infringing technologies would increase its costs.

***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.

***Any capital financing that may be necessary to fund growth may not be available to the Company at economic rates.***

The Company relies on debt and equity capital for capital expenditures, acquisitions, working capital and other purposes. Turmoil in the credit markets and the potential impact on liquidity of major financial institutions may have an adverse effect on the Company's ability to obtain needed capital in the public or private markets on terms the Company believes to be reasonable.

***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 its counterparties. While the financial markets have experienced improvement in recent years, the Company has continued to face challenges due to general financial market volatility. 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. 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 regulations restricting emissions of greenhouse gases could result in increased operating costs and reduced demand for the Company's products or services.***

From time to time, Congress has considered legislation on climate change matters, which, if adopted, could increase the Company's costs or decrease demand for the Company's products.

On December 15, 2009, the U.S. Environmental Protection Agency, or 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.

Additionally, we may also be subject to certain international climate change accords in the foreign countries in which the Company operates. A variety of regulatory developments, proposals or requirements have been introduced and/or adopted in the international regions in which the Company operates 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, or EU ETS, which was launched as an international "cap and trade" system on allowances for emitting greenhouse gases.

The adoption and implementation of any regulations imposing reporting obligations on, or limiting emissions of greenhouse gases from, our equipment and operations or those of our customers 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, which would adversely affect the Company's business, results of operations and financial condition.

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

The market price of the Company's common stock has historically experienced and continues to experience high volatility. 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 and demand for oil and natural gas;
- changes in laws and regulations; and
- general economic and competitive conditions.

Volatility or depressed market prices of the Company's common stock could make it difficult for you to resell shares of its common stock when you want or at attractive prices.

***There may be future dilution of the Company's common stock or other equity, which may adversely affect the market price of its common stock.***

The Company is not restricted from issuing additional shares of its common stock or securities convertible or exchangeable for its common stock. If the Company issues additional shares of its common stock or convertible or exchangeable securities, it may adversely affect the market price of its common stock. The Company's certificate of incorporation authorizes the board of directors to issue up to 120,000,000 shares of its common stock, par value \$1.00 per share, and up to 2,000,000 shares of our preferred stock, no par value specified.

***The Company is able to issue shares of preferred stock with greater rights than its common stock.***

The Company's certificate of incorporation authorizes its board of directors to issue one or more series of preferred stock and set the terms of the preferred stock without seeking any further approval from its shareholders. Any preferred stock that is issued may rank ahead of the Company's common stock in terms of dividends, liquidation rights or voting rights. If the Company issues preferred stock, it may adversely affect the market price of its common stock.

## Item 1B. Unresolved Staff Comments.

None

## Item 2. Properties

The Company's primary manufacturing facilities which are located in and near Lufkin, Texas, are company-owned and include a foundry, machine shops, structural shops, assembly shops, storage yards and warehouses. The facilities by segment are:

### Oilfield:

|                            |                 |
|----------------------------|-----------------|
| Pumping Unit Manufacturing | 628,000 sq. ft. |
| Foundry Operations         | 687,000 sq. ft. |

### Power Transmission:

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

|                        |                |
|------------------------|----------------|
| Corporate Headquarters | 33,000 sq. ft. |
|------------------------|----------------|

In addition, the Company has the following significant locations in the U.S.:

|                                    |                |
|------------------------------------|----------------|
| Lufkin ILS- Houston, TX (leased)   | 50,000 sq. ft. |
| Lufkin RMT- Wellsville, NY (owned) | 55,000 sq. ft. |
| Houston – Automation               | 22,000 sq. ft. |

The Company also owns several international facilities for the production and servicing of pumping units and power transmission products. The facilities by segment are:

### Oilfield:

|                               |                 |
|-------------------------------|-----------------|
| Nisku, Alberta, Canada        | 66,000 sq. ft.  |
| Red Deer, Alberta, Canada     | 80,000 sq. ft.  |
| Edmonton, Alberta, Canada     | 75,000 sq. ft.  |
| Comodoro Rivadavia, Argentina | 125,000 sq. ft. |
| Ploesti, Romania              | 375,000 sq. ft. |

### Power Transmission:

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

Additionally, the Company has numerous service centers located throughout the United States and internationally to support the Oilfield and Power Transmission segments. The majority of these locations are company-owned, with some leased. None of these leases qualify as capital leases.

### **Item 3. Legal Proceedings**

#### **Intellectual Property Matter**

In 2009, the Company brought suit in a Texas state court against the former owners of a business it had previously acquired in order to protect certain of the Company's intellectual property rights. The former owners responded by counter suit against the Company as well as its outside counsel for the acquisition, Andrews Kurth LLP ("AK"), claiming that the Company had improperly acquired title to their inventions. The case was removed from the Texas state court to a U.S. District Court in Midland, Texas in order to address intellectual property and patent issues as well as other claims made by the parties. After reviewing the facts and positions of the parties, in February 2011, the U.S. District Court granted summary judgment for the Company disposing of all federal claims and remanded the remainder of the case back to the Texas state court.

The parties appealed various decisions of the U.S. District Court to the U.S. Court of Appeals for the Federal Circuit, which ultimately dismissed the appeals for lack of jurisdiction and transferred the appeals to the Fifth Circuit in February 2012. In addition to the federal appeals, the plaintiffs asked the Texas state court to proceed with a trial on the remanded case, which set the remanded case for trial over defendants' objections. AK then sought and obtained an injunction from the U.S. District Court prohibiting the plaintiffs from pursuing the Texas state court case until resolution of the federal appeals, which the plaintiffs appealed. In September 2012, the Fifth Circuit ruled in favor of the plaintiffs by vacating the injunction prohibiting the plaintiffs from litigating in state court. Trial in state court was set to begin in March of 2013, while a number of substantive appeals remained before the Fifth Circuit.

On December 10, 2012, the parties entered into a confidential settlement agreement following a successful mediation of all claims between plaintiffs and defendants. Pursuant to the terms of the settlement agreement, Lufkin agreed, among other things, to release all current and future claims arising out of or related to the intellectual property disputes made the basis of the lawsuit in exchange for a corresponding release of claims by plaintiffs.

Upon agreed motions by the parties, the appeals pending before the Fifth Circuit and the state court action were dismissed on January 3, 2013 and January 11, 2013, respectively.

#### **Other Matters**

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 increased risk. 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. Mine Safety Disclosures.**

None.

## PART II

### Item 5. Market for Registrant's Common Equity, Related Shareholder 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." The following table sets forth 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 for each quarterly period during fiscal 2012 and 2011.

| Quarter | 2012        |          |          | 2011        |          |          |
|---------|-------------|----------|----------|-------------|----------|----------|
|         | Stock Price |          | Dividend | Stock Price |          | Dividend |
|         | High        | Low      |          | High        | Low      |          |
| First   | \$ 85.68    | \$ 68.78 | \$ 0.125 | \$ 94.29    | \$ 57.79 | \$ 0.125 |
| Second  | 82.82       | 49.29    | \$ 0.125 | 97.05       | 77.67    | \$ 0.125 |
| Third   | 62.36       | 45.11    | \$ 0.125 | 90.81       | 53.12    | \$ 0.125 |
| Fourth  | 59.48       | 48.41    | \$ 0.125 | 74.46       | 42.10    | \$ 0.125 |

As of January 31, 2013, there were approximately 415 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 Company has paid cash dividends for 72 consecutive years. Total dividend payments were \$16.4 million, \$15.2 million and \$15.0 million in 2012, 2011 and 2010, respectively. Although we anticipate that the Company will continue to pay dividends on our common stock in the future, the payment of future cash dividends is subject to the discretion of our Board of Directors and will depend upon, among other things, our financial condition, results of operations, contractual restrictions and any other factors considered to be relevant by the Board of Directors.

In addition, the Company's credit facility restricts our ability to declare and pay dividends on our common stock when the payment of any such dividend would cause the Company to exceed specified leverage and fixed charge ratios.

### 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 for each of the five years in the period ended December 31, 2012 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. In particular, Note 2 to our Consolidated Financial Statements describes acquisitions consummated since January 1, 2010, which could affect the year-to-year comparability of the information presented below. The following information may not be indicative of future operating results.

| (In millions, except per share data)           | 2012       | 2011     | 2010     | 2009     | 2008     |
|------------------------------------------------|------------|----------|----------|----------|----------|
| Sales                                          | \$ 1,281.2 | \$ 932.1 | \$ 645.6 | \$ 521.4 | \$ 741.2 |
| Earnings from continuing operations            | 81.9       | 66.0     | 43.5     | 22.5     | 88.0     |
| Earnings per share from continuing operations: |            |          |          |          |          |
| Basic                                          | 2.48       | 2.17     | 1.45     | 0.76     | 2.98     |
| Diluted                                        | 2.45       | 2.14     | 1.44     | 0.76     | 2.96     |
| Total assets                                   | 1,435.2    | 1,096.7  | 621.1    | 541.6    | 530.7    |
| Total debt                                     | 326.7      | 350.0    | -        | -        | -        |
| Cash dividends per share                       | 0.50       | 0.50     | 0.50     | 0.50     | 0.50     |

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

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") should be read in conjunction with the consolidated financial statements of the Company and related notes contained in Item 8. Financial Statement of this annual report on Form 10-K. Please also read "Cautionary Statement Regarding Forward-Looking Statements and Assumptions" appearing at the end of this Item 7.

### **Executive Summary**

The Company is a global supplier of oilfield and power transmission products. Through its Oilfield segment, the Company manufactures and services artificial lift equipment and related products, which are used to extract crude oil and other fluids from oil and natural gas wells. Through its Power Transmission segment, the Company manufactures and services high-speed and low-speed increasing and reducing gearboxes for energy and industrial applications. While the markets for the Company's products are price-competitive, we believe that technological and quality differences provide product differentiation.

The Company's objective is to extend its position as a leading global supplier of high quality, mission-critical artificial lift and power transmission products, and related aftermarket services. The Company intends to accomplish its objective and capitalize on long-term industry growth trends through the execution of the following strategies:

- ***Position the Company as the preferred source for artificial lift solutions.*** The Company believes it offers one of the industry's broadest portfolios of artificial lift products, including reciprocating rod, gas, plunger and hydraulic lift equipment, PCs and measurement and control equipment for all types of artificial lift, including ESPs. The Company has developed a specialized optimization team which focuses on assisting producers with well completion design and production management. The Company is integrating its portfolio of artificial lift products, automation technologies, global service team and optimization team to deliver complete artificial lift solutions to its customers. The Company believes that the combination of its more than 80 years of artificial lift experience and its optimization expertise will allow its customers to offset the diminishing artificial lift knowledge base in their organizations.
- ***Continue to expand the Company's global reach.*** The Company intends to continue to expand its global reach by establishing manufacturing, engineering and service platforms on three continents, which will in turn support a network of regional service centers in areas with high actual or potential demand for artificial lift solutions. These platforms include:
  - Lufkin, Texas, which supports its operations in the United States and Canada;
  - Bogota, Colombia, which is the Company's Latin America headquarters, and Comodoro Rivadavia, Argentina, which supports its manufacturing operations in South America;
  - Ploiesti, Romania and Eastern France, which support or will support the Company's operations in Europe, the Middle East, North Africa and elsewhere in the Eastern Hemisphere.

The Company also plans to exploit new market opportunities by deploying sales, distribution, service and manufacturing resources in markets where it believes it is currently under-represented. The Company believes that this strategy has already strengthened its customer relationships and that further expansion will allow it to respond more quickly to its customers' needs. The Company also expects that a broad geographical footprint will improve its support logistics and reduce its costs.

- ***Expand the Company's portfolio of artificial lift products and solutions through acquisitions and internal development.*** The Company intends to continue to selectively pursue acquisitions that increase its exposure to the most important growth trends in the industry, fill critical product gaps and expand its geographic scope. Since the beginning of 2009 the Company has successfully acquired and integrated several businesses across both its segments, including Pentagon, Quinn's reciprocating down-hole pump and PCP businesses, Datac, RealFlex and Zenith. The Company believes these transactions demonstrate its ability to identify and complete strategic transactions that are consistent with its long-term strategy.
- ***Develop the next generation of automation solutions.*** As producers increasingly focus on maximizing the production from existing wells and deploy their capital resources in newer, unconventional plays where reservoir pressures deplete more rapidly, the Company is developing the technologies that will allow its customers to automatically control surface and down-hole pumps, based on real time temperature, pressure and flow data, to optimize artificial lift performance across a variety of well conditions, thereby maximizing recovery rates. The

Company's optimization team provides expertise to help producers design full field optimization programs in order to produce their reserves at a lower cost and with greater reliability. This expertise includes the selection of the appropriate artificial lift and automation technology, facility layout and field electrification. As automation technology evolves, the Company intends to take advantage of opportunities to retrofit existing equipment and then provide its customers with ongoing upgrades.

## Trends/Industry Outlook

The Company's business is largely dependent on the level of capital expenditures in the energy industry, which affects the drilling of new wells, the use of artificial lift technologies to improve the recovery from existing wells and the construction of new energy infrastructure. The Company believes the significant trends impacting its industry include the following:

- global oil and natural gas consumption continues to increase, driven by growing economies in emerging markets;
- growing economies are creating the need for large-scale energy infrastructure projects, such as refineries and LNG facilities; and
- natural gas is gaining market share as a source of fuel for power generation.

In addition, we believe that the following trends are increasing demand for artificial lift solutions:

- producers are increasingly focused on optimizing the ultimate recoveries from mature oilfields, such as the Permian Basin in west Texas and in central California;
- North American exploration and production activity is shifting toward unconventional plays such as the Bakken and Eagle Ford Shale formations, which often require some form of artificial lift earlier in the production life of the well than production from a conventional reservoir does; and
- producers are facing a shortage of experienced personnel due to retirements, and are increasingly relying on outside expertise.

We believe the outlook for the global energy industry is favorable. According to the U.S. Energy Information Administration ("EIA"), oil continues to be the single most significant component of world energy consumption, representing approximately one third of total demand. Forecasts published by the EIA anticipate that worldwide demand for oil will grow approximately 25% from 90 million barrels per day in 2012 to 112 million barrels per day in 2035.

As more readily accessible oil reserves are depleted, producers have been required to make increasing investments in order to maintain their production and increase their reserves to meet the growing demand for energy resources worldwide. As a result, many producers are focused on extending the ultimate recovery from existing producing wells through enhanced oil recovery methods such as in-fill drilling, CO<sub>2</sub> injection and artificial lift as a profitable alternative to finding and developing new reservoirs.

In their search for new reserves, oil and gas producers are increasingly turning to unconventional reservoirs such as shale formations. Due to their geologic characteristics, shale reservoirs have a natural pressure that typically declines more rapidly than in a conventional reservoir. As a result, the Company expects that current trends in shale development will result in increased demand for artificial lift solutions worldwide.

According to Spears and Associates, the global artificial lift market was approximately \$10.9 billion in 2012 and grew at an average annual rate of almost 15% between 2005 and 2012, and Spears estimates that the artificial lift market will grow an additional 18% in 2013.

The Power Transmission segment also benefits from many of these industry trends. Approximately two-thirds of the products the Company sells in this segment are for applications in the oil and gas production, transportation, refining and power generation industries. The Company believes growing global energy consumption will increase demand for energy infrastructure, which will increase demand for custom-engineered, large-scale gearboxes. The Company also believes that the combination of engineering knowledge, specialized machine tools, mechanical test capabilities and reliability that is required in the power transmission industry constitutes a significant barrier to entry to potential new competitors and limits the competitive landscape to a relatively small number of suppliers.

## 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.

Overall, the Company's sales in 2012 increased to \$1,281.2 million from \$932.1 million in 2011, or 37.4%. This increase was primarily driven by higher sales of Oilfield products and services in the North American markets and contributions from the businesses acquired by the Company in 2011 and 2012. In 2010, when oil drilling activity was still rebounding from 2009 lows, sales were \$645.6 million.

Gross margin for 2012 was 24.1% compared to 24.4% for 2011, due primarily to the favorable impact of higher plant utilization on fixed cost coverage and moderate price increases being offset by the costs of new employee training, machine downtime and supply chain shortages. Gross margin in 2010 was 24.6%. 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 \$157.7 million in 2012 from \$110.7 million in 2011 and \$89.9 million in 2010. This increase was primarily related to resources added from the business acquired by the Company, higher employee-related expenses in support of international expansion efforts and new product development. As a percentage of sales, selling, general and administrative expenses increased to 12.3% in 2012 compared to 11.8% in 2011 and decreased from 13.9% in 2010.

The Company reported net earnings from continuing operations of \$81.9 million, or \$2.45 per share (diluted), in 2012, compared to net earnings from continuing operations of \$66.0 million, or \$2.14 per share (diluted), in 2011, and \$43.5 million, or \$1.44 per share (diluted), in 2010.

## Other

During 2012, 2011 and 2010, the Company recorded pre-tax contingent liability provisions of \$0.3 million, \$1.8 million and \$1.0 million, respectively, for a class-action lawsuit that was settled in December 2011. During 2012, the Company incurred \$3.0 million in connection with the settlement of the Company's intellectual property lawsuit described in Part I, Item 3 "Legal Proceedings" of this annual report on Form 10-K. Also, during 2012 and 2011, the Company incurred pre-tax acquisition-related expenses of \$8.7 million and \$7.1 million, respectively, in connection with its acquisitions discussed in Footnote 2, of the Notes to Consolidated Financial Statements.

## Year Ended December 31, 2012 Compared to Year Ended December 31, 2011:

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

| Year Ended December 31 | 2012                | 2011              | Increase/<br>(Decrease) | % Increase/<br>(Decrease) |
|------------------------|---------------------|-------------------|-------------------------|---------------------------|
| <b>Sales</b>           |                     |                   |                         |                           |
| Oilfield               | \$ 1,075,612        | \$ 736,488        | \$ 339,124              | 46.0                      |
| Power Transmission     | 205,588             | 195,647           | 9,941                   | 5.1                       |
| Total                  | <u>\$ 1,281,200</u> | <u>\$ 932,135</u> | <u>\$ 349,065</u>       | 37.4                      |
| <b>Gross Profit</b>    |                     |                   |                         |                           |
| Oilfield               | \$ 265,099          | \$ 172,879        | \$ 92,220               | 53.3                      |
| Power Transmission     | 44,648              | 54,178            | (9,530)                 | (17.6)                    |
| Total                  | <u>\$ 309,747</u>   | <u>\$ 227,057</u> | <u>\$ 82,690</u>        | 36.4                      |

## Oilfield

Oilfield sales increased to \$1,075.6 million, or 46.0%, for the year ended December 31, 2012, from \$736.5 million for the year ended December 31, 2011. New pumping unit sales for 2012 were \$506.4 million, up \$102.7 million, or 25.4%, compared to \$403.7 million during 2011, primarily from higher North American demand from increased oil drilling in the Bakken, Eagle Ford and Permian regions. For 2012, pumping unit service sales of \$136.2 million were up \$7.7 million, or 6.0%, compared to \$128.5 million during 2011 from higher installation and general field activity. Automation sales of \$203.1 million during 2012 increased \$68.2 million, or 50.6%, compared to \$134.9 million during 2011 as a result of the Zenith acquisition and higher new oil well completions. Sales from gas and plunger lift equipment of \$43.7 million during 2012 were up \$8.5 million, or 24.4%, compared to \$35.2 million in 2011. Quinn's sales for 2012 were \$170.8 million compared to the one month's sales in December 2011 of \$13.1 million. Commercial casting sales of \$15.2 million during 2012 were down \$5.8 million, or 27.6%, compared to \$21.0 million during 2011 as the Company's available casting capacity was redirected to satisfy internal demand. Oilfield's backlog increased to \$223.7 million as of December 31, 2012 from \$164.2 million at December 31, 2011. The increase was due to higher orders in the North American market, especially in the North American shale plays, and Argentina.

Gross margin (gross profit as a percentage of sales) for Oilfield increased to 24.6% for year ended December 31, 2012, compared to 23.5% for the year ended December 31, 2011. The benefit of higher volume on fixed cost coverage and moderate price increases during 2012 were partially offset by the Company's U.S. manufacturing facilities experiencing inefficiencies from new employee training and machine downtime and the Company's Argentina operations being impacted by national labor issues and inflation.

Direct selling, general and administrative expenses for Oilfield increased to \$77.9 million, or 82.0%, for the year ended December 31, 2012, from \$42.8 million for the year ended December 31, 2011. This increase was due to the additional costs related to the Quinn's and Zenith acquisitions, expanded international sales and support offices and higher research and development spending. Direct selling, general and administrative expenses as a percentage of sales increased to 7.2% for the year ended December 31, 2012, from 6.5% for the year ended December 31, 2011.

## Power Transmission

Power Transmission sales increased to \$205.6 million, or 5.1%, for the year ended December 31, 2012, compared to \$195.7 million for the year ended December 31, 2011. New unit sales of \$142.8 million during 2012 were up \$1.9 million, or 1.3%, compared to \$141.0 million during 2011. Repair and service sales of \$54.6 million during 2012 were up \$5.7 million, or 11.6%, compared to \$48.9 million during 2011, as energy-related market activity improved. Bearing sales of \$8.3 million during 2012 were up \$2.5 million, or 43.9%, as compared to \$5.8 million in 2011, from higher sales to the LNG market. Power Transmission backlog at December 31, 2012 decreased to \$99.9 million from \$107.4 million at December 31, 2011, primarily from decreased bookings of new units for the energy-related markets.

Gross margin for Power Transmission decreased to 21.7% for the year ended December 31, 2012, compared to 27.7% for the year ended December 31, 2011, or 6.0 percentage points. Gross margins in 2012 were negatively impacted by lower pricing from equipment booked in 2011, an unfavorable mix of low-speed units, equipment downtime and new employee training and efficiency costs.

Direct selling, general and administrative expenses for Power Transmission decreased to \$28.2 million, or 6.6%, for the year ended December 31, 2012, from \$30.2 million for the year ended December 31, 2011. This decrease was primarily due to lower employee-related costs. Direct selling, general and administrative expenses as a percentage of sales decreased to 13.7% for the year ended December 31, 2012, from 15.5% for the year ended December 31, 2011.

## Corporate/Other

Corporate administrative expenses, which are allocated between the Company's segments primarily based on budgeted sales levels, were \$51.9 million for the year ended December 31, 2012, an increase of \$17.4 million, or 50.4%, from \$34.5 million for the year ended December 31, 2011, primarily due to higher employee-related and consulting expenses associated with the implementation of the Company's new SAP enterprise software.

Interest income, interest expense and other income and expense for the year ended December 31, 2012 increased to \$14.1 million of expense compared to \$2.0 million of expense for the year ended December 31, 2011. This increase in expense is related to higher interest expenses related to the debt financing put in place in December 2011 in connection with the Company's 2011 acquisitions.

The Company's net tax rate for the year ended December 31, 2012 was 35.0% compared to 37.4% for the year ended December 31, 2011. This decrease is primarily due to the benefit of greater income earned in lower-tax jurisdictions partially offset by the higher impact of the non-deductibility of certain acquisition-related expenses discussed in Footnote 13, of the Notes to Consolidated Financial Statements.

### Year Ended December 31, 2011 Compared to Year Ended December 31, 2010:

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

| Year Ended December 31 | 2011              | 2010              | Increase/<br>(Decrease) | % Increase/<br>(Decrease) |
|------------------------|-------------------|-------------------|-------------------------|---------------------------|
| <u>Sales</u>           |                   |                   |                         |                           |
| Oilfield               | \$ 736,488        | \$ 477,867        | \$ 258,621              | 54.1                      |
| Power Transmission     | 195,647           | 167,776           | 27,871                  | 16.6                      |
| Total                  | <u>\$ 932,135</u> | <u>\$ 645,643</u> | <u>\$ 286,492</u>       | 44.4                      |
| <u>Gross Profit</u>    |                   |                   |                         |                           |
| Oilfield               | \$ 172,879        | \$ 112,236        | \$ 60,643               | 54.0                      |
| Power Transmission     | 54,178            | 46,282            | 7,896                   | 17.1                      |
| Total                  | <u>\$ 227,057</u> | <u>\$ 158,518</u> | <u>\$ 68,539</u>        | 43.2                      |

### Oilfield

Oilfield sales increased to \$736.5 million, or 54.1%, for the year ended December 31, 2011, from \$477.9 million for the year ended December 31, 2010. New pumping unit sales for 2011 were \$403.7 million, up \$149.4 million, or 58.7%, compared to \$254.4 million during 2010, primarily from higher North American demand from increased oil drilling in the Bakken, Eagle Ford and Permian regions. For 2011, pumping unit service sales of \$128.5 million were up \$24.4 million, or 23.5%, compared to \$104.1 million during 2010 from higher installation and general field activity. Automation sales of \$134.9 million during 2011 were up \$51.1 million, or 61.0%, compared to \$83.8 million during 2010 from new oil well completions and greater market penetration in existing fields. Sales from gas and plunger lift equipment of \$35.2 million during 2011 were up \$10.8 million, or 44.2%, compared to \$24.4 million in 2010. Quinn's sales for the month of December were \$13.1 million. Commercial casting sales of \$21.0 million during 2011 were up \$9.7 million, or 87.0%, compared to \$11.3 million during 2010. Oilfield's backlog increased to \$164.2 million as of December 31, 2011 from \$131.4 million at December 31, 2010. The increase was due to higher orders in the North American market, especially in the Bakken.

Gross margin (gross profit as a percentage of sales) for Oilfield remained at 23.5% for year ended December 31, 2011, compared to the year ended December 31, 2010. Despite higher sales, pricing remained very competitive during 2011 and the Company's U.S. manufacturing facilities experienced inefficiencies from new employee training, machine downtime due to excessive heat during the summer and inadequate castings from new vendors.

Direct selling, general and administrative expenses for Oilfield increased to \$47.8 million, or 30.2%, for the year ended December 31, 2011, from \$36.7 million for the year ended December 31, 2010. This increase was due to expanded international sales and support offices and higher research and development spending. Direct selling, general and administrative expenses as a percentage of sales decreased to 6.5% for the year ended December 31, 2011, from 7.7% for the year ended December 31, 2010.

### Power Transmission

Power Transmission sales increased to \$195.7 million, or 16.6%, for the year ended December 31, 2011, compared to \$167.8 million for the year ended December 31, 2010. New unit sales of \$141.0 million during 2011 were up \$26.8 million, or 23.4%, compared to \$114.2 million during 2010, as demand for high-speed units for the energy markets improved. Repair and service sales of \$48.9 million during 2011 were up \$0.1 million, or 0.2%, compared to \$48.8 million during 2010. Bearing sales of \$5.8 million during 2011 were up \$1.1 million, or 23.0%, as compared to \$4.7 million in 2010, from higher sales to the LNG market. Power Transmission backlog at December 31, 2011 increased to \$107.4 million from \$103.1 million at December 31, 2010, primarily from increased bookings of new units for the energy-related markets.

Gross margin for Power Transmission increased slightly to 27.7% for the year ended December 31, 2011, compared to 27.6% for the year ended December 31, 2010, or 0.1 percentage points. The benefit of higher production activity on fixed cost leverage was offset by a competitive pricing environment, new employee training costs and machine downtime costs.

Direct selling, general and administrative expenses for Power Transmission increased to \$30.2 million, or 9.8%, for the year ended December 31, 2011, from \$27.5 million for the year ended December 31, 2010. This increase was primarily due to increased personnel necessary to support higher sales volumes in 2011. However, direct selling, general and administrative expenses as a percentage of sales decreased to 15.5% for the year ended December 31, 2011, from 16.4% for the year ended December 31, 2010.

### **Corporate/Other**

Corporate administrative expenses, which are allocated between the Company's segments primarily based on budgeted sales levels, were \$34.5 million for the year ended December 31, 2011, an increase of \$8.8 million, or 34.4%, from \$25.6 million for the year ended December 31, 2010, primarily due to higher employee related expenses, legal costs and insurance claims.

Interest income, interest expense and other income and expense for the year ended December 31, 2011 increased to \$2.0 million of expense compared to \$0.2 million of expense for the year ended December 31, 2010. This increase in expense is related to higher interest expense related to the new debt financing put in place in connection with the Company's 2011 acquisitions and the unfavorable impact of exchange rate changes.

The Company's net tax rate for the year ended December 31, 2011 was 37.4% compared to 35.5% for the year ended December 31, 2010. This increase is primarily due to the non-deductibility of certain acquisition-related expenses.

### **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, business combinations, debt repayments and dividend payments, through December 31, 2013, and for the foreseeable future.

The Company's cash balance totaled \$72.3 million at December 31, 2012, compared to \$38.4 million at December 31, 2011. For the year ended December 31, 2012, net cash provided by operating activities was \$77.6 million, net cash used in investing activities totaled \$225.0 million and net cash provided by financing activities amounted to \$180.7 million. Significant components of cash provided by operating activities included net earnings from continuing operations, adjusted for non-cash expenses, of \$156.2 million, partially offset by an increase in working capital of \$60.3 million. This working capital increase was primarily due to an increase in trade receivables and inventory balances of \$23.2 million and \$50.3 million, respectively, due to increased sales volumes during 2012, partially offset by an increase in accounts payable and accrued liabilities of \$15.1 million. The Company also contributed \$15.6 million to its U.S. pension plan during 2012. Net cash used in investing activities included net capital expenditures totaling \$78.1 million, net of \$18.1 million in government incentives, acquisition expenses for Zenith and Datac/Realflex totaling \$148.6 million and a holdback payment of \$1.5 million related to ILS. Capital expenditures in 2012 were primarily for new facilities to support geographical and product line expansions in the Oilfield and Power Transmission segments. Capital expenditures for 2013, which are expected to be funded by operating cash flows, are projected to remain at approximately 2012 spending levels, primarily for the manufacturing capacity additions, other new manufacturing and service facilities to support geographical and product line expansions and equipment replacement for efficiency improvements in the Oilfield and Power Transmission segments. Significant components of net cash provided by financing activities during 2012 included equity offering proceeds of \$217.6 million and \$25 million drawn from the Bank Facility described below, partially offset by term loan payments of \$48.3 million and dividend payments of \$16.4 million, or \$0.50 per share.

The Company has a five year secured credit facility with a group of lenders (the "Bank Facility") consisting of a revolving line of credit that provides up to \$175.0 million of aggregate borrowing and a \$350.0 million term loan. Under the Bank Facility the Company has granted a first priority lien, security interest and collateral assignment of substantially all of its current assets. The Bank Facility matures on November 30, 2016. Borrowings under the Bank Facility bear interest, at the Company's option, at either (A) the highest of (i) the Prime Rate, (ii) the Federal Funds Effective Rate plus 0.5%, and (iii) the Adjusted LIBO Rate for an Interest Period of one month plus 1.0%, in each case plus an Applicable Margin based on the Company's Leverage Ratio or (B) the interest rate equal to (i) the rate for US dollar deposits in the London interbank market for such Interest Period multiplied by (ii) the Statutory Reserve Rate, plus (iii) the Applicable Margin. Throughout the term of the Bank Facility, the

Company pays an Unused Commitment Fee which ranges from 0.25 percent to 0.50 percent based on the Company's Leverage Ratio. As of December 31, 2012, \$301.7 million of borrowings under the term loan and \$25.0 million of borrowings under the revolving line of credit were outstanding. Additionally, there was \$10.4 million in letters of credit outstanding against the revolving credit facility. As of December 31, 2012 the interest rate was 2.75% on the credit facility and the Company paid \$10.2 million of interest expense in the year ended December 31, 2012. The carrying value of debt is not materially different from its fair value. The Company was in compliance with all financial covenants under the Bank Facility as of December 31, 2012 and had borrowing capacity of \$139.6 million.

The following table summarizes the Company's expected cash outflows from financial contracts and commitments as of December 31, 2012. 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)

| Contractual obligations                             | Total             | Payments due by period |                   |                   |                      |
|-----------------------------------------------------|-------------------|------------------------|-------------------|-------------------|----------------------|
|                                                     |                   | Less than<br>1 year    | 1 - 3<br>years    | 3 - 5<br>years    | More than<br>5 years |
| Operating lease obligations                         | \$ 30,255         | \$ 8,694               | \$ 15,099         | \$ 4,133          | \$ 2,329             |
| Debt obligations                                    | 326,704           | 26,250                 | 140,000           | 160,454           | -                    |
| Interest expense                                    | 33,008            | 10,673                 | 17,338            | 4,997             | -                    |
| Contractual commitments<br>for capital expenditures | 30,815            | 30,815                 | -                 | -                 | -                    |
| Total                                               | <u>\$ 420,782</u> | <u>\$ 76,432</u>       | <u>\$ 172,437</u> | <u>\$ 169,584</u> | <u>\$ 2,329</u>      |

Since the Company has no significant tax loss carry forwards, the Company expects to make quarterly estimated tax payments in 2013 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 non-qualified pension plans of approximately \$0.4 million and to its post-retirement life plans of approximately \$0.2 million in 2013. Due to pension funding legislation passed in 2012, the Company may not be required to make contributions to its U.S. qualified pension plan but may elect to make contributions of \$10-15 million. Contribution levels to these plans after 2014 will depend on participation in the plans, possible plan changes, discount rates and actual rates of return on plan assets.

As discussed in Note 13 – "Income Taxes" 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, 2012 includes approximately \$5.6 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 June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income* – ("ASU 2011-05"), which changes the presentation of comprehensive income. The topic requires the Company to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company adopted ASU 2011-05 on January 1, 2012 and has presented consolidated net earnings and consolidated comprehensive income in two separate, but consecutive, statements.

In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05* – ("ASU 2011-12"), which defers only those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. The Company adopted ASU 2011-12 on January 1, 2012. The adoption of ASU 2011-12 did not have a material impact on the statement of other comprehensive income.

In September 2011, the FASB issued ASU 2011-08, *Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment* – (“ASU 2011-08”), which simplifies how entities test for goodwill impairment. The topic allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under ASU 2011-08, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. ASU 2011-08 includes a number of events and circumstances for an entity to consider in conducting the qualitative assessment. The Company adopted this ASU for the 2012 goodwill impairment testing. The Company elected to continue to calculate the value of each reporting unit within its annual goodwill impairment testing. Therefore, the adoption of ASU 2011-08 did not have any impact on the Company’s condensed consolidated financial statements.

Management believes the impact of other recently issued standards, which are 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 collectability 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, requires the product to be stored and to be invoiced under a bill-and-hold arrangement;
- the customer provides 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 that 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 2012 results:

| (Thousands of dollars) | Pension  |  | Other    |  |
|------------------------|----------|--|----------|--|
|                        | Benefits |  | Benefits |  |

### Discount rate

Effect of change on net periodic benefit cost (income):

|                               |    |         |    |      |
|-------------------------------|----|---------|----|------|
| .25 percentage point increase | \$ | (1,016) | \$ | (16) |
| .25 percentage point decrease |    | 1,068   |    | 16   |

Effect of change on PBO/APBO:

|                               |    |          |    |       |
|-------------------------------|----|----------|----|-------|
| .25 percentage point increase | \$ | (11,202) | \$ | (159) |
| .25 percentage point decrease |    | 11,859   |    | 169   |

### Long-term rate of return on plan assets

Effect of change on net periodic benefit cost (income):

|                               |    |       |    |   |
|-------------------------------|----|-------|----|---|
| .25 percentage point increase | \$ | (475) | \$ | - |
| .25 percentage point decrease |    | 475   |    | - |

## Cautionary Statement Regarding Forward-Looking Statements and Assumptions

This annual report on Form 10-K contains forward-looking statements and information, within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995, as amended, 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 "anticipate," "believe," "estimate," "expect," "plan," "schedule," "could," "may," "might," "should," "project" or similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying them. Similarly, statements that describe the Company's future plans, objectives or goals are also forward-looking statements. Such statements reflect the Company's current views with respect to certain events and are subject to certain assumptions, risks and uncertainties, many of which are outside the control of the Company. These risks and uncertainties include, but are not limited to:

- oil and natural gas prices;
- declines in domestic and worldwide oil and natural gas drilling;
- capital spending levels of exploration and production companies;
- availability and prices for raw materials;
- the inherent dangers and complexities of the Company's operations;
- loss of customer relationships from consolidation and other reasons;
- uninsured losses, unavailability of insurance or a rise in insurance premiums;
- the inability to effectively identify and integrate acquisitions and to achieve cost savings and revenue growth;
- labor disruptions and increasing labor costs;
- the availability of qualified and skilled labor;
- disruption of the Company's operating facilities or management information systems, including cyber-attacks;
- 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, or have similar adverse effects on our customers;
- unfavorable results of litigation and the fruition of contingencies referred to in the notes to the financial statements included in this report; 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.

Forward-looking statements speak only as of the date they were made and, except to the extent required by law, we undertake no obligation to update or review any forward-looking statements because of new information, future events or other factors. Forward-looking statements involve risks and uncertainties and are not guaranties of future performance. There is no assurance that any of the matters listed above or any of the risks described in Item 1A "Risk Factors" of this report will occur or, if any of them do occur, when they will occur or what impact they will have on our operations or financial condition. Future results and performance may differ materially from those expressed in these forward-looking statements due to, but not limited to, the factors mentioned above. Because of these uncertainties, you should not place undue reliance on these forward-looking statements when making an investment decision.

## **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. 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.

## Interest Rate Risk

The Company is exposed to interest rate fluctuations on its credit facility of \$326.7 million due to the fact that the interest rate on the credit facility is variable. As of December 31, 2012, a .25 percent increase in the interest rate on our credit facility would increase the Company's annual interest expense by \$0.8 million.

## Commodity Price Risk

The Company uses large amounts of steel, iron and electricity in the manufacture of its products and the prices of these raw materials have a significant impact on the cost of producing the Company's products. 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. Steel and electricity prices have increased significantly in the last five years, caused primarily by higher energy prices and increased global demand. 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. Certain items such as steel round and bearings have continued to experience price increases, price volatility and longer lead times. Raw material prices may increase significantly in the future. If the Company is unable to pass future raw material price increases on to its customers, its margins, results of operations, cash flow and financial condition could be adversely affected.

## Foreign Currency Exchange Price Risk

The Company is exposed to currency fluctuations with intercompany debt denominated in U.S. dollars owed by its foreign subsidiaries. As of December 31, 2012, this inter-company debt was comprised of a negligible payable and a \$7.3 million receivable. As of December 31, 2012, if the U.S. dollar strengthened or weakened by 10% against these currencies, the net income and expense impact would be \$0.3 million. Also, certain assets and liabilities, in Argentina and Romania are 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, 2012, if the U.S. dollar strengthened or weakened by 10% against these currencies, the net income and expense impact would be \$0.1 million and \$0.3 million, respectively.

## Item 8. Financial Statements and Supplementary Data

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders 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, 2012 and 2011, and the related consolidated statements of earnings, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. 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, 2012, 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 9A. 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, 2012 and 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012, 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, 2012, based on the criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/DELOITTE & TOUCHE LLP  
Houston, Texas  
March 1, 2013

## LUFKIN INDUSTRIES, INC. CONSOLIDATED BALANCE SHEETS

December 31, 2012 and 2011

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

|                                                                                                                                   | 2012                | 2011                |
|-----------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| <b>Assets</b>                                                                                                                     |                     |                     |
| <b>Current Assets:</b>                                                                                                            |                     |                     |
| Cash and cash equivalents                                                                                                         | \$ 72,308           | \$ 38,438           |
| Receivables, net                                                                                                                  | 253,269             | 216,607             |
| Income tax receivable                                                                                                             | 8,454               | 6,732               |
| Inventories                                                                                                                       | 218,475             | 166,148             |
| Deferred income tax assets                                                                                                        | 574                 | 1,140               |
| Other current assets                                                                                                              | 7,368               | 6,417               |
| Total current assets                                                                                                              | <u>560,448</u>      | <u>435,482</u>      |
| Property, plant and equipment, net                                                                                                | 401,673             | 346,430             |
| Goodwill, net                                                                                                                     | 354,319             | 232,932             |
| Other assets, net                                                                                                                 | 118,779             | 81,861              |
| Total assets                                                                                                                      | <u>\$ 1,435,219</u> | <u>\$ 1,096,705</u> |
| <b>Liabilities and Shareholders' Equity</b>                                                                                       |                     |                     |
| <b>Current liabilities:</b>                                                                                                       |                     |                     |
| Accounts payable                                                                                                                  | \$ 88,391           | \$ 65,065           |
| Current portion of long-term debt                                                                                                 | 26,250              | 17,500              |
| <b>Accrued liabilities:</b>                                                                                                       |                     |                     |
| Payroll and benefits                                                                                                              | 17,997              | 17,610              |
| Warranty expenses                                                                                                                 | 6,182               | 4,847               |
| Taxes payable                                                                                                                     | 8,156               | 10,536              |
| Other                                                                                                                             | 33,983              | 26,194              |
| Total current liabilities                                                                                                         | <u>180,959</u>      | <u>141,752</u>      |
| Long-term debt                                                                                                                    | 300,454             | 332,500             |
| Deferred income tax liabilities                                                                                                   | 5,848               | 3,886               |
| Postretirement benefits                                                                                                           | 4,506               | 7,515               |
| Pension benefits                                                                                                                  | 112,121             | 92,936              |
| Other liabilities                                                                                                                 | 17,360              | 10,583              |
| <b>Shareholders' equity:</b>                                                                                                      |                     |                     |
| Common stock, \$1.00 par value per share; 120,000,000 shares authorized;<br>35,383,999 and 32,317,467 shares issued, respectively | 35,384              | 32,318              |
| Capital in excess par                                                                                                             | 320,445             | 87,598              |
| Retained earnings                                                                                                                 | 566,890             | 501,455             |
| Treasury stock, 1,815,648 and 1,824,336 shares, respectively, at cost                                                             | (34,729)            | (34,902)            |
| Accumulated other comprehensive loss                                                                                              | (74,019)            | (78,936)            |
| Total shareholders' equity                                                                                                        | <u>813,971</u>      | <u>507,533</u>      |
| Total liabilities and shareholders' equity                                                                                        | <u>\$ 1,435,219</u> | <u>\$ 1,096,705</u> |

See accompanying notes to consolidated financial statements.

# LUFKIN INDUSTRIES, INC.

## CONSOLIDATED STATEMENTS OF EARNINGS

Years ended December 31, 2012, 2011 and 2010  
(Thousands of dollars, except per share data)

|                                                                 | 2012                    | 2011                    | 2010                    |
|-----------------------------------------------------------------|-------------------------|-------------------------|-------------------------|
| Sales                                                           | \$ 1,281,200            | \$ 932,135              | \$ 645,643              |
| Cost of sales                                                   | <u>971,453</u>          | <u>705,078</u>          | <u>487,125</u>          |
| Gross profit                                                    | 309,747                 | 227,057                 | 158,518                 |
| Selling, general and administrative expenses                    | 157,625                 | 110,733                 | 89,859                  |
| Acquisition expenses                                            | 8,693                   | 7,066                   | -                       |
| Litigation reserve                                              | <u>3,377</u>            | <u>1,780</u>            | <u>1,000</u>            |
| Operating income                                                | 140,052                 | 107,478                 | 67,659                  |
| Interest income                                                 | 421                     | 116                     | 54                      |
| Interest expense                                                | (12,436)                | (1,643)                 | (562)                   |
| Other (expense) income, net                                     | <u>(2,082)</u>          | <u>(482)</u>            | <u>294</u>              |
| Earnings from continuing operations before income tax provision | 125,955                 | 105,469                 | 67,445                  |
| Income tax provision                                            | <u>44,098</u>           | <u>39,498</u>           | <u>23,914</u>           |
| Earnings from continuing operations                             | 81,857                  | 65,971                  | 43,531                  |
| Earnings from discontinued operations, net of tax               | <u>-</u>                | <u>-</u>                | <u>292</u>              |
| Net earnings                                                    | <u><u>\$ 81,857</u></u> | <u><u>\$ 65,971</u></u> | <u><u>\$ 43,823</u></u> |
| Basic earnings per share                                        |                         |                         |                         |
| Earnings from continuing operations                             | \$ 2.48                 | \$ 2.17                 | \$ 1.45                 |
| Earnings from discontinued operations                           | <u>-</u>                | <u>-</u>                | <u>0.01</u>             |
| Net earnings                                                    | <u><u>\$ 2.48</u></u>   | <u><u>\$ 2.17</u></u>   | <u><u>\$ 1.46</u></u>   |
| Diluted earnings per share                                      |                         |                         |                         |
| Earnings from continuing operations                             | \$ 2.45                 | \$ 2.14                 | \$ 1.44                 |
| Earnings from discontinued operations                           | <u>-</u>                | <u>-</u>                | <u>0.01</u>             |
| Net earnings                                                    | <u><u>\$ 2.45</u></u>   | <u><u>\$ 2.14</u></u>   | <u><u>\$ 1.45</u></u>   |

See accompanying notes to consolidated financial statements.

**LUFKIN INDUSTRIES, INC.**  
**STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME**  
(In thousands of dollars)

Years ended December 31, 2012, 2011 and 2010

|                                                                          | 2012             | 2011             | 2010             |
|--------------------------------------------------------------------------|------------------|------------------|------------------|
| Net earnings                                                             | \$ 81,857        | \$ 65,971        | \$ 43,823        |
| Other comprehensive (loss) income                                        |                  |                  |                  |
| Foreign currency translation adjustments                                 | 12,654           | (3,316)          | (960)            |
| Pension and other postretirement benefits adjustments                    | (11,748)         | (61,861)         | 3,552            |
| Income tax benefit (expense) related to pension and postretirement plans | 4,011            | 22,887           | (1,312)          |
| Total other comprehensive income (loss)                                  | 4,917            | (42,290)         | 1,280            |
| Total comprehensive income                                               | <u>\$ 86,774</u> | <u>\$ 23,681</u> | <u>\$ 45,103</u> |

See accompanying notes to consolidated financial statements.

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

| Years Ended December 31, 2012, 2011<br>and 2010<br>(Thousands of dollars, except share data) | Common<br>Stock<br>Shares, net<br>of Treasury | Common<br>Stock | Capital<br>In Excess<br>of Par | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Compre-<br>hensive<br>Income (Loss) | Total      |
|----------------------------------------------------------------------------------------------|-----------------------------------------------|-----------------|--------------------------------|----------------------|-------------------|-------------------------------------------------------------|------------|
| <b>Balance, Dec. 31, 2009</b>                                                                | 29,770,840                                    | \$ 31,618       | \$ 55,617                      | \$ 421,908           | \$ (35,539)       | \$ (37,926)                                                 | \$ 435,678 |
| Comprehensive income:                                                                        |                                               |                 |                                |                      |                   |                                                             |            |
| Net earnings                                                                                 |                                               |                 |                                | 43,823               |                   |                                                             | 43,823     |
| Other comprehensive income, net of tax:                                                      |                                               |                 |                                |                      |                   | 1,280                                                       | 1,280      |
| Cash dividends                                                                               |                                               |                 |                                | (15,017)             |                   |                                                             | (15,017)   |
| Treasury stock purchases                                                                     | -                                             |                 |                                |                      | -                 |                                                             | -          |
| Tax settlement on stock-based compensation                                                   |                                               |                 | -                              |                      |                   |                                                             | -          |
| Stock-based compensation                                                                     |                                               |                 | 4,627                          |                      |                   |                                                             | 4,627      |
| Exercise of stock options                                                                    | 533,641                                       | 515             | 14,567                         |                      | 487               |                                                             | 15,569     |
| <b>Balance, Dec. 31, 2010</b>                                                                | 30,304,481                                    | 32,133          | 74,811                         | 450,714              | (35,052)          | (36,646)                                                    | 485,960    |
| Comprehensive income:                                                                        |                                               |                 |                                |                      |                   |                                                             |            |
| Net earnings                                                                                 |                                               |                 |                                | 65,971               |                   |                                                             | 65,971     |
| Other comprehensive income, net of tax:                                                      |                                               |                 |                                |                      |                   | (42,290)                                                    | (42,290)   |
| Cash dividends                                                                               |                                               |                 |                                | (15,230)             |                   |                                                             | (15,230)   |
| Stock-based compensation                                                                     |                                               |                 | 5,310                          |                      |                   |                                                             | 5,310      |
| Exercise of stock options                                                                    | 188,649                                       | 185             | 7,477                          |                      | 150               |                                                             | 7,812      |
| <b>Balance, Dec. 31, 2011</b>                                                                | 30,493,130                                    | 32,318          | 87,598                         | 501,455              | (34,902)          | (78,936)                                                    | 507,533    |
| Comprehensive income:                                                                        |                                               |                 |                                |                      |                   |                                                             |            |
| Net earnings                                                                                 |                                               |                 |                                | 81,857               |                   |                                                             | 81,857     |
| Other comprehensive income, net of tax:                                                      |                                               |                 |                                |                      |                   | 4,917                                                       | 4,917      |
| Cash dividends                                                                               |                                               |                 |                                | (16,422)             |                   |                                                             | (16,422)   |
| Tax withholdings paid for net settlement of stock awards                                     |                                               |                 | (280)                          |                      |                   |                                                             | (280)      |
| Stock-based compensation                                                                     |                                               |                 | 7,666                          |                      |                   |                                                             | 7,666      |
| Issuance of units in connection with                                                         |                                               |                 |                                |                      |                   |                                                             |            |
| Datac acquisition on January 19, 2012                                                        | 116,716                                       | 116             | 8,300                          |                      |                   |                                                             | 8,416      |
| Equity offering                                                                              | 2,875,000                                     | 2,875           | 214,690                        | -                    |                   |                                                             | 217,565    |
| Exercise of equity awards                                                                    | 83,505                                        | 75              | 2,471                          |                      | 173               |                                                             | 2,719      |
| <b>Balance, Dec. 31, 2012</b>                                                                | 33,568,351                                    | \$ 35,384       | \$ 320,445                     | \$ 566,890           | \$ (34,729)       | \$ (74,019)                                                 | \$ 813,971 |

See accompanying notes to consolidated financial statements.

# LUFKIN INDUSTRIES, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2012, 2011 and 2010  
(Thousands of dollars)

|                                                                                 | 2012             | 2011             | 2010             |
|---------------------------------------------------------------------------------|------------------|------------------|------------------|
| Cash flows from operating activities:                                           |                  |                  |                  |
| Net earnings                                                                    | \$ 81,857        | \$ 65,971        | \$ 43,823        |
| Adjustments to reconcile net earnings to cash provided by operating activities: |                  |                  |                  |
| Depreciation and amortization                                                   | 43,283           | 24,266           | 21,158           |
| Loss (recovery) on receivables                                                  | 94               | (57)             | (86)             |
| LIFO expense (income)                                                           | 2,851            | 3,327            | (1,185)          |
| Litigation expense                                                              | 3,377            | 1,780            | -                |
| Deferred income tax (benefit)/provision                                         | (3,280)          | 9,566            | 1,436            |
| Excess tax benefit from share-based compensation                                | (859)            | (2,701)          | (2,344)          |
| Share-based compensation expense                                                | 7,386            | 5,310            | 4,627            |
| Pension expense                                                                 | 3,558            | 9,813            | 7,861            |
| Postretirement (income) expense                                                 | (79)             | 156              | 422              |
| (Gain) loss on disposition of property, plant and equipment                     | (312)            | 1,614            | (451)            |
| Earnings from discontinued operations                                           | -                | -                | (292)            |
| Changes in:                                                                     |                  |                  |                  |
| Receivables, net                                                                | (23,240)         | (59,574)         | (34,965)         |
| Income tax receivable                                                           | (713)            | (2,466)          | (2,359)          |
| Inventories                                                                     | (50,272)         | (27,021)         | (4,986)          |
| Other current assets                                                            | (1,232)          | (639)            | (357)            |
| Accounts payable                                                                | 11,243           | 13,641           | 6,550            |
| Accrued liabilities                                                             | 3,918            | 3,671            | 20,646           |
| Net cash provided by operating activities                                       | <u>77,580</u>    | <u>46,657</u>    | <u>59,498</u>    |
| Cash flows from investing activities:                                           |                  |                  |                  |
| Additions to property, plant and equipment (net of incentives)                  | (78,119)         | (103,559)        | (60,363)         |
| Proceeds from disposition of property, plant and equipment                      | 2,293            | 970              | 1,021            |
| Decrease (increase) in other assets                                             | 937              | 552              | (265)            |
| Acquisition of other companies and assets                                       | (150,127)        | (331,484)        | (9,857)          |
| Net cash used in investing activities                                           | <u>(225,016)</u> | <u>(433,521)</u> | <u>(69,464)</u>  |
| Cash flows from financing activities:                                           |                  |                  |                  |
| Issuance of long-term debt                                                      | 25,000           | 350,000          |                  |
| Debt issuance cost                                                              | -                | (5,247)          |                  |
| Payments of notes payable                                                       | (48,296)         | -                | (2,888)          |
| Dividends paid                                                                  | (16,422)         | (15,230)         | (15,017)         |
| Excess tax benefit from share-based compensation                                | 859              | 2,701            | 2,344            |
| Proceeds from exercise of stock options                                         | 1,950            | 5,162            | 13,277           |
| Proceeds from equity offering                                                   | 217,565          | -                | -                |
| Net cash provided by (used in) financing activities                             | <u>180,656</u>   | <u>337,386</u>   | <u>(2,284)</u>   |
| Effect of translation on cash and cash equivalents                              | <u>650</u>       | <u>(676)</u>     | <u>(15)</u>      |
| Net increase (decrease) in cash and cash equivalents                            | 33,870           | (50,154)         | (12,266)         |
| Cash and cash equivalents at beginning of period                                | <u>38,438</u>    | <u>88,592</u>    | <u>100,858</u>   |
| Cash and cash equivalents at end of period                                      | <u>\$ 72,308</u> | <u>\$ 38,438</u> | <u>\$ 88,592</u> |

See accompanying 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 oilfield 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.

**Basis of presentation:** Certain amounts in the Balance Sheet and the Property, Plant and Equipment footnote for the prior period have been reclassified to conform to the current presentation. All pension and property classifications for the prior period have been reclassified to reflect these changes.

**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.

**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) within shareholders' equity section. 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 provides 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 1.73%, 3.23%, and 3.14% of revenues in bill-and-hold transactions outstanding as of December 31, 2012, 2011, and 2010, 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 and 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.

**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 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. The following is a summary of the Company's P. P. & E. useful lives:

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

**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 2012, 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 \$115.5 million at December 31, 2012, 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, which 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 and cash equivalents, 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, 2012 and 2011, 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-based awards is measured based on the grant-date fair value. The fair value is estimated using the Black-Scholes option-pricing model. 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.

The Company has also granted performance shares to members of senior management, at no cost to the recipient. Performance is based on shareholder return relative to a specific group of companies over a three-year performance cycle. Compensation expense is based on the fair value at grant date and the anticipated number of shares of the Company's common stock, which is determined on a Monte Carlo probability model.

In addition to stock options and performance shares, officers, directors and key employees may be granted restricted stock awards ("RSA"), which is an award of common stock with no exercise price, or restricted stock units ("RSU"), where each unit represents the right to receive, at the end of a stipulated period, one unrestricted share of stock with no exercise price. RSAs and RSUs vest over a three year period and the fair value is based on the market price on the date of issuance.

**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 June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income* – ("ASU 2011-05"), which changes the presentation of comprehensive income. The topic requires the Company to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company adopted ASU 2011-05 on January 1, 2012 and has presented consolidated net earnings and consolidated comprehensive income in two separate, but consecutive, statements.

In December 2011, the FASB issued ASU 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05* – ("ASU 2011-12"), which defers only those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. The Company adopted ASU 2011-12 on January 1, 2012. The adoption of ASU 2011-12 did not have a material impact on the statement of other comprehensive income.

In September 2011, the FASB issued ASU 2011-08, *Intangibles-Goodwill and Other (Topic 350): Testing Goodwill for Impairment* – ("ASU 2011-08"), which simplifies how entities test for goodwill impairment. The topic allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under ASU 2011-08, an entity would not be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. ASU 2011-

08 includes a number of events and circumstances for an entity to consider in conducting the qualitative assessment. The Company adopted this ASU for the 2012 goodwill impairment testing. The Company elected to continue to calculate the value of each reporting unit within its annual goodwill impairment testing. Therefore, the adoption of ASU 2011-08 did not have any impact on the Company's consolidated financial statements.

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

## (2) Acquisitions

### *Pentagon*

On September 1, 2011, the Company completed the acquisition of Pentagon Optimization Services, Inc. ("Pentagon"), an Alberta corporation based in Red Deer, Alberta, Canada. Pentagon, a diversified well optimization company serving the oil and gas industry, provides a wide range of products and services, including plunger lift systems and well engineering and testing. The addition of the proprietary "Angel" pump, which can pump both liquid and gas simultaneously without gas locking, will upgrade the Company's product portfolio and provide a cost effective method to produce pressure-depleted gas wells.

The following table represents the final purchase price consideration and purchase price allocation (in thousands of dollars):

|                           |                  |
|---------------------------|------------------|
| Cash paid at closing, net | \$ 18,982        |
| Royalty consideration     | <u>2,381</u>     |
| Total consideration paid  | <u>\$ 21,363</u> |

|                               |                  |
|-------------------------------|------------------|
| Purchase price                | <u>\$ 21,363</u> |
| Receivables                   | 1,763            |
| Inventories                   | 1,183            |
| Other current assets          | 470              |
| Property, plant and equipment | 680              |
| Intangible assets             | 4,195            |
| Accounts payable              | (258)            |
| Other accrued liabilities     | <u>(981)</u>     |
| Goodwill recorded             | <u>\$ 14,311</u> |

The Pentagon purchase price allocation was finalized in the third quarter of 2012. The final valuation for Pentagon did not result in material changes to the preliminary allocations.

### *Quinn's*

On December 1, 2011, the Company completed the acquisition of Quinn's Oilfield Supply Ltd., including certain affiliates ("Quinn's"), an Alberta corporation based in Red Deer, Alberta, Canada. Quinn's is one of the largest reciprocating rod pump manufacturers in North America and also manufactures and distributes progressive cavity pumps ("PCPs") and related equipment.

The following table represents the final purchase price consideration and purchase price allocation (in thousands of dollars):

|                                        |                   |
|----------------------------------------|-------------------|
| Cash paid at closing, net              | \$ 311,003        |
| Cash paid as a working capital true-up | 250               |
| Total consideration paid               | <u>\$ 311,253</u> |

|                               |                   |
|-------------------------------|-------------------|
| Purchase price                | <u>\$ 311,253</u> |
| Receivables                   | 27,680            |
| Inventories                   | 23,006            |
| Other current assets          | 715               |
| Property, plant and equipment | 62,734            |
| Intangible assets             | 57,400            |
| Accounts payable              | (24,924)          |
| Other accrued liabilities     | (9,046)           |
| Deferred tax liabilities      | (41)              |
| Goodwill recorded             | <u>\$ 173,729</u> |

The Quinn's purchase price allocation was finalized in the fourth quarter of 2012. The final valuation resulted in an additional payout of \$250,000 dollars.

#### ***Datac/RealFlex***

On January 19, 2012, the Company completed the acquisition of Datac Instrumentation Limited ("Datac") and RealFlex Technologies Limited ("Realflex"). Datac, based in Dublin, Ireland, is a solutions company serving the oil and gas, power, water and waste water, and transportation and marine industries that provides systems integration for supervisory control and data acquisition ("SCADA"). RealFlex, also based in Dublin, provides real-time software packages for SCADA and process control applications.

The Datac and Realflex acquisition was 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 consisted of the following (in thousands of dollars):

|                              |                  |
|------------------------------|------------------|
| Cash paid at closing, net    | \$ 18,586        |
| Common stock paid at closing | <u>8,414</u>     |
| Total consideration paid     | <u>\$ 27,000</u> |

In connection with the Datac and Realflex acquisition, the Company issued 116,716 restricted shares at a value of \$72.09 per share. The restrictions on the shares lapsed on July 19, 2012.

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, which totaled \$20.7 million, was recorded as goodwill in the Company's consolidated balance sheet in the Oilfield segment. 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>\$ 27,000</u> |
| Receivables                           | 323              |
| Inventories                           | 449              |
| Other current assets                  | 57               |
| Property, plant and equipment         | 51               |
| Non-compete agreements and trademarks | 350              |
| Customer relationships and contracts  | 5,983            |
| Indemnification asset                 | 5,500            |
| Accounts payable                      | (178)            |
| Other accrued liabilities             | (484)            |
| Deferred tax liabilities              | (229)            |
| Uncertain tax liability               | (5,500)          |
| Goodwill recorded                     | <u>\$ 20,678</u> |

In connection with the Datac acquisition the Company identified uncertain tax liabilities of the target company related to previous tax years. As a result, the Company entered into an agreement whereby the former owners funded an escrow account for \$5.5 million dollars. In accordance with ASC 805, *Business Combinations*, the Company has identified an indemnification asset resulting from this agreement.

The Datac and Realflex preliminary purchase price allocations, which are based on relevant facts and circumstances, are subject to change upon completion of the final valuation analysis by the Company's management. The final valuations for Datac and Realflex, which were required to be completed by January 2013, did not result in material changes to the preliminary allocations.

#### **Zenith**

On February 29, 2012, the Company completed the acquisition of Zenith Oilfield Technology Ltd ("Zenith"). Zenith, based in Aberdeen, Scotland, is an international provider of innovative technology and products for the monitoring and analysis of down-hole data and related completion products for the oilfield artificial lift market.

The Zenith acquisition was recorded using the acquisition method of accounting, and accordingly, the acquired operations have been included in the Company's results of operations since the date of acquisition. The preliminary purchase price consideration consisted of the following (in thousands of dollars):

|                           |                   |
|---------------------------|-------------------|
| Cash paid at closing, net | <u>\$ 133,972</u> |
| Total consideration paid  | <u>\$ 133,972</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, which totaled \$86.6 million, was recorded as goodwill in the Company's consolidated balance sheet in the Oilfield segment. 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>\$ 133,972</u> |
| Receivables                           | 13,236            |
| Inventories                           | 4,226             |
| Other current assets                  | 7,711             |
| Property, plant and equipment         | 518               |
| Non-compete agreements and trademarks | 3,614             |
| Customer relationships and contracts  | 32,665            |
| Other long term assets                | 355               |
| Accounts payable                      | (3,698)           |
| Other accrued liabilities             | (2,144)           |
| Deferred tax liabilities              | (9,380)           |
| Goodwill recorded                     | <u>\$ 86,869</u>  |

The Zenith preliminary purchase price allocations, which are based on relevant facts and circumstances, are subject to change upon completion of the final valuation analysis by the Company's management. The final valuations for Zenith, which were required to be completed by February 2013, did not result in material changes to the preliminary allocations.

#### **Other**

During 2012, the Company also acquired the assets of two businesses for a total price consideration of \$3.3 million. The two acquisitions were included in the Company's consolidated financial statements for the periods subsequent to the acquisitions.

#### **Supplemental Pro Forma Data**

Revenues and earnings to date for the Pentagon, Datac, Realflex, and Zenith acquisitions are not material and pro forma information is not provided. Results of operations for all acquisitions have been included in the Company's financial statements for periods subsequent to the effective date of the acquisition. The following unaudited supplemental pro forma data ("pro forma data") presents consolidated information as if the Quinn's acquisition had been completed on January 1, 2010:

Years ended December 31, 2012 and 2011  
(Thousands of dollars, except per share data)

|                                                       | <u>2011</u>    | <u>2010</u>    |
|-------------------------------------------------------|----------------|----------------|
| Sales                                                 | \$ 1,070,623   | \$ 761,327     |
| Net earnings                                          | \$ 75,601      | \$ 39,467      |
| Diluted earnings per share from continuing operations | <u>\$ 2.45</u> | <u>\$ 1.36</u> |

The pro forma data was prepared based on the historical financial information of Quinn's and Lufkin and has been adjusted to give effect to pro forma adjustments that are (i) directly attributable to the transaction, (ii) factually supportable and (iii) expected to have a continuing impact on the combined results. The pro forma data is not necessarily indicative of what Quinn's results of operations actually would have been had the transactions been completed on January 1, 2010. Additionally, the pro forma data does not project the future results of operations of the combined company nor do they reflect the expected realization of synergies associated with the transactions. The pro forma data reflects the application of the following adjustments:

- Additional depreciation and amortization expense associated with fair value adjustments to acquired identifiable intangible assets and property, plant and equipment.
- Increase in interest expense resulting from the issuance of debt to finance the purchase price, as well as the amortization of related deferred financing costs.
- Elimination of transaction costs incurred in 2010 that are directly related to the transactions, and do not have a continuing impact on the combined company's operating results.

**(3) Receivables**

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

| (Thousands of dollars)                     | 2012              | 2011              |
|--------------------------------------------|-------------------|-------------------|
| Accounts receivable                        | \$ 252,413        | \$ 214,608        |
| Notes receivable                           | -                 | 16                |
| Other receivables                          | 1,623             | 2,108             |
| Gross receivables                          | 254,036           | 216,732           |
| Allowance for doubtful accounts receivable | (767)             | (125)             |
| Net receivables                            | <u>\$ 253,269</u> | <u>\$ 216,607</u> |

Bad debt expense related to the year ended December 31, 2012 was \$0.1 million. Collections on previous bad debts related to receivables resulted in a recovery of \$0.1 million at December 31, 2011 and 2010.

**(4) Inventories**

Inventories used in determining cost of sales were as follows at December 31:

| (Thousands of dollars)            | 2012              | 2011              |
|-----------------------------------|-------------------|-------------------|
| Gross inventories at FIFO:        |                   |                   |
| Finished goods                    | \$ 26,751         | \$ 11,914         |
| Work in progress                  | 31,136            | 27,749            |
| Raw materials and component parts | 185,739           | 144,731           |
| Maintenance, tooling and supplies | 14,864            | 17,001            |
| Total gross inventories at FIFO   | 258,490           | 201,395           |
| Less reserves:                    |                   |                   |
| LIFO                              | 34,954            | 32,103            |
| Valuation                         | 5,061             | 3,144             |
| Total inventories as reported     | <u>\$ 218,475</u> | <u>\$ 166,148</u> |

Gross inventories on a FIFO basis shown above that were accounted for on a LIFO basis were \$120.7 million and \$97.9 million at December 31, 2012 and 2011, respectively.

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

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

| (Thousands of dollars)                   | 2012              | 2011              |
|------------------------------------------|-------------------|-------------------|
| Land                                     | \$ 29,026         | \$ 27,883         |
| Land improvements                        | 13,142            | 10,379            |
| Buildings                                | 158,984           | 137,923           |
| Machinery and equipment                  | 310,944           | 306,151           |
| Furniture and fixtures                   | 9,647             | 8,779             |
| Computer equipment and software          | 37,708            | 16,359            |
| Construction in progress                 | 125,545           | 106,789           |
| Total property, plant and equipment      | 684,996           | 614,263           |
| Less accumulated depreciation            | (283,323)         | (267,833)         |
| Total property, plant and equipment, net | <u>\$ 401,673</u> | <u>\$ 346,430</u> |

Depreciation expense related to property, plant and equipment was \$28.5 million, \$21.6 million and \$19.4 million in 2012, 2011 and 2010, respectively.

As of December 31, 2012 there was \$6.6 million of additions to property, plant and equipment in accounts payable.

The Romanian Government granted an economic incentive to the Company for the construction of its Romanian facility, which was ongoing at December 31, 2012. This incentive is subject to employment requirements the Company must maintain for five years. For the years ended December 31, 2012 and 2011 capital expenditures were reduced by \$18.1 million and \$5.9 million in the additions to property, plant, and equipment on the Consolidated Statements of Cash Flows as a result of incentives received from the government.

## **(6) Goodwill & Acquired Intangible Assets**

### Goodwill

The changes in the carrying amount of goodwill during the years ended December 31, 2012 and 2011 are as follows:

| (Thousands of dollars)                  | Power             |                 | Total             |
|-----------------------------------------|-------------------|-----------------|-------------------|
|                                         | Oilfield          | Transmission    |                   |
| Balance as of January 1, 2011           | \$ 45,862         | \$ 7,149        | \$ 53,011         |
| Goodwill acquired during the period     | 179,910           | -               | 179,910           |
| Foreign currency translation            | (2)               | 13              | 11                |
| Balance as of December 31, 2011         | 225,770           | 7,162           | 232,932           |
| Goodwill acquired during the period     | 109,385           | -               | 109,385           |
| Adjustments for prior year acquisitions | 5,302             | -               | 5,302             |
| Foreign currency translation            | 6,742             | (42)            | 6,700             |
| Balance as of December 31, 2012         | <u>\$ 347,199</u> | <u>\$ 7,120</u> | <u>\$ 354,319</u> |

The purchase price allocations relating to the businesses acquired are initially based on estimates. The Company adjusts these estimates based upon final analysis including input from third party appraisals, when deemed appropriate. The determination of fair value is finalized no later than twelve months from acquisition. Goodwill adjustments represent subsequent adjustments to the purchase price allocation for acquisitions as determined by the respective accounting guidance requirements based on the date of acquisition.

### 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 acquisitions since 2009. The components of these intangible assets are as follows (in thousands of dollars):

|                                       | December 31, 2012           |                             |                   | Weighted<br>Average<br>Amortization<br>Period<br>(years) |
|---------------------------------------|-----------------------------|-----------------------------|-------------------|----------------------------------------------------------|
|                                       | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net               |                                                          |
| Non-compete agreements and trademarks | \$ 10,281                   | \$ 2,082                    | \$ 8,199          | 5.7                                                      |
| Customer relationships and contracts  | 112,050                     | 15,788                      | 96,262            | 9.4                                                      |
|                                       | <u>\$ 122,331</u>           | <u>\$ 17,870</u>            | <u>\$ 104,461</u> | <u>7.6</u>                                               |

|                                       | December 31, 2011           |                             |                  | Weighted<br>Average<br>Amortization<br>Period<br>(years) |
|---------------------------------------|-----------------------------|-----------------------------|------------------|----------------------------------------------------------|
|                                       | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net              |                                                          |
| Non-compete agreements and trademarks | \$ 6,258                    | \$ 1,091                    | \$ 5,167         | 5.1                                                      |
| Customer relationships and contracts  | 72,818                      | 4,572                       | 68,246           | 9.6                                                      |
|                                       | <u>\$ 79,076</u>            | <u>\$ 5,663</u>             | <u>\$ 73,413</u> | <u>7.4</u>                                               |

Amortization expense of intangible assets was approximately \$14.8 million, \$2.7 million and \$1.7 million during 2012, 2011 and 2010, respectively. Expected amortization expense by year is (in thousands of dollars):

|                                      |           |
|--------------------------------------|-----------|
| For the year ended December 31, 2013 | \$ 15,473 |
| For the year ended December 31, 2014 | 14,808    |
| For the year ended December 31, 2015 | 14,742    |
| For the year ended December 31, 2016 | 14,645    |
| For the year ended December 31, 2017 | 14,276    |
| Thereafter                           | 30,517    |

#### (7) Other Current Accrued Liabilities

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

| (Thousands of dollars)                          | 2012             | 2011             |
|-------------------------------------------------|------------------|------------------|
| Customer prepayments                            | \$ 15,681        | \$ 10,659        |
| Litigation reserves                             | -                | 2,743            |
| Deferred compensation and benefit plans         | 6,918            | 6,884            |
| Acquisition hold back and royalty consideration | 2,330            | 2,219            |
| Other accrued liabilities                       | 9,054            | 3,689            |
| Total other current accrued liabilities         | <u>\$ 33,983</u> | <u>\$ 26,194</u> |

#### (8) Debt Obligations

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

| (Thousands of dollars)                 | 2012              | 2011              |
|----------------------------------------|-------------------|-------------------|
| Long-term notes payable                | \$ 326,704        | \$ 350,000        |
| Less current portion of long-term debt | (26,250)          | (17,500)          |
| Long-term debt                         | <u>\$ 300,454</u> | <u>\$ 332,500</u> |

Scheduled maturities of long-term debt in future years as of December 31, 2012 are as follows (in thousands of dollars):

|       |                   |
|-------|-------------------|
| 2013  | \$ 26,250         |
| 2014  | 52,500            |
| 2015  | 87,500            |
| 2016  | <u>160,454</u>    |
| Total | <u>\$ 326,704</u> |

The Company has a five year secured credit facility with a group of lenders (the "Bank Facility") consisting of a revolving line of credit that provides up to \$175.0 million of aggregate borrowing and a \$350.0 million term loan. Under the Bank Facility the Company has granted a first priority lien, security interest and collateral assignment of substantially all of its current assets. The Bank Facility matures on November 30, 2016. Borrowings under the Bank Facility bear interest, at the Company's option, at either (A) the highest of (i) the Prime Rate, (ii) the Federal Funds Effective Rate plus 0.5%, and (iii) the Adjusted LIBO Rate for an Interest Period of one month plus 1.0%, in each case plus an Applicable Margin based on the Company's Leverage Ratio or (B) the interest rate equal to (i) the rate for US dollar deposits in the London interbank market for such Interest Period multiplied by (ii) the Statutory Reserve Rate, plus (iii) the Applicable Margin. Throughout the term of the Bank Facility, the Company pays an Unused Commitment Fee which ranges from 0.25 percent to 0.50 percent based on the Company's Leverage Ratio. As of December 31, 2012, \$301.7 million of borrowings under the term loan and \$25.0 million of borrowings under the revolving line of credit were outstanding. Additionally, there was \$10.4 million in letters of credit outstanding against the revolving credit facility. As of December 31, 2012, the interest rate was 2.75% on the credit facility and the Company paid \$10.2 million of interest expense in the year ended December 31, 2012. The carrying value of debt is not materially different from its fair value. The Company was in compliance with all financial covenants under the Bank Facility as of December 31, 2012 and had borrowing capacity of \$139.6 million.

In addition, the Company's credit facility restricts the ability to declare and pay dividends on common stock when the payment of any such dividend would cause the Company to exceed specified leverage and fixed charge ratios.

#### (9) 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. As of December 31, 2011, the qualified noncontributory pension plan was closed to new participants. 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.

Effective January 1, 2013, the Company's postretirement health plan was amended to discontinue medical benefits for all future retirees under the age of 65 and all future and current employees over the age of 65. Premiums for current retirees under the age of 65 were increased and the company subsidy was eliminated. The plan amendment resulted in a \$3.4 million reduction in the Accumulated Postretirement Benefit Obligation at December 31, 2012.

The Company also has qualified defined contribution retirement plans covering substantially all of its U.S. employees and certain Canadian employees. For U.S. salaried employees, the Company makes contributions of 75% of employee contributions up to a maximum employee contribution of 6% of employee earnings. For U.S. hourly employees, the Company made contributions of 75% of employee contributions from January 1, 2011 through September 30, 2011 and then 100% of employee contributions thereafter up to a maximum employee contribution of 6% of employee earnings. The plan was amended to include the change for U.S. hourly employees on October 1, 2011. 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, 2012. 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 \$11.3 million, \$4.6 million and \$3.8 million in the years ended December 31, 2012, 2011 and 2010, respectively. The liability for the non-qualified deferred defined contribution plan is included in "Other current accrued liabilities" in the Consolidated Balance Sheet.

**Obligations and Funded Status  
At December 31**

| (Thousands of dollars)                         | Pension Benefits    |                    | Other Benefits    |                   |
|------------------------------------------------|---------------------|--------------------|-------------------|-------------------|
|                                                | 2012                | 2011               | 2012              | 2011              |
| <b>Changes in benefit obligation</b>           |                     |                    |                   |                   |
| Benefit obligation at beginning of year        | \$ 283,866          | \$ 227,259         | \$ 7,894          | \$ 6,961          |
| Service cost                                   | 10,209              | 6,881              | 176               | 129               |
| Interest cost                                  | 12,147              | 11,842             | 311               | 347               |
| Plan participants' contributions               | -                   | -                  | 516               | 646               |
| Actuarial loss                                 | 32,547              | 48,250             | 182               | 673               |
| Benefits paid                                  | (11,220)            | (10,333)           | (860)             | (862)             |
| Plan change                                    | -                   | -                  | (3,434)           | -                 |
| Other                                          | 29                  | (33)               | -                 | -                 |
| Benefit obligation at end of year              | 327,578             | 283,866            | 4,785             | 7,894             |
| <b>Change in plan assets</b>                   |                     |                    |                   |                   |
| Fair value of plan assets at beginning of year | 190,547             | 205,054            | -                 | -                 |
| Actual return (loss) on plan assets            | 19,511              | (4,595)            | -                 | -                 |
| Employer contributions                         | 16,131              | 441                | 343               | 216               |
| Plan participants' contributions               | -                   | -                  | 516               | 646               |
| Benefits paid                                  | (11,220)            | (10,333)           | (859)             | (862)             |
| Other                                          | 12                  | (20)               | -                 | -                 |
| Fair value of plan assets at end of year       | 214,981             | 190,547            | -                 | -                 |
| Unfunded status at end of year                 | <u>\$ (112,597)</u> | <u>\$ (93,319)</u> | <u>\$ (4,785)</u> | <u>\$ (7,894)</u> |

Amounts recognized in the balance sheet consist of:

| (Thousands of dollars)            | Pension Benefits    |                    | Other Benefits    |                   |
|-----------------------------------|---------------------|--------------------|-------------------|-------------------|
|                                   | 2012                | 2011               | 2012              | 2011              |
| Other current accrued liabilities | \$ (476)            | \$ (383)           | \$ (279)          | \$ (379)          |
| Postretirement benefits           | -                   | -                  | (4,506)           | (7,515)           |
| Pension benefits                  | (112,121)           | (92,936)           | -                 | -                 |
|                                   | <u>\$ (112,597)</u> | <u>\$ (93,319)</u> | <u>\$ (4,785)</u> | <u>\$ (7,894)</u> |

Amounts recognized in accumulated other comprehensive income consist of:

| (Thousands of dollars) | Pension Benefits |                  | Other Benefits    |                   |
|------------------------|------------------|------------------|-------------------|-------------------|
|                        | 2012             | 2011             | 2012              | 2011              |
| Prior service cost     | \$ 2,661         | \$ 3,247         | \$ (1,950)        | \$ 245            |
| Net loss (gain)        | 88,137           | 78,238           | (1,089)           | (1,320)           |
|                        | <u>\$ 90,798</u> | <u>\$ 81,485</u> | <u>\$ (3,039)</u> | <u>\$ (1,075)</u> |

The accumulated benefit obligation for all defined benefit pension plans was \$301.1 million and \$268.3 million at December 31, 2012, and 2011, respectively.

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

| (Thousands of dollars)             | Pension Benefits |                  |                 | Other Benefits |               |               |
|------------------------------------|------------------|------------------|-----------------|----------------|---------------|---------------|
|                                    | 2012             | 2011             | 2010            | 2012           | 2011          | 2010          |
| <b>Net Periodic Benefit Cost</b>   |                  |                  |                 |                |               |               |
| Service cost                       | \$ 10,209        | \$ 6,881         | \$ 5,654        | \$ 176         | \$ 129        | \$ 92         |
| Interest cost                      | 12,147           | 11,842           | 11,585          | 311            | 346           | 350           |
| Expected return on plan assets     | (12,932)         | (13,564)         | (12,752)        | -              | -             | -             |
| Amortization of prior service cost | 930              | 946              | 785             | 51             | 51            | 51            |
| Amortization of net loss (gain)    | 9,769            | 3,917            | 3,712           | (186)          | (223)         | (291)         |
| Net periodic benefit cost          | <u>\$ 20,123</u> | <u>\$ 10,022</u> | <u>\$ 8,984</u> | <u>\$ 352</u>  | <u>\$ 303</u> | <u>\$ 202</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 \$9.8 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 \$0.1 million and \$0.3 million, respectively.

### Additional Information

#### Assumptions

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

|                               | Pension Benefits |               | Other Benefits |       |
|-------------------------------|------------------|---------------|----------------|-------|
|                               | 2012             | 2011          | 2012           | 2011  |
| Discount rate                 | 3.58% - 3.77%    | 4.09% - 4.19% | 3.75%          | 4.05% |
| Rate of compensation increase | 4.80%            | 4.90%         | N/A            | N/A   |

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

|                                          | Pension Benefits |               |               | Other Benefits |       |       |
|------------------------------------------|------------------|---------------|---------------|----------------|-------|-------|
|                                          | 2012             | 2011          | 2010          | 2012           | 2011  | 2010  |
| Discount rate                            | 4.09% - 4.19%    | 5.19% - 5.26% | 5.26% - 5.80% | 4.05%          | 4.97% | 5.58% |
| Expected long-term return on plan assets | 6.80%            | 6.80%         | 6.80%         | N/A            | N/A   | N/A   |
| Rate of compensation increase            | 4.80%            | 4.90%         | 5.12%         | N/A            | N/A   | N/A   |

Discount rates are estimated based upon a cash flow matching exercise against the Citigroup Pension Discount Curve. Guidance for determining this rate is taken from the yield on high-quality, long-term, corporate bonds.

For 2012, 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, 2012), 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, 2012 are as follows:

#### Fair Value Measurements at December 31, 2012 (in thousands)

| <u>Asset Category</u>                      | <u>Total</u> | <u>Quoted Prices in<br/>Active markets for<br/>Identical Assets<br/>(Level 1)</u> | <u>Significant<br/>Observable<br/>Inputs<br/>(Level 2)</u> | <u>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</u> |
|--------------------------------------------|--------------|-----------------------------------------------------------------------------------|------------------------------------------------------------|--------------------------------------------------------------|
| Cash                                       | \$ 7,678     | \$ 7,678                                                                          |                                                            |                                                              |
| Equity securities:                         |              |                                                                                   |                                                            |                                                              |
| Common stock                               | 53,559       | 53,559                                                                            |                                                            |                                                              |
| International stock - commingled funds (a) | 32,683       |                                                                                   | \$ 32,683                                                  |                                                              |
| International stock - mutual fund          | 18,787       | 18,787                                                                            |                                                            |                                                              |
| Fixed income securities:                   |              |                                                                                   |                                                            |                                                              |
| U.S. Treasuries                            | 12,160       | 12,160                                                                            |                                                            |                                                              |
| Mortgage-backed securities                 | 6,853        |                                                                                   | 6,853                                                      |                                                              |
| Collateralized mortgage obligations        | 596          |                                                                                   |                                                            | \$ 596                                                       |
| Corporate bonds (b)                        | 22,981       |                                                                                   | 22,981                                                     |                                                              |
| Other types of investments:                |              |                                                                                   |                                                            |                                                              |
| Equity long/short hedge funds (c)          | 37,010       |                                                                                   |                                                            | 37,010                                                       |
| Insurance policy (d)                       | 675          |                                                                                   |                                                            | 675                                                          |
| Real Estate (e)                            | 21,999       |                                                                                   |                                                            | 21,999                                                       |
| Total                                      | \$ 214,981   | \$ 92,184                                                                         | \$ 62,517                                                  | \$ 60,280                                                    |

- (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 and Black Rock Granite Properties which consists of commingled private real estate.

|                                                        | Equity Long/Short<br>Hedge Funds | Real Estate | Insurance<br>Contracts | Collateralized<br>Mortgage Obligations | Total     |
|--------------------------------------------------------|----------------------------------|-------------|------------------------|----------------------------------------|-----------|
| Beginning balance at December 31, 2011                 | \$ 35,288                        | \$ 21,001   | \$ 645                 | \$ 2,156                               | \$ 59,090 |
| Actual return on plan assets:                          |                                  |             |                        |                                        |           |
| Relating to assets still held<br>at the reporting date | 1,722                            | 998         |                        |                                        | 2,720     |
| Relating to assets sold during<br>the period           |                                  |             |                        |                                        | -         |
| Purchases, sales, and settlements                      |                                  |             |                        | (1,560)                                | (1,560)   |
| Other                                                  |                                  |             | 30                     |                                        | 30        |
| Transfers in and/or out of Level 3                     |                                  |             |                        |                                        | -         |
| Ending balance at December 31, 2012                    | \$ 37,010                        | \$ 21,999   | \$ 675                 | \$ 596                                 | \$ 60,280 |

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. Hedge fund investments are primarily concentrated in funds focused on long/short investment strategies.

### 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.

No equity or debt securities of the Company were held by the plan at December 31, 2012 or 2011.

The unqualified pension plans and the postretirement benefit plan of the Company are unfunded and thus had no plan assets as of December 31, 2012 and 2011.

## Contributions

The Company expects to make contributions of \$0.4 million to the pension plans and \$0.2 million to the postretirement plan, in 2013. Due to pension funding legislation passed in 2012, the Company may not be required to make contributions to its U.S. qualified pension plan but may elect to make contributions of \$10 to \$15 million.

## Estimated Future Benefit Payments

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

| (Thousands of dollars) | Pension<br>Benefits | Other<br>Benefits |
|------------------------|---------------------|-------------------|
| 2013                   | \$ 12,687           | \$ 249            |
| 2014                   | 13,459              | 250               |
| 2015                   | 14,323              | 251               |
| 2016                   | 15,158              | 251               |
| 2017                   | 16,129              | 253               |
| 2018 - 2022            | 92,957              | 1,267             |

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

| (Thousands of dollars)        | Foreign<br>Currency<br>Translation | Defined<br>Benefit<br>Pension<br>Plans | Defined<br>Benefit<br>Postretirement<br>Plans | Accumulated<br>Other<br>Comprehensive<br>Loss |
|-------------------------------|------------------------------------|----------------------------------------|-----------------------------------------------|-----------------------------------------------|
| <b>Balance, Dec. 31, 2010</b> | \$ 5,077                           | \$ (43,372)                            | \$ 1,649                                      | \$ (36,646)                                   |
| Current-period change         | (3,316)                            | (38,441)                               | (533)                                         | (42,290)                                      |
| <b>Balance, Dec. 31, 2011</b> | 1,761                              | (81,813)                               | 1,116                                         | (78,936)                                      |
| Current-period change         | 12,654                             | (9,701)                                | 1,964                                         | 4,917                                         |
| <b>Balance, Dec. 31, 2012</b> | <u>\$ 14,415</u>                   | <u>\$ (91,514)</u>                     | <u>\$ 3,080</u>                               | <u>\$ (74,019)</u>                            |

## (10) Earnings per Share

A reconciliation of the number of weighted shares used to compute basic and diluted net earnings per share for 2012, 2011 and 2010, are illustrated below:

|                                                                     | 2012              | 2011              | 2010              |
|---------------------------------------------------------------------|-------------------|-------------------|-------------------|
| Weighted average common shares outstanding for basic EPS            | 33,015,323        | 30,445,772        | 29,978,034        |
| Effect of dilutive securities: employee stock options               | 346,395           | 396,741           | 328,328           |
| Adjusted weighted average common shares outstanding for diluted EPS | <u>33,361,718</u> | <u>30,842,513</u> | <u>30,306,362</u> |

Options to purchase a total of 440,786, 154,449 and 125,543 shares of the Company's common stock were excluded from the calculation of fully diluted earnings per share for 2012, 2011 and 2010, respectively, because their effect on fully diluted earnings per share for the period were antidilutive.

**(11) 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. Unrestricted 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, 2012, 2011 and 2010:

| (Thousands of dollars)                 | 2012            | 2011            | 2010            |
|----------------------------------------|-----------------|-----------------|-----------------|
| Stock options                          | \$ 5,162        | \$ 4,881        | \$ 4,627        |
| Performance shares                     | 288             | -               | -               |
| Restricted stock awards and units      | 2,216           | 429             | -               |
| Total stock-based compensation expense | 7,666           | 5,310           | 4,627           |
| Tax benefit                            | (2,836)         | (1,964)         | (1,712)         |
| Total compensation expense, net of tax | <u>\$ 4,830</u> | <u>\$ 3,346</u> | <u>\$ 2,915</u> |

**Stock Options**

The fair value of each option grant during the years ended December 31, 2012, 2011 and 2010 was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

|                                                     | 2012            | 2011            | 2010            |
|-----------------------------------------------------|-----------------|-----------------|-----------------|
| Expected dividend yield                             | 0.64% - 1.02%   | 0.60% - 0.80%   | 0.94% - 1.60%   |
| Expected stock price volatility                     | 45.00% - 56.40% | 48.10% - 57.90% | 51.20% - 57.80% |
| Risk free interest rate                             | 0.27% - 0.82%   | 0.28% - 2.39%   | 0.53% - 2.96%   |
| Expected life of options                            | 2 - 4 years     | 3 - 4 years     | 2 - 6 years     |
| Weighted-average fair value per share at grant date | \$63.84         | \$26.29         | \$17.05         |

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 year's 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 the year ended December 31, 2012, is presented below:

| Options                          | Shares           | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value (\$000's) |
|----------------------------------|------------------|---------------------------------|---------------------------------------------|-------------------------------------|
| Outstanding at January 1, 2012   | 1,504,311        | \$42.26                         |                                             |                                     |
| Granted                          | 236,800          | 50.58                           |                                             |                                     |
| Exercised                        | (71,026)         | 27.46                           |                                             |                                     |
| Forfeited or expired             | (44,758)         | 48.04                           |                                             |                                     |
| Outstanding at December 31, 2012 | <u>1,625,327</u> | <u>\$43.96</u>                  | <u>7.3</u>                                  | <u>\$25,474</u>                     |
| Exercisable at December 31, 2012 | <u>921,461</u>   | <u>\$38.37</u>                  | <u>6.4</u>                                  | <u>\$19,430</u>                     |

As of December 31, 2012, there was \$4.8 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 1.96 years. The intrinsic value of stock options exercised in 2012, 2011 and 2010 was \$3.4 million, \$9.2 million and \$11.4 million, respectively.

### Performance Shares

The Company has granted performance shares to members of senior management, at no cost to the recipient, as a means of rewarding them for the Company's shareholder return performance relative to a specific group of companies over a three-year performance cycle. Compensation expense, which is recorded ratably over the vesting period, is based on the fair value at grant date and the anticipated number of shares of the Company's common stock to be issued, which is determined on a Monte Carlo probability model. Grant recipients do not have any shareholder rights until the granted shares have been issued.

The following table summarizes information about the performance shares that remain outstanding as of December 31, 2012:

| Period<br>Granted | Target Shares<br>Outstanding at<br>Beginning<br>of Year | Target<br>Shares<br>Granted | Target<br>Shares<br>Forfeited | Target Shares<br>Outstanding<br>at End<br>of Year | Weighted<br>Average<br>Grant Date<br>Fair Value<br>per Share |
|-------------------|---------------------------------------------------------|-----------------------------|-------------------------------|---------------------------------------------------|--------------------------------------------------------------|
| 2012              | -                                                       | 70,151                      | (2,996)                       | 67,155                                            | \$ 59.55                                                     |
| Total             | -                                                       | 70,151                      | (2,996)                       | 67,155                                            |                                                              |

As of December 31, 2012, there was \$3.9 million of total unrecognized compensation expense related to unvested PSAs. The cost is expected to be recognized over a weighted average period of 1.5 years.

### Restricted Stock Awards and Units

The 2000 Incentive Stock Compensation Plan also provides for other forms of stock-based compensation such as restricted stock awards ("RSA") and restricted stock units ("RSU"). The Company granted 74,705 shares and 57,300 shares of restricted stock to employees and non-employee directors for the years ended December 31, 2012 and 2011, respectively. These awards vest over a three year period and had a fair value of \$62.36 and \$57.40 on date of issuance for the years ended December 31, 2012 and 2011, respectively.

A summary of the combined changes of RSAs and RSUs for the year ended December 31, 2012, is presented below:

| Awards                        | Number of<br>Awards | Weighted-<br>Average<br>Grant Date<br>Fair Value |
|-------------------------------|---------------------|--------------------------------------------------|
| Unvested at January 1, 2012   | 57,300              | \$57.40                                          |
| Granted                       | 74,705              | 62.36                                            |
| Vested                        | (19,102)            | 57.40                                            |
| Forfeited                     | (2,996)             | 79.64                                            |
| Unvested at December 31, 2012 | 109,907             | \$60.13                                          |

As of December 31, 2012 and 2011, there was \$7.7 million and \$2.9 million of total unrecognized compensation cost related to unvested RSAs and RSUs. The cost is expected to be recognized over a weighted average period of 2.3 years.

### (12) 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, 2012 and 2011, no shares of preferred stock had been issued.

During the quarter ended March 31, 2012, the Company completed an equity offering, which resulted in the issuance of 2,875,000 shares of common stock and net proceeds of \$217.6 million.

**(13) Income Taxes**

Earnings from continuing operations before income taxes for 2012, 2011 and 2010 consisted of the following:

| (Thousands of dollars)             | 2012              | 2011              | 2010             |
|------------------------------------|-------------------|-------------------|------------------|
| United States                      | \$ 88,301         | \$ 76,025         | \$ 50,278        |
| Foreign                            | 37,654            | 29,444            | 17,167           |
| Total earnings before income taxes | <u>\$ 125,955</u> | <u>\$ 105,469</u> | <u>\$ 67,445</u> |

The income tax provision for 2012, 2011 and 2010 consisted of the following:

| (Thousands of dollars)              | 2012             | 2011             | 2010             |
|-------------------------------------|------------------|------------------|------------------|
| Current:                            |                  |                  |                  |
| U.S. federal and state income taxes | \$ 35,054        | \$ 21,466        | \$ 15,815        |
| Foreign                             | 12,324           | 8,465            | 6,663            |
| Total current                       | <u>47,378</u>    | <u>29,931</u>    | <u>22,478</u>    |
| Deferred:                           |                  |                  |                  |
| U.S. federal and state income taxes | 1,885            | 9,820            | 2,819            |
| Foreign                             | (5,165)          | (253)            | (1,383)          |
| Total deferred                      | <u>(3,280)</u>   | <u>9,567</u>     | <u>1,436</u>     |
| Total                               | <u>\$ 44,098</u> | <u>\$ 39,498</u> | <u>\$ 23,914</u> |

Cash payments for income taxes totaled \$44.1 million, \$30.5 million and \$18.8 million for 2012, 2011 and 2010, 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)                     | 2012             | 2011             | 2010             |
|--------------------------------------------|------------------|------------------|------------------|
| Tax provision computed at statutory rate   | \$ 44,084        | \$ 36,914        | \$ 23,606        |
| Tax effect of:                             |                  |                  |                  |
| Expenses for which no benefit was realized | 492              | 702              | 202              |
| Change in effective state tax rate         | 23               | (6)              | 13               |
| Tax credit                                 | (239)            | (733)            | (930)            |
| State taxes net of federal benefit         | 2,512            | 1,779            | 1,813            |
| Benefit of manufacturing deduction         | (3,093)          | (1,492)          | (1,127)          |
| Acquisition costs                          | 2,437            | 1,919            | -                |
| Foreign operations                         | (1,217)          | 520              | 530              |
| Other, net                                 | (901)            | (105)            | (193)            |
| Total provision for taxes                  | <u>\$ 44,098</u> | <u>\$ 39,498</u> | <u>\$ 23,914</u> |

The American Taxpayer Relief Act of 2012, signed into law on January 2, 2013, extends retroactively the US R&D tax credit for the period January 1, 2012 through December 31, 2013. Although reinstated retroactively, since the enactment of this tax law occurred after December 31, 2012, the tax benefit of the US R&D tax credit for the year 2012 will be recognized in our financial results for the first quarter of 2013. This tax benefit is estimated to be \$678,000.

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 was

\$115.5 million at December 31, 2012, 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. 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 primary components of the deferred tax assets and liabilities and the related valuation allowances are as follows:

| (Thousands of dollars)                                | 2012       | 2011       |
|-------------------------------------------------------|------------|------------|
| <b>Deferred income tax assets:</b>                    |            |            |
| Pension costs                                         | \$ 43,788  | \$ 36,430  |
| Payroll and benefits                                  | 1,129      | 1,365      |
| Accrued warranty expenses                             | 1,906      | 1,425      |
| Postretirement benefits                               | 9,137      | 8,143      |
| Accrued liabilities                                   | 261        | 591        |
| Other, net                                            | 8,573      | 1,680      |
| Total deferred income tax assets                      | 64,794     | 49,634     |
| Less valuation allowance                              | (4,779)    | (1,117)    |
| Total deferred income tax assets                      | 60,015     | 48,517     |
| <b>Noncurrent deferred income tax liabilities:</b>    |            |            |
| Prepaid expenses                                      | (792)      | (993)      |
| Depreciation                                          | (33,781)   | (34,143)   |
| Inventories                                           | (974)      | (1,758)    |
| Intangible assets                                     | (17,527)   | (8,784)    |
| Liability for unremitted earnings                     | (12,005)   |            |
| Other, net                                            | (210)      | (5,585)    |
| Total noncurrent deferred income tax liabilities, net | (65,289)   | (51,263)   |
| Total net deferred tax liability                      | \$ (5,274) | \$ (2,746) |
| Current deferred tax asset                            | \$ 574     | \$ 1,140   |
| Non-current deferred tax liability                    | (5,848)    | (3,886)    |
| Total net deferred tax liability                      | \$ (5,274) | \$ (2,746) |

At December 31, 2012, 2011 and 2010 there are \$5.6 million, \$2.1 million and \$1.8 million, respectively, of unrecognized tax benefits. Of these amounts, \$3.0 million, \$2.1 million, and \$1.8 million, respectively, represent the amounts 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)                            | 2012            | 2011            | 2010            |
|---------------------------------------------------|-----------------|-----------------|-----------------|
| Balance at January 1,                             | \$ 2,060        | \$ 1,838        | \$ 1,509        |
| Gross increases- current year tax positions       | 4,255           | 791             | 372             |
| Gross increases- tax positions from prior periods | 3               | 115             | 233             |
| Gross decreases- tax positions from prior periods | (683)           | (657)           | (262)           |
| Settlements                                       | -               | (27)            | (14)            |
| Balance at December 31,                           | <u>\$ 5,635</u> | <u>\$ 2,060</u> | <u>\$ 1,838</u> |

In connection with the Datacube acquisition the Company identified uncertain tax liabilities of the target company related to previous tax years. As a result, the Company entered into an agreement whereby the former owners funded an escrow account for \$5.5 million dollars. In accordance with ASC 805, Business Combinations, the Company has identified an indemnification asset resulting from this agreement.

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 2009 are closed to assessment. Statutes for years prior to 2009 remain subject to review in certain U.S. state jurisdictions; however, the outcome of any future audit is not expected to have a material effect on the Company's results of operations. The Company also remains subject to income tax examinations in the following material international jurisdictions: Canada (2009-2011), France (2010-2011), Argentina (2006- 2011) and United Kingdom (2011).

The Company has unrecognized tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within the next twelve months. The unrecognized tax benefits relate to tax credits and other various deductions. The Company estimates the change to be approximately \$1,900,000.

The Company's continuing policy is to recognize interest and penalties related to income tax matters in administrative costs. The Company had \$100,000 accrued for interest and penalties at December 31, 2012. Net penalty and interest income of \$10,000 and \$45,000 were recognized in December 31, 2012 and 2011 respectively. Net penalty and interest expense of \$30,000 was expensed in December 31, 2010.

## (14) Commitments and Contingencies

### Legal proceedings:

#### Intellectual Property Matter

In 2009, the Company brought suit in a Texas state court against the former owners of a business it had previously acquired in order to protect certain of the Company's intellectual property rights. The former owners responded by counter suit against the Company as well as its outside counsel for the acquisition, Andrews Kurth LLP ("AK"), claiming that the Company had improperly acquired title to their inventions. The case was removed from the Texas state court to a U.S. District Court in Midland, Texas in order to address intellectual property and patent issues as well as other claims made by the parties. After reviewing the facts and positions of the parties, in February 2011, the U.S. District Court granted summary judgment for the Company disposing of all federal claims and remanded the remainder of the case back to the Texas state court.

The parties appealed various decisions of the U.S. District Court to the U.S. Court of Appeals for the Federal Circuit, which ultimately dismissed the appeals for lack of jurisdiction and transferred the appeals to the Fifth Circuit in February 2012. In addition to the federal appeals, the plaintiffs asked the Texas state court to proceed with a trial on the remanded case, which set the remanded case for trial over defendants' objections. AK then sought and obtained an injunction from the U.S. District Court prohibiting the plaintiffs from pursuing the Texas state court case until resolution of the federal appeals, which the plaintiffs appealed. In September 2012, the Fifth Circuit ruled in favor of the plaintiffs by vacating the injunction prohibiting the plaintiffs from litigating in state court. Trial in state court was set to begin in March of 2013, while a number of substantive appeals remained before the Fifth Circuit.

On December 10, 2012, the parties entered into a confidential settlement agreement following a successful mediation of all claims between plaintiffs and defendants. Pursuant to the terms of the settlement agreement, Lufkin agreed, among other things, to release all current and future claims arising out of or related to the intellectual property disputes made the basis of the lawsuit in exchange for a corresponding release of claims by plaintiffs.

Upon agreed motions by the parties, the appeals pending before the Fifth Circuit and the state court action were dismissed on January 3, 2013 and January 11, 2013, respectively.

#### Other Matters

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 increased risk. 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, 2012 and 2011, is as follows:

| (Thousands of dollars)       | 2012            | 2011            |
|------------------------------|-----------------|-----------------|
| Beginning balance            | \$ 4,847        | \$ 3,620        |
| Claims paid or accrued       | (4,714)         | (3,032)         |
| Additional warranties issued | 5,404           | 4,225           |
| Revisions in estimates       | 624             | 67              |
| Foreign currency translation | 21              | (33)            |
| Ending balance               | <u>\$ 6,182</u> | <u>\$ 4,847</u> |

**Operating leases:** Future minimum rental payments for operating leases having initial or remaining noncancelable lease terms in excess of one year as of December 31, 2012 are:

(Thousands of dollars)

|            |          |
|------------|----------|
| 2013       | \$ 8,694 |
| 2014       | 7,368    |
| 2015       | 5,006    |
| 2016       | 3,642    |
| 2017       | 2,191    |
| Thereafter | 3,353    |

Expenses for rentals and leases, including short-term rental contracts, were \$14.2 million, \$9.9 million and \$7.8 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Capital expenditures: As of December 31, 2012, the Company had contractual commitments for capital expenditures of \$30.8 million that are expected to be paid in 2013.

**(15) Business Segment Information**

The Company operates with two business segments: Oilfield 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)                                            | 2012                | 2011                | 2010              |
|-------------------------------------------------------------------|---------------------|---------------------|-------------------|
| <b>Sales by segment:</b>                                          |                     |                     |                   |
| Oilfield                                                          | \$ 1,075,612        | \$ 736,488          | \$ 477,867        |
| Power Transmission                                                | 205,588             | 195,647             | 167,776           |
| <b>Total sales</b>                                                | <b>\$ 1,281,200</b> | <b>\$ 932,135</b>   | <b>\$ 645,643</b> |
| <b>Sales by geographic region:</b>                                |                     |                     |                   |
| United States                                                     | \$ 823,432          | \$ 582,947          | \$ 390,129        |
| Europe                                                            | 77,785              | 64,926              | 46,799            |
| Canada                                                            | 157,292             | 88,317              | 33,668            |
| Latin America                                                     | 115,148             | 100,287             | 103,390           |
| Middle East/North Africa                                          | 86,472              | 69,703              | 43,913            |
| Other                                                             | 21,071              | 25,955              | 27,744            |
| <b>Total sales</b>                                                | <b>\$ 1,281,200</b> | <b>\$ 932,135</b>   | <b>\$ 645,643</b> |
| <b>Earnings (loss) before income taxes:</b>                       |                     |                     |                   |
| Oilfield                                                          | \$ 121,666          | \$ 91,278           | \$ 57,690         |
| Power Transmission                                                | 4,359               | 16,402              | 10,937            |
| Corporate & Other                                                 | (70)                | (2,211)             | (1,182)           |
| <b>Total earnings (loss) before income taxes</b>                  | <b>\$ 125,955</b>   | <b>\$ 105,469</b>   | <b>\$ 67,445</b>  |
| <b>Assets by segment:</b>                                         |                     |                     |                   |
| Oilfield                                                          | \$ 1,162,071        | \$ 869,519          |                   |
| Power Transmission                                                | 165,136             | 153,429             |                   |
| Corporate & Other                                                 | 108,012             | 73,757              |                   |
| <b>Total assets</b>                                               | <b>\$ 1,435,219</b> | <b>\$ 1,096,705</b> |                   |
| <b>Property, plant &amp; equipment, net, by geographic region</b> |                     |                     |                   |
| United States                                                     | \$ 191,583          | \$ 175,921          |                   |
| Europe                                                            | 127,883             | 86,213              |                   |
| Canada                                                            | 68,679              | 69,047              |                   |
| Latin America                                                     | 13,237              | 14,884              |                   |
| Other                                                             | 291                 | 365                 |                   |
| <b>Total P, P &amp; E, net</b>                                    | <b>\$ 401,673</b>   | <b>\$ 346,430</b>   |                   |
| <b>Capital expenditures by segment</b>                            |                     |                     |                   |
| Oilfield                                                          | \$ 71,579           | \$ 83,871           | \$ 43,938         |
| Power Transmission                                                | 10,062              | 5,995               | 8,445             |
| Corporate & Other                                                 | 3,078               | 13,693              | 7,980             |
| <b>Total capital expenditures</b>                                 | <b>\$ 84,719</b>    | <b>\$ 103,559</b>   | <b>\$ 60,363</b>  |
| <b>Depreciation/amortization by segment:</b>                      |                     |                     |                   |
| Oilfield                                                          | \$ 33,361           | \$ 16,548           | \$ 13,484         |
| Power Transmission                                                | 6,436               | 6,893               | 6,752             |
| Corporate & Other                                                 | 3,486               | 825                 | 922               |
| <b>Total depreciation/amortization</b>                            | <b>\$ 43,283</b>    | <b>\$ 24,266</b>    | <b>\$ 21,158</b>  |

Additional key segment information is presented below:

Year Ended December 31, 2012

| (Thousands of dollars)                         | <u>Oilfield</u>     | <u>Power<br/>Transmission</u> | <u>Corporate<br/>&amp; Other</u> | <u>Total</u>        |
|------------------------------------------------|---------------------|-------------------------------|----------------------------------|---------------------|
| Gross sales                                    | \$ 1,083,152        | \$ 212,724                    | \$ -                             | \$ 1,295,876        |
| Inter-segment sales                            | (7,540)             | (7,136)                       | -                                | (14,676)            |
| Net sales                                      | <u>\$ 1,075,612</u> | <u>\$ 205,588</u>             | <u>\$ -</u>                      | <u>\$ 1,281,200</u> |
| Operating income (loss)                        | \$ 135,745          | \$ 4,315                      | \$ (8)                           | \$ 140,052          |
| Other (expense) income, net                    | (14,080)            | 45                            | (62)                             | (14,097)            |
| Earnings (loss) before<br>income tax provision | <u>\$ 121,665</u>   | <u>\$ 4,360</u>               | <u>\$ (70)</u>                   | <u>\$ 125,955</u>   |

Year Ended December 31, 2011

| (Thousands of dollars)                         | <u>Oilfield</u>   | <u>Power<br/>Transmission</u> | <u>Corporate<br/>&amp; Other</u> | <u>Total</u>      |
|------------------------------------------------|-------------------|-------------------------------|----------------------------------|-------------------|
| Gross sales                                    | \$ 743,545        | \$ 206,978                    | \$ -                             | \$ 950,523        |
| Inter-segment sales                            | (7,057)           | (11,331)                      | -                                | (18,388)          |
| Net sales                                      | <u>\$ 736,488</u> | <u>\$ 195,647</u>             | <u>\$ -</u>                      | <u>\$ 932,135</u> |
| Operating income (loss)                        | \$ 93,058         | \$ 16,298                     | \$ (1,878)                       | \$ 107,478        |
| Other (expense) income, net                    | (1,780)           | 104                           | (333)                            | (2,009)           |
| Earnings (loss) before<br>income tax provision | <u>\$ 91,278</u>  | <u>\$ 16,402</u>              | <u>\$ (2,211)</u>                | <u>\$ 105,469</u> |

Year Ended December 31, 2010

| (Thousands of dollars)                         | <u>Oilfield</u>   | <u>Power<br/>Transmission</u> | <u>Corporate<br/>&amp; Other</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>\$ 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<br>income tax provision | <u>\$ 57,690</u>  | <u>\$ 10,937</u>              | <u>\$ (1,182)</u>                | <u>\$ 67,445</u>  |

# **(16) 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. 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 or accounts receivable as of December 31, 2012, 2011, and 2010.

# **(17) Quarterly Financial Data (Unaudited)**

The following table sets forth unaudited quarterly financial data for 2012 and 2011:

## Quarterly Financial Data (Unaudited)

| (Millions of dollars, except per share data) | First<br>Quarter | Second<br>Quarter | Third<br>Quarter | Fourth<br>Quarter |
|----------------------------------------------|------------------|-------------------|------------------|-------------------|
| <b>2012</b>                                  |                  |                   |                  |                   |
| Sales                                        | \$ 279.5         | \$ 305.6          | \$ 340.3         | \$ 355.8          |
| Gross profit                                 | 67.5             | 76.5              | 79.3             | 86.4              |
| Net earnings                                 | 10.9             | 19.3              | 26.3             | 25.4              |
| Basic earnings per share                     | 0.35             | 0.57              | 0.78             | 0.78              |
| Diluted earnings per share                   | 0.34             | 0.57              | 0.78             | 0.76              |
| <b>2011</b>                                  |                  |                   |                  |                   |
| Sales                                        | \$ 194.4         | \$ 226.8          | \$ 231.7         | \$ 279.3          |
| Gross profit                                 | 46.2             | 57.4              | 53.9             | 69.0              |
| Net earnings                                 | 12.4             | 18.5              | 14.4             | 20.7              |
| Basic earnings per share                     | 0.41             | 0.61              | 0.47             | 0.68              |
| Diluted earnings per share                   | 0.40             | 0.60              | 0.47             | 0.67              |

## **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, 2012, 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.

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

The Company's management 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, 2012. 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, 2012, 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, 2012, has been audited by Deloitte & Touche LLP, an independent registered public accounting firm, as stated in their report which appears in item 8 of this report.

#### **Changes in Internal Control Over Financial Reporting**

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended December 31, 2012, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### **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 Continuing Directors and Director Nominees" in the Company's definitive Proxy Statement for the 2013 Annual Meeting of Shareholders (the "Proxy Statement"), which will be filed within 120 days after December 31, 2012. 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 Continuing Directors and Director Nominees – 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 shareholders the Code of Ethics for Senior Financial Officers of the Company and the Corporate Code of Conduct on its website at [www.lufkin.com](http://www.lufkin.com) or a copy can be obtained by writing to the Corporate 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," "Equity Compensation 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 Shareholder Matters**

The information required by Item 12 related to security ownership of certain beneficial owners and management and related shareholder 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 on Form 10-K and is incorporated in Item 12 of this report by reference.

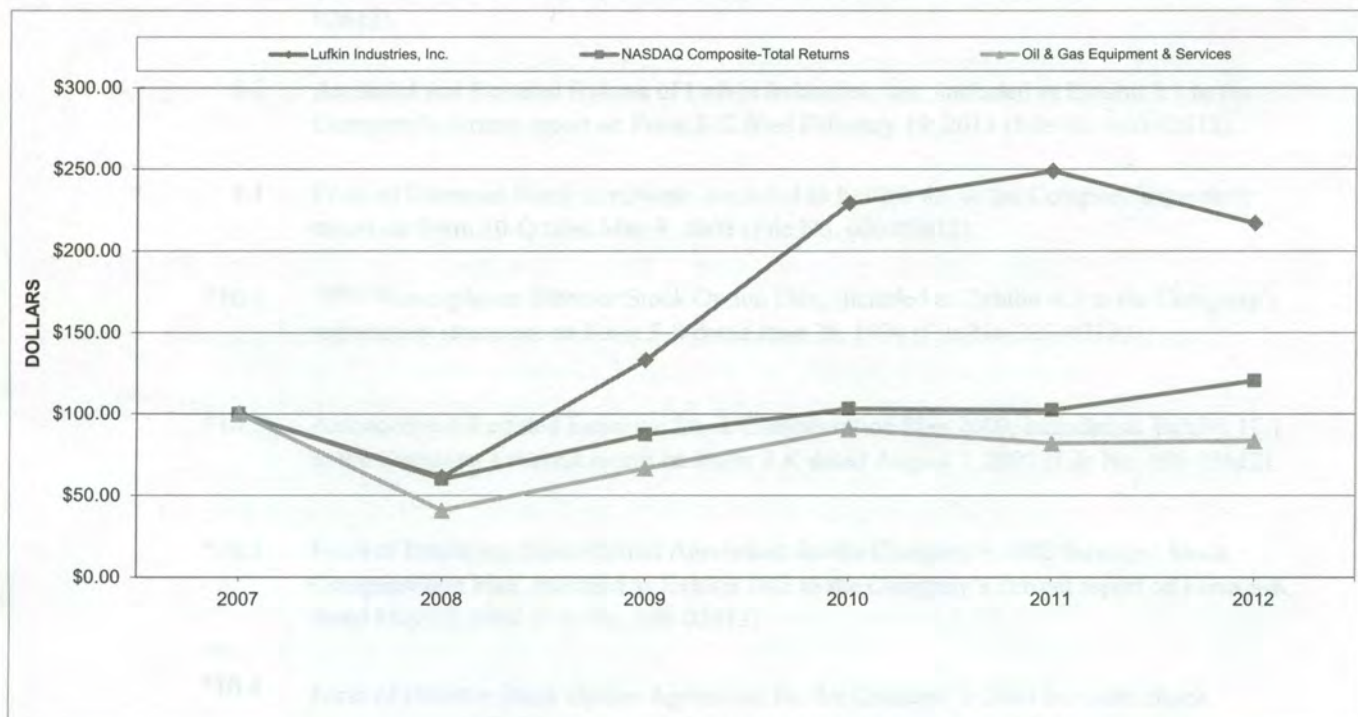
#### **Equity Compensation Plan Information**

The following table sets forth shares of the Company's common stock authorized for issuance under the Company's equity compensation plans at December 31, 2012.

| 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     | 1,625,327                                                                                       | \$43.96                                                                         | 438,223                                                                                                                                     |
| Equity compensation plans not approved by security holders | -                                                                                               | -                                                                               | -                                                                                                                                           |
| Total                                                      | <u>1,625,327</u>                                                                                | \$43.96                                                                         | <u>438,223</u>                                                                                                                              |

As of January 31, 2012, 600,000 shares of common stock were authorized for issuance pursuant to the Company's 1996 Nonemployee Director Stock Option Plan and 5,600,000 shares of common stock were authorized for issuance pursuant to the Company's Incentive Stock Compensation Plan 2000. Each of these plans has been approved by our shareholders. Awards that 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.

The following performance graph compares cumulative, five-year total shareholder return to holders of the Company's common stock with the cumulative total returns of the NASDAQ Market Index and the Morningstar Oil and Gas Equipment and Services, a published industry index of oil and gas equipment/service providers. The graph assumes that the value of the investment in the Company's common stock and each index (including reinvestment of dividends) was \$100 at December 31, 2007 and tracks the return on the investment through December 31, 2012.



The preceding graph shall not be deemed incorporated by reference by any general statement incorporating by reference this annual report on 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.



## 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 Comprehensive Income  
 Consolidated Statements of Shareholders' Equity  
 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 Fifth Amended and Restated Articles of Incorporation of Lufkin Industries, Inc., included as Exhibit 3.1 to the Company's current report on Form 8-K filed May 16, 2012 (File No. 000-02612).

3.2 Amended and Restated Bylaws of Lufkin Industries, Inc., included as Exhibit 3.1 to the Company's current report on Form 8-K filed February 19, 2013 (File No. 000-02612).

4.1 Form of Common Stock Certificate, included as Exhibit 4.1 to the Company's quarterly report on Form 10-Q filed May 9, 2005 (File No. 000-02612).

\*10.1 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).

\*10.2 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 7, 2007 (File No. 000-02612).

\*10.3 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. 000-02612).

\*10.4 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. 000-02612),.

- \*10.5 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. 000-02612).
- \*10.6 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. 000-02612).
- \*10.7 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. 000-02612).
- \*10.8 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. 000-02612).
- \*10.9 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. 000-02612).
- \*10.10 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. 000-02612).
- \*10.11 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. 000-02612).
- \*10.12 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. 000-02612).
- \*10.13 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. 000-02612).
- \*10.14 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. 000-02612).
- \*10.15 Severance Agreement, dated as of May 9, 2011, between Lufkin Industries, Inc. and Alejandro "Alex" Cestero included as Exhibit 10.1 to the Company's current report on Form 8-K filed on May 9, 2011 (File No. 000-02612).

- \*10.16 Severance Agreement, dated as of September 23, 2011, between Lufkin Industries, Inc. and C.D. "Bud" Hay included as Exhibit 10.1 to the Company's current report on Form 8-K filed on September 21, 2011 (File No. 000-02612).[2]
- \*10.17 Amended and Restated Credit Agreement dated as of November 30, 2011, 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 December 13, 2011 (File No. 000-02612).
- 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

The documents listed on the Exhibit Index following the signature pages hereto are filed with this annual report on Form 10-K, and the contents of such Exhibit Index are hereby incorporated herein by reference.

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- 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.

# EXHIBIT 23

## CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement Nos. 33-62021, 333-112890, 333-07129 and 333-145324 on Form S-8 and Registration Statement No. 333-179723 on Form S-3 of our report dated March 1, 2013, relating to the consolidated financial statements and financial statement schedule of Lufkin Industries, Inc., and the effectiveness of Lufkin Industries, Inc.'s internal control over financial reporting appearing in this Annual Report on Form 10-K of Lufkin Industries, Inc. for the year ended December 31, 2012.

/s/Deloitte & Touche LLP

Houston, Texas  
March 1, 2013

|     |                                                 |                   |        |
|-----|-------------------------------------------------|-------------------|--------|
| 1   | Lufkin Industries, Inc.                         | U.S.A. (Delaware) | Parent |
| 2   | Lufkin Industries International Ltd.            | U.S.A. (Delaware) | 100%   |
| 3   | Lufkin Industries Mexico Holdings I, LLC        | U.S.A. (Delaware) | 100%   |
| 4   | Lufkin Industries Mexico Holdings II, LLC       | U.S.A. (Delaware) | 100%   |
| 5   | Lufkin Industries Canada Holdings, LLC          | U.S.A. (Delaware) | 100%   |
| 6   | Lufkin Industries Canada Holdings I, LLC        | U.S.A. (Delaware) | 100%   |
| 7   | Lufkin Industries Canada Holdings II, LLC       | U.S.A. (Delaware) | 100%   |
| 8   | Lufkin Industries Canada Holdings III, LLC      | U.S.A. (Delaware) | 100%   |
| 9   | Lufkin Industries Canada Holdings IV, LLC       | U.S.A. (Delaware) | 100%   |
| 10  | Lufkin Industries Canada Holdings V, LLC        | U.S.A. (Delaware) | 100%   |
| 11  | Lufkin Industries Canada Holdings VI, LLC       | U.S.A. (Delaware) | 100%   |
| 12  | Lufkin Industries Canada Holdings VII, LLC      | U.S.A. (Delaware) | 100%   |
| 13  | Lufkin Industries Canada Holdings VIII, LLC     | U.S.A. (Delaware) | 100%   |
| 14  | Lufkin Industries Canada Holdings IX, LLC       | U.S.A. (Delaware) | 100%   |
| 15  | Lufkin Industries Canada Holdings X, LLC        | U.S.A. (Delaware) | 100%   |
| 16  | Lufkin Industries Canada Holdings XI, LLC       | U.S.A. (Delaware) | 100%   |
| 17  | Lufkin Industries Canada Holdings XII, LLC      | U.S.A. (Delaware) | 100%   |
| 18  | Lufkin Industries Canada Holdings XIII, LLC     | U.S.A. (Delaware) | 100%   |
| 19  | Lufkin Industries Canada Holdings XIV, LLC      | U.S.A. (Delaware) | 100%   |
| 20  | Lufkin Industries Canada Holdings XV, LLC       | U.S.A. (Delaware) | 100%   |
| 21  | Lufkin Industries Canada Holdings XVI, LLC      | U.S.A. (Delaware) | 100%   |
| 22  | Lufkin Industries Canada Holdings XVII, LLC     | U.S.A. (Delaware) | 100%   |
| 23  | Lufkin Industries Canada Holdings XVIII, LLC    | U.S.A. (Delaware) | 100%   |
| 24  | Lufkin Industries Canada Holdings XIX, LLC      | U.S.A. (Delaware) | 100%   |
| 25  | Lufkin Industries Canada Holdings XX, LLC       | U.S.A. (Delaware) | 100%   |
| 26  | Lufkin Industries Canada Holdings XXI, LLC      | U.S.A. (Delaware) | 100%   |
| 27  | Lufkin Industries Canada Holdings XXII, LLC     | U.S.A. (Delaware) | 100%   |
| 28  | Lufkin Industries Canada Holdings XXIII, LLC    | U.S.A. (Delaware) | 100%   |
| 29  | Lufkin Industries Canada Holdings XXIV, LLC     | U.S.A. (Delaware) | 100%   |
| 30  | Lufkin Industries Canada Holdings XXV, LLC      | U.S.A. (Delaware) | 100%   |
| 31  | Lufkin Industries Canada Holdings XXVI, LLC     | U.S.A. (Delaware) | 100%   |
| 32  | Lufkin Industries Canada Holdings XXVII, LLC    | U.S.A. (Delaware) | 100%   |
| 33  | Lufkin Industries Canada Holdings XXVIII, LLC   | U.S.A. (Delaware) | 100%   |
| 34  | Lufkin Industries Canada Holdings XXIX, LLC     | U.S.A. (Delaware) | 100%   |
| 35  | Lufkin Industries Canada Holdings XXX, LLC      | U.S.A. (Delaware) | 100%   |
| 36  | Lufkin Industries Canada Holdings XXXI, LLC     | U.S.A. (Delaware) | 100%   |
| 37  | Lufkin Industries Canada Holdings XXXII, LLC    | U.S.A. (Delaware) | 100%   |
| 38  | Lufkin Industries Canada Holdings XXXIII, LLC   | U.S.A. (Delaware) | 100%   |
| 39  | Lufkin Industries Canada Holdings XXXIV, LLC    | U.S.A. (Delaware) | 100%   |
| 40  | Lufkin Industries Canada Holdings XXXV, LLC     | U.S.A. (Delaware) | 100%   |
| 41  | Lufkin Industries Canada Holdings XXXVI, LLC    | U.S.A. (Delaware) | 100%   |
| 42  | Lufkin Industries Canada Holdings XXXVII, LLC   | U.S.A. (Delaware) | 100%   |
| 43  | Lufkin Industries Canada Holdings XXXVIII, LLC  | U.S.A. (Delaware) | 100%   |
| 44  | Lufkin Industries Canada Holdings XXXIX, LLC    | U.S.A. (Delaware) | 100%   |
| 45  | Lufkin Industries Canada Holdings XL, LLC       | U.S.A. (Delaware) | 100%   |
| 46  | Lufkin Industries Canada Holdings XLI, LLC      | U.S.A. (Delaware) | 100%   |
| 47  | Lufkin Industries Canada Holdings XLII, LLC     | U.S.A. (Delaware) | 100%   |
| 48  | Lufkin Industries Canada Holdings XLIII, LLC    | U.S.A. (Delaware) | 100%   |
| 49  | Lufkin Industries Canada Holdings XLIV, LLC     | U.S.A. (Delaware) | 100%   |
| 50  | Lufkin Industries Canada Holdings XLV, LLC      | U.S.A. (Delaware) | 100%   |
| 51  | Lufkin Industries Canada Holdings XLVI, LLC     | U.S.A. (Delaware) | 100%   |
| 52  | Lufkin Industries Canada Holdings XLVII, LLC    | U.S.A. (Delaware) | 100%   |
| 53  | Lufkin Industries Canada Holdings XLVIII, LLC   | U.S.A. (Delaware) | 100%   |
| 54  | Lufkin Industries Canada Holdings XLIX, LLC     | U.S.A. (Delaware) | 100%   |
| 55  | Lufkin Industries Canada Holdings L, LLC        | U.S.A. (Delaware) | 100%   |
| 56  | Lufkin Industries Canada Holdings LI, LLC       | U.S.A. (Delaware) | 100%   |
| 57  | Lufkin Industries Canada Holdings LII, LLC      | U.S.A. (Delaware) | 100%   |
| 58  | Lufkin Industries Canada Holdings LIII, LLC     | U.S.A. (Delaware) | 100%   |
| 59  | Lufkin Industries Canada Holdings LIV, LLC      | U.S.A. (Delaware) | 100%   |
| 60  | Lufkin Industries Canada Holdings LV, LLC       | U.S.A. (Delaware) | 100%   |
| 61  | Lufkin Industries Canada Holdings LVI, LLC      | U.S.A. (Delaware) | 100%   |
| 62  | Lufkin Industries Canada Holdings LVII, LLC     | U.S.A. (Delaware) | 100%   |
| 63  | Lufkin Industries Canada Holdings LVIII, LLC    | U.S.A. (Delaware) | 100%   |
| 64  | Lufkin Industries Canada Holdings LIX, LLC      | U.S.A. (Delaware) | 100%   |
| 65  | Lufkin Industries Canada Holdings LX, LLC       | U.S.A. (Delaware) | 100%   |
| 66  | Lufkin Industries Canada Holdings LXI, LLC      | U.S.A. (Delaware) | 100%   |
| 67  | Lufkin Industries Canada Holdings LXII, LLC     | U.S.A. (Delaware) | 100%   |
| 68  | Lufkin Industries Canada Holdings LXIII, LLC    | U.S.A. (Delaware) | 100%   |
| 69  | Lufkin Industries Canada Holdings LXIV, LLC     | U.S.A. (Delaware) | 100%   |
| 70  | Lufkin Industries Canada Holdings LXV, LLC      | U.S.A. (Delaware) | 100%   |
| 71  | Lufkin Industries Canada Holdings LXVI, LLC     | U.S.A. (Delaware) | 100%   |
| 72  | Lufkin Industries Canada Holdings LXVII, LLC    | U.S.A. (Delaware) | 100%   |
| 73  | Lufkin Industries Canada Holdings LXVIII, LLC   | U.S.A. (Delaware) | 100%   |
| 74  | Lufkin Industries Canada Holdings LXIX, LLC     | U.S.A. (Delaware) | 100%   |
| 75  | Lufkin Industries Canada Holdings LXX, LLC      | U.S.A. (Delaware) | 100%   |
| 76  | Lufkin Industries Canada Holdings LXXI, LLC     | U.S.A. (Delaware) | 100%   |
| 77  | Lufkin Industries Canada Holdings LXXII, LLC    | U.S.A. (Delaware) | 100%   |
| 78  | Lufkin Industries Canada Holdings LXXIII, LLC   | U.S.A. (Delaware) | 100%   |
| 79  | Lufkin Industries Canada Holdings LXXIV, LLC    | U.S.A. (Delaware) | 100%   |
| 80  | Lufkin Industries Canada Holdings LXXV, LLC     | U.S.A. (Delaware) | 100%   |
| 81  | Lufkin Industries Canada Holdings LXXVI, LLC    | U.S.A. (Delaware) | 100%   |
| 82  | Lufkin Industries Canada Holdings LXXVII, LLC   | U.S.A. (Delaware) | 100%   |
| 83  | Lufkin Industries Canada Holdings LXXVIII, LLC  | U.S.A. (Delaware) | 100%   |
| 84  | Lufkin Industries Canada Holdings LXXIX, LLC    | U.S.A. (Delaware) | 100%   |
| 85  | Lufkin Industries Canada Holdings LXXX, LLC     | U.S.A. (Delaware) | 100%   |
| 86  | Lufkin Industries Canada Holdings LXXXI, LLC    | U.S.A. (Delaware) | 100%   |
| 87  | Lufkin Industries Canada Holdings LXXXII, LLC   | U.S.A. (Delaware) | 100%   |
| 88  | Lufkin Industries Canada Holdings LXXXIII, LLC  | U.S.A. (Delaware) | 100%   |
| 89  | Lufkin Industries Canada Holdings LXXXIV, LLC   | U.S.A. (Delaware) | 100%   |
| 90  | Lufkin Industries Canada Holdings LXXXV, LLC    | U.S.A. (Delaware) | 100%   |
| 91  | Lufkin Industries Canada Holdings LXXXVI, LLC   | U.S.A. (Delaware) | 100%   |
| 92  | Lufkin Industries Canada Holdings LXXXVII, LLC  | U.S.A. (Delaware) | 100%   |
| 93  | Lufkin Industries Canada Holdings LXXXVIII, LLC | U.S.A. (Delaware) | 100%   |
| 94  | Lufkin Industries Canada Holdings LXXXIX, LLC   | U.S.A. (Delaware) | 100%   |
| 95  | Lufkin Industries Canada Holdings LXXXX, LLC    | U.S.A. (Delaware) | 100%   |
| 96  | Lufkin Industries Canada Holdings LXXXXI, LLC   | U.S.A. (Delaware) | 100%   |
| 97  | Lufkin Industries Canada Holdings LXXXXII, LLC  | U.S.A. (Delaware) | 100%   |
| 98  | Lufkin Industries Canada Holdings LXXXXIII, LLC | U.S.A. (Delaware) | 100%   |
| 99  | Lufkin Industries Canada Holdings LXXXXIV, LLC  | U.S.A. (Delaware) | 100%   |
| 100 | Lufkin Industries Canada Holdings LXXXXV, LLC   | U.S.A. (Delaware) | 100%   |

## EXHIBIT 31.1

### CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, John F. Glick, certify that:

1. I have reviewed this Annual Report on Form 10-K of Lufkin Industries, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 1, 2013

/s/ John F. Glick

John F. Glick

Chief Executive Officer

**EXHIBIT 32.2**

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Lufkin Industries, Inc. (the "Company") on Form 10-K for the period ended December 31, 2012, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Christopher L. Boone, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Christopher L. Boone

Christopher L. Boone  
Chief Financial Officer  
March 1, 2013

This certification is made solely for the purpose of 18 U.S.C. §1350, and not for any other purpose.

## Corporate Information

### CORPORATE OFFICERS

**John F. Glick**

President  
Chief Executive Officer

**Mark E. Crews**

Senior Vice President, General Manager—  
Oilfield Division

**Christopher L. Boone**

Vice President, Chief Financial Officer

**Alejandro Cestero**

Vice President, General Counsel,  
Corporate Secretary

**Brian J. Gifford**

Vice President of Human Resources

**Claude D. Hay**

Vice President, General Manager—  
Power Transmission Division

**Scott H. Semlinger**

Vice President, Manufacturing Technology

### CORPORATE OFFICE

Lufkin Industries, Inc.  
P.O. Box 849  
Lufkin, TX 75902-0849  
936-634-2211

### ANNUAL MEETING

The Annual Meeting of Shareholders of Lufkin Industries, Inc. will be held at the Crown Colony Country Club, 900 Crown Colony Drive, Lufkin, TX on May 1, 2013, at 9:00 a.m. CDT.

### WORLD WIDE WEB

For information on Lufkin Industries, Inc.'s products and services, and the latest industry news visit [www.lufkin.com](http://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 SUPPORT

Dennard • Lascar Associates, LLC  
1800 West Loop South, Suite 200  
Houston, TX 77056  
713-529-6600



**Lufkin Industries, Inc.**

P.O. Box 849

Lufkin, TX 75902-0849

936.634.2211

[www.lufkin.com](http://www.lufkin.com)