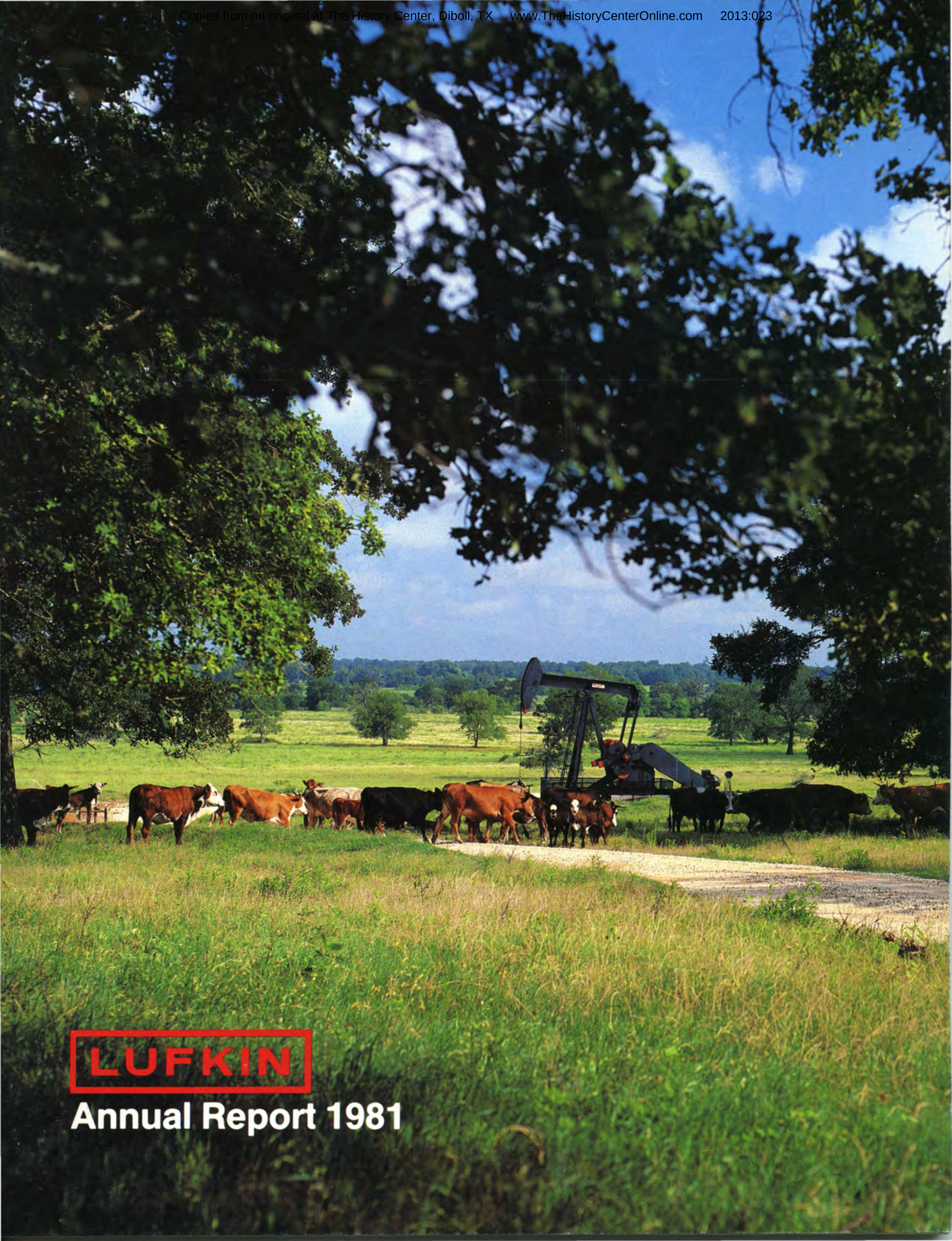


LUFKIN
Annual Report 1981


LUFKIN

Financial Highlights

(In thousands of dollars, except per share data)

Year ended December 31	**1981**	1980	1979	1978	1977
Net sales	**$364,443**	$273,936	$206,386	$173,266	$147,916
Net earnings	**62,697**	40,682	26,414	19,052	22,568
Net earnings per share	**36.02**	23.37	15.17	10.94	12.96
Total assets	**247,478**	186,085	142,457	124,384	112,459
Long-term debt	**3,500**	4,000	4,500	5,000	5,500
Cash dividends per share	**9.00**	6.50	5.50	5.25	5.00
Book value per share	**109.88**	82.87	65.99	56.32	50.63

COVERS:
FRONT: A LUFKIN conventional pumping unit works in harmony with grazing white-face herefords in this pastoral scene near Bryan-College Station, Texas.
OPPOSITE: In this field near Fellows, California, LUFKIN's Mark II Unitorque units are working as far as the eye can see.

Despite a depressed national economy, 1981 was a record year for Lufkin Industries in sales, earnings and growth. Net sales were $364,443,000 in 1981, up 33 per cent over net sales of $273,936,000 in 1980. Net earnings in 1981 were $62,697,000, up 54 per cent over net earnings of $40,682,000 in 1980. Total assets reached $247,478,000 in 1981, compared to $186,085,000 in 1980, a 33 per cent increase.

Dividends in 1981 were $9.00 per share compared to $6.50 per share in 1980. Shareholders' equity reached $191,277,000 in 1981, a 33 per cent increase over $144,246,000 in 1980. Book value of the company's stock increased 33 per cent to $109.88 in 1981, compared to $82.87 in 1980. While sales for all three divisions increased 33 per cent, selling, general administrative expenses increased only 17 per cent in 1981.

There are many reasons for such a good report. One important reason was extraordinarily dedicated employees —both in the shops and in the offices. Two other reasons were the continued demand for our products and the efforts of the personnel in all three Divisions. Added to the foregoing was greater interest income on a larger holding of temporary investments and marketable securities with higher yields during 1981.

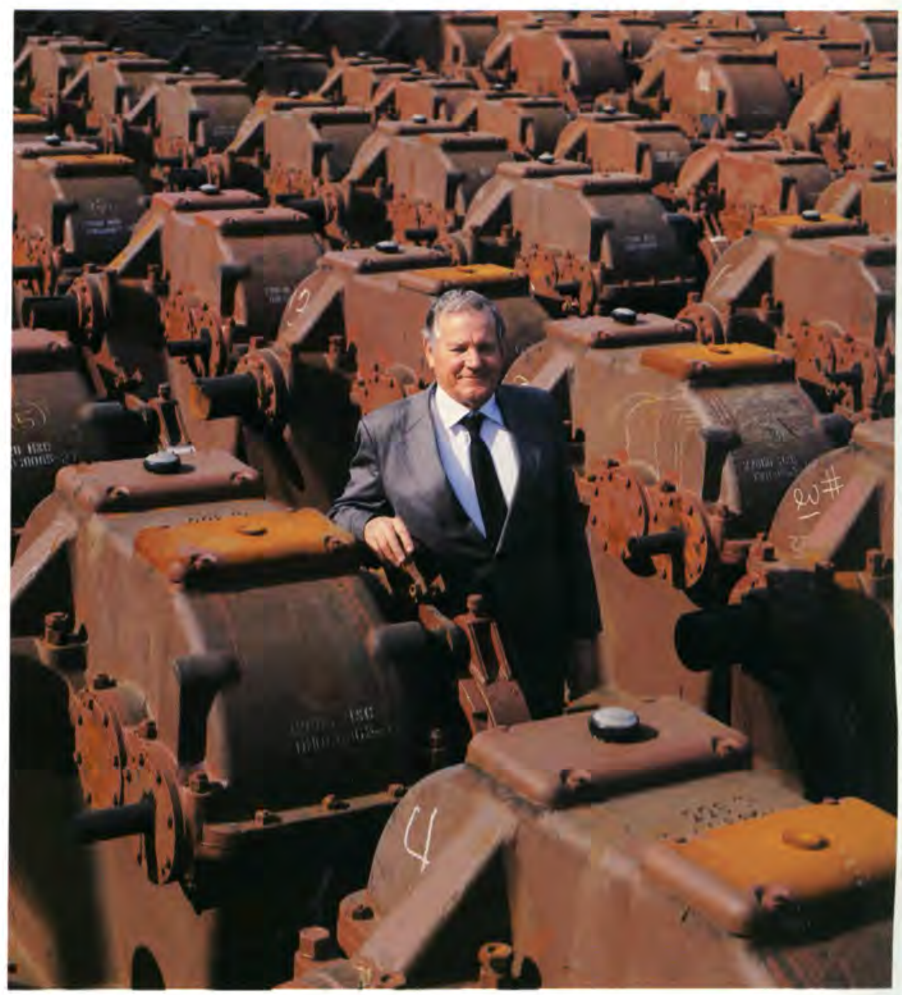
During 1981, the Machinery Division manufactured and shipped about 8800 pumping units, some 1180 units more than in 1980. These shipments included some 2150 structures and parts produced in the Trailer Division. The Machinery Division also built and shipped 750 industrial and marine gear units.

The Trailer Division produced almost 2100 trailers in 1981, in addition to its pumping unit production. This represented an increase of some 500 trailers over the 1600 built in 1980. These increases were attained although the trucking industry nationwide was undergoing a second recessive year.

The Industrial Supplies Division had net sales of $7,198,000 in 1981. This was down slightly from net sales of $7,377,000 in 1980; however, operating income for this Division was up over 1980, from $522,000 to $585,000 in 1981. The reduction in net sales can be attributed primarily to weaker economic conditions of the customers it serves, whereas the increase in operating income in 1981 is attributed to price increases and more efficient operations.

Capital investments in 1981 totaled $33,683,000. This compares to $19,894,000 in 1980, a 69 per cent increase. Substantial portions of these expenditures were for a $7.5 million industrial and marine gear manufacturing facility, a $3.5 million melting system for foundry operations, a $7 million steel fabricating, final assembly and shipping plant and a $2 million corporate office building. Significant capital expenditures also were for highly sophisticated machine tools to keep our manufacturing facilities as modern as the state of the art permits in order to continue our goal of the highest quality products at the most competitive prices.

Some of our major accomplishments during 1981 include the move-in and start-up of production of industrial and



marine gears in a new manufacturing facility. This $7.5 million expansion was the company's commitment to a two-factory concept in which our production of gear units was separated from our production of oilfield pumping units. In addition to the installation of some $5 million in production machine tools for this plant, a sophisticated gear testing facility for enclosed gearing was installed in the center of this 57,600-square-foot building. When planning the new testing center, the company's primary objective was to develop an enclosed gear testing area that could perform even the most complicated high-speed precision gearing tests. Such test results are documented to meet American Petroleum Institute standards or the strictest customer specifications.

Another milestone begun in 1981 and to be completed in 1982 was the building of a new steel fabricating and final assembly facilities with increased loading docks for shipment of our pumping units. These facilities are located on part of a 400-acre tract of land owned by the company southeast of Lufkin. These new buildings are adjacent to our trailer manufacturing plant, and will house automated production tools for the manufacture of structures for our standard crank-balanced pumping units. Production of structures for the air-balanced and Mark II Unitorque pumping units will continue in the present structural plant at the downtown location.

A new gearbox machining building was completed in 1981. Installed in this building are numerically-controlled machining centers that can machine as many as 4000 average-sized gear reducers per year.

Continuing improvements were made in the company's foundry operations. A new $3.5 million melting system was put in operation during 1981, increasing our melting production from 25 to 35 tons per hour, with the capability to produce up to 50 tons per hour in the future. Its pollution control system more than meets state and federal codes.

The above accomplishments are only some of the many attained by your company during 1981. More detailed reports are listed in the following pages.

Suffice it to say that Lufkin Industries has enjoyed a most successful year. Perhaps some of you read the article in the February 23, 1981, issue of FORTUNE magazine. It was, on the whole, complimentary, we think. And undoubtedly, the company received publicity of inestimable value. Several hundred copies of the reprint have been requested by our sales force for distribution to our customers.

The number of employees increased by 600 in 1981, with more than 4200 employed by year's end.

Exciting activities are planned for 1982. New goals for production have been set. We hope to move into our new corporate headquarters sometime in the second quarter. We will be observing our 80th anniversary with the publishing of a definitive history of our company, an open house will be held for the public to visit our manufacturing facilities, and the publishing of a special calendar with artist E. M. (Buck) Schiwetz' paintings as our participation in the celebration of the City of Lufkin's Centennial.

Our production goals for 1982 are ambitious but not unattainable, particularly with the continuing dedication and support of our employees and loyalty of our customers.

R. L. Poland
President and Chief Executive

This special accuracy 120-inch gear hobbing machine features high speed roughing with a carbide gashing tool and precision finish hobbing.

Machinery Division

This gear-tooth checker, a capital investment in 1981, is an extremely precise machine used for industrial and marine gear quality assurance.

Used in high-speed, automated production of pumping unit gear housings, this horizontal machining center does all machining required on pumping unit gearboxes. Prior to this 1981 capital investment, the many machining processes were accomplished on several different machines.

The Machinery Division accounted for $327,157,000 of the company's 1981 net sales, a 35 per cent increase over 1980 net sales for this Division. Pumping units and related oilfield equipment sales increased 36 per cent, and gear products sales increased 33 per cent in 1981.

This Division was responsible for 90 per cent of the company's sales and 98 per cent of its operating income in 1981.

The Machinery Division is comprised of the manufacturing facilities for oilfield pumping units and industrial and marine propulsion gears. Major segments of these manufacturing facilities are the machining and assembling operations, the foundry operations and the steel fabricating, final assembly and shipping operations.

Machining and Assembling Operations

The machining operations were affected dramatically during 1981 with the physical separation of pumping unit and industrial and marine gear manufacturing. With the completion of a new gear manufacturing complex, highly sophisticated, new and specialized machinery was purchased representing a capital investment of $5,000,000. These tools allow the company to offer

A $3.2 million melting system was installed in the foundry operations in 1981, increasing the main bay foundry's melting capacity from 25 to 35 tons per hours, and with the added capability of melting 50 tons of iron per hour in the future. It exceeds state and federal air quality codes.

Plans were approved and construction was scheduled to begin on a new large castings foundry in January, 1982, as the company continues projects to reduce the number of castings purchased from outside sources. In 1981, almost half the company's castings requirements were purchased elsewhere.

heavy, low-speed gearing and precision, high-speed gearing at lower costs.

With the addition of the new machines, the company entered into hardened and ground gearing markets, as well as improved its existing product line in both accuracy and productivity.

In a climate-controlled area for inspection of industrial gears, a testing lab was built and outfitted with the state of the art inspection equipment for enclosed gearing.

In the pumping unit areas of machining operations, a record number of parts were produced for shipment in 1981, including 9163 pumping unit gearboxes and 8800 pumping units shipped. During the year, capital investments of some $6,000,000 were made in this area for new production machines.

A new pumping unit gearbox machining area was completed in the fourth quarter of 1981, in which numerically-controlled machining centers were installed and additional ones will be added in 1982, so that 4000 average-sized speed reducers can be built in this area per year.

Plans for 1982 include the installation of new gear shaper machines in other machining areas which will provide increased gear cutting capacity for pumping unit reducers.

The engineering department, charged with the responsibility of product design for the Machinery Division, has during the past two years redesigned the company's high-speed increaser and reducer lines to effect higher horsepower ratings. In 1982, this department plans to redesign the marine gear line and introduce a line of hardened and ground gearing.

Also during 1980-1981, a review was made of the entire oilfield pumping unit line to improve

This data display panel is part of new testing facilities for both high-speed and low-speed precision gearing. It is one of the major installations in the recently completed gear manufacturing complex.

A new $7 million plant for structural fabrication, final assembly and shipping operations was built in 1981. Full production in this plant is scheduled for mid-1982.

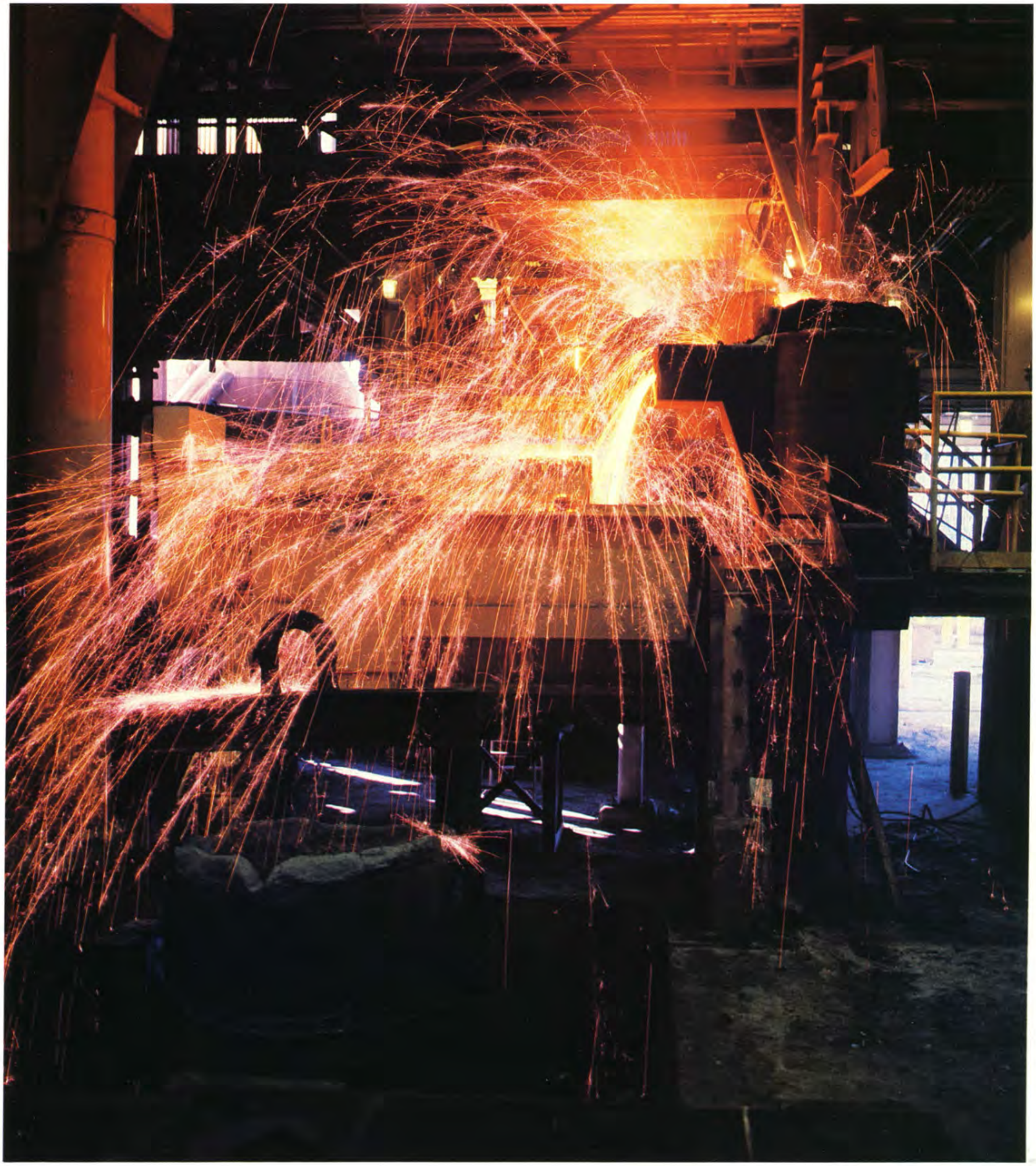
The new structural steel fabrication plant houses the optimum in welding equipment, including a computer actuated plasma arc shape burning machine (left) and a state-of-the-art torch cutting machine (below).

effectiveness of operation and ease of manufacture without sacrificing quality or safety to personnel. This included review of gear tooth design, bearing design and all aspects of structural design.

A new product design tool was added to the engineering department in April, 1981. It is a CAD/CAM (Computer-Aided-Design/Computer-Aided-Manufacturing) system which enables designers to make engineering drawings by a computer and electrostatic printer.

Foundry Operations

One of the major accomplishments of this area of the Machinery Division was the completion of a $3.5 million melting system. Considered to be one of the finest in the country, the new system's cupola increased the melting capacity from 25 to 35 tons per hour, and has the further capability to produce up to 50 tons per hour in the future. Its pollution control system is the largest of its type ever installed on a cupola and when it is completely operational, it will be 99 per cent efficient in removing pollutants from the air.



Continuing capital investments in the foundry operations bring the company nearer to furnishing all its castings requirements.

(Left) In 1981, the company began separation of its pumping unit and gear manufacturing areas when the $7.5 million industrial and marine gear facility was completed. The two-factory concept improves productivity and scheduling, while new production machinery assures more quality gearing.

(Top) A precision gear grinder added new dimensions to LUFKIN's gear manufacturing capabilities. (Below) Standing sentinel at the entrance to the World Oil and Gas Show in Dallas in December, 1981, was Rudolph, the Red-Nosed Reindeer, alias LUFKIN's Mark II, outfitted with a special coat of paint and Christmas lights twinkling as it bobbed up and down against the Dallas skyline.

During 1981, the company continued to purchase almost half of its needs for castings from outside sources. However, continued renovation and modernization projects will in time eliminate this necessity.

Conversion of the counterweight foundry to a pumping unit gear foundry was begun in late 1981. Plans were approved and construction scheduled to begin in January, 1982 on a new foundry for the manufacture of large castings. With its completion in the next two years, the company's requirements for castings should be internally produced and outside castings purchases eliminated.

Steel Fabrication, Final Assembly and Shipping Operations

Structural fabrication, final assembly and shipping operations began its move in 1981 into a new $7 million plant built on a portion of the company's 400-acre tract of land located seven miles southeast of Lufkin. Manufacturing in this plant will be confined for some time to the conventional crank pumping units while production of the air-balanced and Mark II units will continue at the present facilities. Full production in the new facilities is slated for second or early third quarter, 1982.

This plant is equipped with modern, automated production tools. With the transition to the new plant production will be enhanced significantly in fabricating, assembling and shipping pumping units.

A new aluminum dump trailer was marketed in 1981, offering customers more fuel economy with heavier payloads.

Trailer Division

Although the trucking industry nationally was down during 1981, the company's Trailer Division had a good year by virtue of its involvement in pumping unit production as well as building trailers.

Sales of trailers in 1981 totaled slightly more than $30,000,000, an increase of more than $5,000,000 over sales in 1980. This Division built more than 2000 trailers and fabricated structural parts and assembled some 2100 pumping units.

A new aluminum dump trailer designed by the Trailer Division's engineering department was marketed in 1981. The lighter dump offered customers more fuel economy with heavier payloads. Sales continued on the fiberglass reinforced van which was introduced in 1980.

Employment in the Trailer Division increased by 14 per cent in 1981 compared to 1980. More than 520 persons were employed with some 415 in the manufacturing plant and about 105 in the nine sales and service branches throughout Texas, Louisiana, Georgia, Oklahoma and Tennessee. About 50 per cent of manufacturing employees work in pumping unit production and 50 per cent in trailer production.

A new sales and service branch was opened in Houston, and the New Orleans branch was remodeled during 1981.

Plans call for the remodeling of the Memphis, Tennessee, branch in 1982.

Although 1981 was almost a carbon copy of 1980 for the Trailer Division, projections are for the trucking industry to improve for the next three years. It is expected that this segment of the company's business will increase accordingly.

The company designs, manufactures, sells and services a variety of van (middle) and flatbed (top, left) trailers in lengths up to 50 feet and capacities up to 60,000 pounds in vans and 75,000 pounds in flatbeds. During 1981, this Division fabricated structural parts and assembled (above) some 2100 pumping units.

Occupying new quarters in 1981, the Industrial Supplies Division increased its operating income although its sales volume decreased due to the general economy of its customers.

Industrial Supplies Division

Warehousing facilities (left) at the new location of the Industrial Supplies Division enhanced its operations. Due to the housing economy in general, sales of plumbing fixtures (below) were depressed.

The Industrial Supplies Division was in new quarters in 1981, having moved to the 14.5-acre site west of the manufacturing plant in December, 1980.

Sales decreased by two per cent in 1981, as they did in 1980. However, about 60 per cent of the custom line of automotive parts was dropped when the move was made. This Division was able to increase its operating income in 1981 even though its sales volume decreased. This was due in part to more efficient operations.

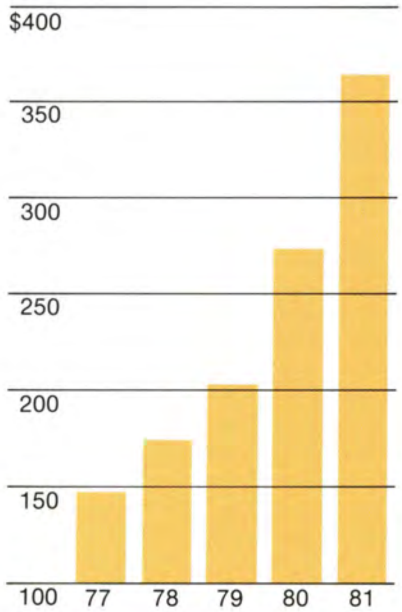
The new location offered ample parking space, a convenient pick-up department and better loading facilities for pipe and bulky items, in addition to greatly increased warehousing.

Due to the housing economy in general, sales of plumbing fixtures were depressed as were sales of knives and saws to the lumber manufacturing industries.

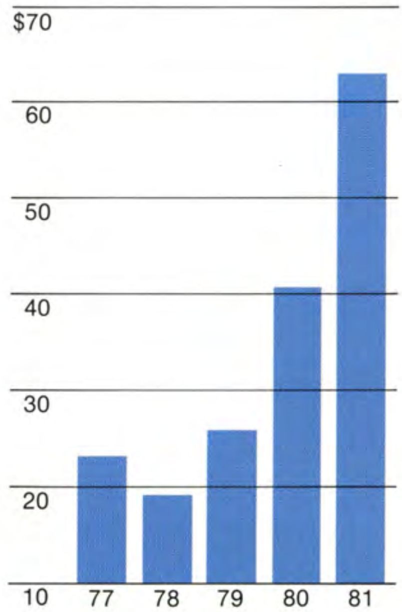
About 40 per cent of the sales of the Industrial Supplies Division go to other areas of Lufkin Industries. The company's numerous expansion programs contributed heavily to this Division's sales during 1981.

Plans for 1982 include expansion of current product lines as well as securing new lines for its wholesale operations.

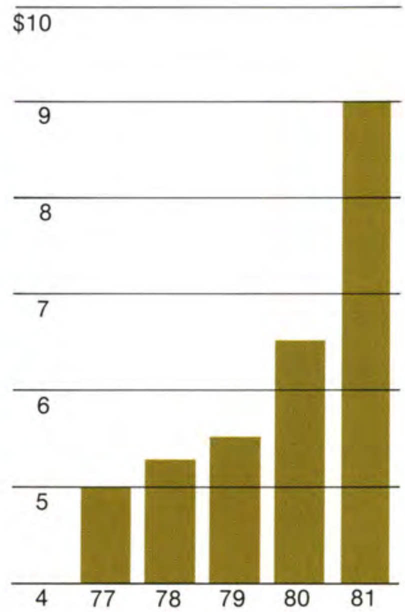
Sales
(in millions)



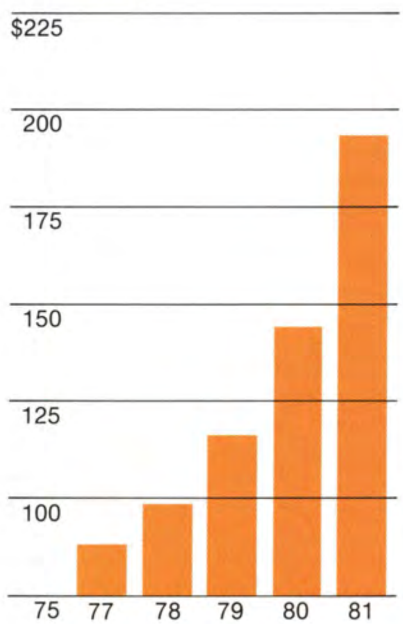
Earnings
(in millions)



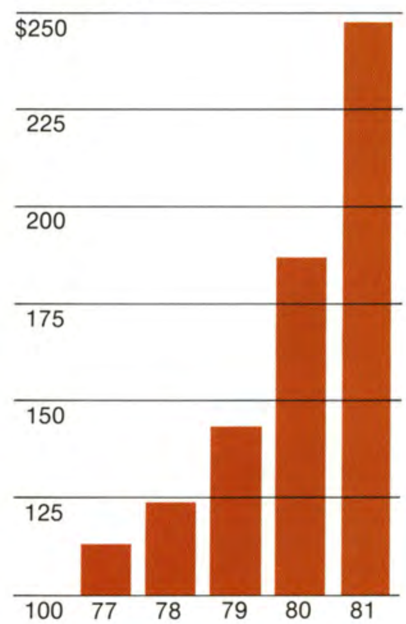
Dividends
(per share)



Stockholders' Equity
(in millions)



Total Assets
(in millions)



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Financial Review and Financial Statements

Financial Review

Description of Business

The Company was incorporated under the laws of Texas on March 4, 1902 and has since that date maintained its principal office and manufacturing facilities in Lufkin, Texas. The Company's operations are divided into three divisions, the Machinery Division, Trailer Division and Industrial Supplies Division, which correspond to the Company's principal industry segments.

Machinery Division

The Company's Machinery Division designs, manufactures, sells, and services various types of oilfield pumping units as well as industrial and marine gears. Lufkin manufactures four basic types of pumping units: an air balanced unit; a beam balanced unit; a crank balanced unit; and a Mark II Unitorque unit. The basic differences between the four types relate to the counterbalancing system. The depth of a well and the desired fluid production determine the type of counterbalancing configuration that is required. There are numerous sizes and combinations of Lufkin oilfield pumping units within the four basic types. The Company's gears (speed increasers and reducers) are designed, manufactured, and sold primarily for use in marine propulsion units and for use in conjunction with machinery in heavy industries such as the steel, rubber, paper and sugar industries. The Company produces numerous sizes and combinations of gears.

The Company manufactures most of the component parts used in its products and purchases the raw materials and outside manufactured parts from a variety of suppliers on an order basis. The inventory of the Machinery Division consists primarily of raw materials and component parts which are generally assembled into finished products to fill specific customer orders. These finished products are sold by the division's own employees directly to the domestic petroleum, manufacturing and shipbuilding industries. The Company has operated its Machinery Division manufacturing facilities at or above the maximum efficient operating capacity for the past five years.

Oilfield pumping units are the Company's primary products sold in export. These sales, other than to Canada, are made principally through foreign sales representatives, licensees and distributors. During 1981, foreign sales accounted for approximately 18 percent of the Company's total net sales. While foreign sales are generally more profitable, they are subject to the risk of fluctuations in foreign import duties and taxes.

The domestic and international markets for the products of the Company's Machinery Division are highly competitive with price, quality and the speed of delivery being important factors. While the Company believes that it is one of the larger manufacturers of sucker rod pumping units in the United States, manufacturers of other types of units (submersibles and hydraulics) have a significant share of the total pumping unit market. The Company does not believe it is a significant factor in the gear market.

Trailer Division

The Company designs, manufactures, sells and services a variety of van, flatbed, and dump trailers, ranging in length from 18 to 50 feet and having capacities up to 75,000 pounds in flatbeds, 60,000 pounds in vans, and 30 cubic yards in dump trailers. Manufacturing operations are keyed mainly to specific customer orders.

The Trailer Division is also involved in repairing and selling used trailers which the Company receives in connection with the sale of its new trailers. The Company has trailer sales and service facilities in Atlanta, Georgia; Shreveport, Louisiana; Oklahoma City, Oklahoma; Memphis, Tennessee; and Lufkin, Dallas, San Antonio, Houston and Lubbock, Texas. A trailer sales and parts facility is located in New Orleans, Louisiana.

The Company uses a sales force of approximately 30 employees to distribute its trailers, primarily in the South. The Company also markets trailers through dealers. The Company's trailers are sold to a large number of customers, including trucking concerns operating nationally.

The truck trailer market is extremely competitive and the Company's products compete directly with those of other manufacturers, a number of which are larger and have greater resources than the Company. Price, quality, speed of delivery, and financing are primary competitive factors. The Company does not believe it is a significant factor in the market for truck trailers either in the South or nationally.

Industrial Supplies Division

The Industrial Supplies Division is essentially a wholesale supplier of heavy hardware items, plumbing fixtures, pole line hardware, and miscellaneous industrial items.

The division's sales are made at the Company's facilities in Lufkin and through approximately six traveling salesmen. Sales are primarily in the East Texas area and the division is not a substantial factor in the markets in which it competes.

General Information

Properties. The Company's major manufacturing facilities are located in and near Lufkin and are owned in fee.

Machinery Division—The Machinery Division is located on approximately 100 acres and includes a foundry, machine shops, structural shops, assembly shops and warehouses. In addition, the Company has a foundry in Little Rock, Arkansas, and a plant in Cushing, Texas, which produce structural parts for pumping units. The production from both the Little Rock and the Cushing facilities is sent to the Lufkin plant for further manufacture.

The Company also has a plant in Nisku, Canada, which produces structural parts for pumping units. These parts are then assembled with parts shipped from Lufkin and are delivered to the Company's Canadian customers.

Trailer Division—The Company's trailer manufacturing facilities are located on a 60-acre portion of a 400-acre tract of land owned in fee by the Company and consist of one large building with a floor area of approximately eight acres. The plant operations are highly automated and consist principally of fabrication, welding and assembly activities.

Industrial Supplies Division—The Industrial Supplies Division has one warehouse which is located in Lufkin and contains approximately 120,000 square feet. A portion of this space is used for administrative operations.

Employees. The Company employs approximately 4,200 people, of whom approximately 3,400 are hourly paid. The Company has an open shop contract with three labor unions, all members of the AFL-CIO, which runs to September 30, 1982. The Company considers employee relations to be satisfactory.

Information on Voting Stock

There is no active market in the Company's common stock. As of February, 1982, the Company had approximately 1,100 record holders of its common stock.

The Company has paid cash dividends for 42 consecutive years. Total dividend payments were $15,666,000 in 1981 and $11,315,000 in 1980.

Quarterly Financial Data

In millions, except earnings per share	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1981				
Net sales	$69.4	$90.0	$93.3	$111.7
Gross income	21.8	31.3	30.9	37.8
Net earnings	10.5	15.6	15.4	21.2
Earnings per share	6.06	8.94	8.84	12.18
Dividends per share	2.00	2.00	2.00	3.00*
1980				
Net sales	$55.2	$67.6	$70.4	$80.7
Gross income	15.8	21.1	21.6	24.6
Net earnings	7.1	9.8	10.2	13.6
Earnings per share	4.09	5.64	5.89	7.75
Dividends per share	1.40	1.50	1.50	2.10

*Dividend distributed on January 4, 1982 to stockholders of record on December 1, 1981.

Additional Financial Information

Stockholders may obtain additional financial information for the year ended December 31, 1981 from the Company's Form 10-K Report filed with the Securities and Exchange Commission. A copy of this report may be obtained by written request to The Secretary, Lufkin Industries, Inc., P. O. Box 849, Lufkin, Texas 75901.

This report is presented for the general information of the stockholders and not in connection with the sale or offer to sell or solicitation of any offer to buy any securities nor is it intended as a representation by the Company of the value of any of its securities.

Business Segment Information

(In thousands of dollars)	1981	1980	1979
Net sales:			
Machinery Division			
Pumping units	**$291,694**	$215,089	$143,732
Gears	**35,463**	26,732	21,016
Trailer Division	**30,088**	24,738	34,110
Industrial Supplies Division	**7,198**	7,377	7,528
Total net sales	**364,443**	273,936	206,386
Operating income:			
Machinery Division	**102,314**	66,331	40,644
Trailer Division	**1,432**	1,337	3,361
Industrial Supplies Division	**585**	522	523
Total operating income	**104,331**	68,190	44,528
Assets:			
Machinery Division	**164,195**	116,623	88,346
Trailer Division	**23,775**	18,597	22,709
Industrial Supplies Division	**5,438**	4,968	4,586
General corporate assets	**54,070**	45,897	26,816
Total assets	**247,478**	186,085	142,457
Capital expenditures:			
Machinery Division	**29,902**	16,628	9,257
Trailer Division	**666**	1,053	488
Industrial Supplies Division	**195**	1,063	78
General corporate	**2,920**	1,150	—
Total capital expenditures	**33,683**	19,894	9,823
Depreciation:			
Machinery Division	**5,067**	3,577	2,908
Trailer Division	**612**	586	526
Industrial Supplies Division	**111**	99	89
General corporate	**281**	169	195
Total depreciation	**6,071**	4,431	3,718
Net sales by geographic region:			
United States	**299,255**	220,065	154,884
Canada	**22,515**	17,148	16,095
Latin America	**34,326**	28,560	22,843
Other regions	**8,347**	8,163	12,564
Total sales	**$364,443**	$273,936	$206,386

Management's Analysis of Operating Results and Financial Condition

Operating Results

The Company continued its record setting with new records in both net sales and net earnings. The results of 1980 had also exceeded 1979 as had 1979's results exceeded 1978.

Revenues

In the Machinery Division, sales increased 35% in 1981 (47% in 1980). Pumping units and related oilfield equipment sales increased 36% in 1981 and 50% in 1980 as a result of both increased volume and prices. In 1981, the number of pumping units shipped was 8,800 as compared to 7,622 in 1980. The demand for the Company's oilfield products continues to exceed its production capacity and the increased production reflected above resulted from enlarged and improved production facilities. Gear products showed an increase in revenue of 33% in 1981 and 27% in 1980, primarily resulting from increased prices.

Trailer Division sales increased 22% in 1981, whereas they decreased 27% in 1980. This increase resulted from an increased demand for these trailer products.

Net sales in the Industrial Supplies Division decreased 2% in 1981 and 2% in 1980. The decrease can be attributed primarily to weaker economic conditions of the customers it serves.

Operating income

The Company's operating income increased 53% in 1981 and 53% in 1980. This resulted primarily because of the increased volume of shipments along with increased gross margins in the Machinery Division. The Company was able during 1981 and 1980 to increase the prices on its oilfield products at a level to offset the increases in its variable costs. With the significant increase in sales volume, the fixed costs per unit were decreased, resulting in the improved operating income. The operating income of the Trailer Division increased as a result of the increased sales volume. The Industrial Supplies Division was able to increase its operating income in 1981 even though its sales volume decreased. This was done by price increases and more efficient operations.

While sales increased 33% for all three divisions, selling, general and administrative expenses increased only 17% in 1981. Other income (expense) increased from $5,284,000 in 1980 to $7,457,000 in 1981, a 41% increase. Most of this increase was from greater interest income on a larger holding of temporary investments and marketable securities with higher yields during 1981.

Liquidity and Capital Resources

At December 31, 1981, the Company had working capital of $93,993,000 as compared to $76,088,000 at December 31, 1980. In recent years, the expansion of the Company's facilities has been financed with internally generated funds and the Company plans to continue the expansion and improvement of its facilities in this manner.

Consolidated Balance Sheet

December 31, 1981 and 1980

Assets	1981	1980
Current assets:		
Cash	$ 2,716,000	$ 488,000
Temporary investments	23,785,000	23,650,000
Accounts receivable, less allowances of $225,000	54,326,000	43,671,000
Installment notes and contracts receivable, less allowances of $75,000	10,360,000	6,207,000
Inventories:		
Finished goods	5,494,000	4,389,000
Work in process	18,979,000	13,289,000
Raw materials	22,166,000	16,656,000
	46,639,000	34,334,000
Total current assets	137,826,000	108,350,000
Property, plant and equipment:		
Land	5,884,000	4,554,000
Buildings	33,151,000	23,697,000
Machinery and equipment	81,637,000	59,335,000
	120,672,000	87,586,000
Less accumulated depreciation	33,734,000	28,260,000
	86,938,000	59,326,000
Investments in marketable securities	22,498,000	18,045,000
Other assets	216,000	364,000
	$247,478,000	$186,085,000

See notes to consolidated financial statements.

Liabilities and Stockholders' Equity	**1981**	1980
Current liabilities:		
Current portion of long-term debt	**$ 500,000**	$ 500,000
Accounts payable	**13,001,000**	8,374,000
Accrued liabilities:		
Payrolls	**1,156,000**	2,008,000
Contributions to pension plans	**4,521,000**	3,769,000
Taxes	**19,433,000**	17,562,000
Dividends declared	**5,222,000**	—
Other accrued liabilities	**—**	49,000
Total current liabilities	**43,833,000**	32,262,000
Long-term debt, net of current portion	**3,000,000**	3,500,000
Deferred income taxes	**9,368,000**	6,077,000
Stockholders' equity:		
Common stock, par $1 per share; 2,000,000 shares authorized; 1,740,730 shares outstanding	**1,741,000**	1,741,000
Capital in excess of par	**15,750,000**	15,750,000
Retained earnings	**173,786,000**	126,755,000
Total stockholders' equity	**191,277,000**	144,246,000
	$247,478,000	$186,085,000

Consolidated Statements of Earnings & Retained Earnings

Years ended December 31, 1981, 1980 and 1979

	1981	1980	1979
Earnings			
Net sales	**$364,443,000**	$273,936,000	$206,386,000
Cost of sales	**242,647,000**	190,815,000	148,119,000
Gross income	**121,796,000**	83,121,000	58,267,000
Selling, general and administrative expenses	**17,465,000**	14,931,000	13,739,000
Operating income	**104,331,000**	68,190,000	44,528,000
Other income (expense):			
Interest income	**7,837,000**	4,933,000	2,528,000
Interest expense	**(283,000)**	(290,000)	(368,000)
Other, net	**(97,000)**	641,000	71,000
Earnings before income taxes	**111,788,000**	73,474,000	46,759,000
Provision for income taxes:			
Current	**45,800,000**	32,000,000	19,203,000
Deferred	**3,291,000**	792,000	1,142,000
	49,091,000	32,792,000	20,345,000
Net earnings	**$ 62,697,000**	$ 40,682,000	$ 26,414,000
Earnings per share	**$36.02**	$23.37	$15.17
Retained Earnings			
Retained earnings, beginning of year	**$126,755,000**	$ 97,388,000	$ 80,548,000
Net earnings	**62,697,000**	40,682,000	26,414,000
Cash dividends	**(15,666,000)**	(11,315,000)	(9,574,000)
Retained earnings, end of year	**$173,786,000**	$126,755,000	$ 97,388,000

See notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

Years ended December 31, 1981, 1980 and 1979

	1981	1980	1979
Source of funds:			
From operations:			
Net earnings	**$ 62,697,000**	$ 40,682,000	$ 26,414,000
Expenses not currently requiring outlay of working capital:			
Depreciation	**6,071,000**	4,431,000	3,718,000
Deferred income taxes	**3,291,000**	792,000	1,142,000
Funds generated from operations	**72,059,000**	45,905,000	31,274,000
Decrease (increase) in marketable securities and other assets	**(4,305,000)**	(471,000)	3,087,000
Total funds provided	**67,754,000**	45,434,000	34,361,000
Use of funds:			
Net additions to property, plant and equipment	**33,683,000**	19,894,000	9,823,000
Dividends	**15,666,000**	11,315,000	9,574,000
Reduction in long-term debt	**500,000**	500,000	500,000
Total funds used	**49,849,000**	31,709,000	19,897,000
Increase in working capital	**$ 17,905,000**	$ 13,725,000	$ 14,464,000
Working capital increase (decrease) resulted from changes in:			
Cash	**$ 2,228,000**	$ (2,456,000)	$ 1,782,000
Temporary investments	**135,000**	21,150,000	(150,000)
Accounts receivable	**10,655,000**	6,965,000	11,450,000
Installment notes and contracts receivable	**4,153,000**	(868,000)	(216,000)
Inventories	**12,305,000**	2,903,000	2,189,000
Accounts payable	**(4,627,000)**	(3,288,000)	3,408,000
Accrued liabilities	**(6,944,000)**	(10,681,000)	(3,999,000)
Increase in working capital	**$ 17,905,000**	$ 13,725,000	$ 14,464,000

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(1) Summary of major accounting policies

Principles of consolidation: The consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of all significant intercompany accounts and transactions.

Temporary investments and investments in marketable securities: In the accompanying balance sheet, temporary investments are carried at cost, which approximates market. The investment in marketable securities consisting of corporate bonds, government securities and common stock are carried at cost and had a market value of $18,629,000 and $14,320,000 at December 31, 1981 and 1980, respectively. In management's opinion, there is no permanent impairment in value and there is no present intention to liquidate these securities at less than cost.

Installment notes and contracts receivable: A portion of the Company's sales is made on notes and conditional sales contracts which are payable on an installment basis over a period generally from three to five years. The profit from such sales is included in income at the time of sale for financial reporting purposes; however, for tax purposes such profit is recognized as installments are collected. The amounts due after one year ($7,976,000 at December 31, 1981 and $4,222,000 at December 31, 1980) are included in current assets in accordance with trade practice.

Inventories: The Company uses the last-in, first-out (LIFO) method of determining inventory cost, which does not exceed market, for substantially all inventories. Under FIFO and average cost methods, inventories would have been $43,904,000, $31,936,000 and $23,274,000 higher at December 31, 1981, 1980 and 1979, respectively. Inventory costs include material, labor and factory overhead.

Property, plant and equipment: The Company records investments in these assets at cost. Improvements are capitalized, while repair and maintenance costs are charged to operations as incurred. Gains or losses realized on the sale or retirement of these assets are reflected in income.

The Company uses the straight-line depreciation method for financial reporting and accelerated methods for tax purposes.

Income taxes: The Company provides for United States taxes that may ultimately be payable on all undistributed foreign earnings and on undistributed earnings of its DISC subsidiary. Provision is also made in the financial statements for the deferred taxes applicable to depreciation, income on installment notes and contracts receivable and other timing differences between financial and tax reporting methods. Current recognition is given in the statement of earnings to tax benefits resulting from the utilization of investment tax credits. A reconciliation of provision for income taxes to the United States tax rate of 46% of earnings before income taxes is as follows:

	(In thousands)		
	1981	1980	1979
Taxes computed at statutory rate	**$51,422**	$33,798	$21,509
Investment tax credits	**(2,129)**	(925)	(870)
Other, net	**(202)**	(81)	(294)
Actual provision	**$49,091**	$32,792	$20,345

(2) Long-term debt

The long-term debt at December 31, 1981 is payable $250,000 semi-annually through 1987 and bears interest at 6.7 percent. The Company is in compliance with the covenants of its debt agreements and does not believe that the covenants will have any adverse effect on future operations.

(3) Retirement plans

The Company and its subsidiaries have retirement plans covering substantially all employees. The total unfunded prior service cost at January 1, 1981, the date of the latest actuarial valuation, was estimated to be $13,393,000. The total pension expense was $4,538,000 in 1981, $3,769,000 in 1980, and $3,260,000 in 1979 including amortization of prior service costs principally over a 10-year period. The amount provided each year for pension expense is paid into pension trust funds.

A comparison of accumulated plan benefits and plan net assets for the plans are presented below:

(In thousands) January 1	**1981**	1980
Actuarial present value of accumulated plan benefits		
Vested	**$24,864**	$21,178
Nonvested	**2,404**	1,881
	$27,268	$23,059
Net assets available for benefits	**$29,557**	$24,359
Assumed rates of return used in determining the actuarial present values of accumulated plan benefits	**4.5%**	4.5%

(4) Supplementary income statement information

The following costs and expenses were charged to income during 1981, 1980, and 1979:

(In thousands)	**1981**	1980	1979
Maintenance and repairs	**$14,527**	$11,576	$7,486
Depreciation	**6,071**	4,431	3,718

(5) Business segment information

Information concerning the Company's various business segments is included on Page 20 of this report.

Report of Independent Public Accountants

To the Stockholders of Lufkin Industries, Inc.

We have examined the consolidated balance sheet of Lufkin Industries, Inc. (a Texas corporation), and subsidiaries as of December 31, 1981 and 1980 and the related consolidated statements of earnings, retained earnings and changes in financial position for each of the three years in the period ended December 31, 1981. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of Lufkin Industries, Inc., and subsidiaries as of December 31, 1981 and 1980, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1981, in conformity with generally accepted accounting principles applied on a consistent basis.

ARTHUR ANDERSEN & CO.

Houston, Texas
February 12, 1982

Directors and Officers

Board of Directors

*S.W. Henderson, Jr.
S.W. Henderson, III
J.G. Kurth
*M.E. Kurth, Jr.
*L.A. Little
W.T. Little
*R.L. Poland
H.J. Trout, Jr.
*W.W. Trout, Jr.
*J.L. Wiener
J.L. Wiener, Jr.
Samson Wiener

*Member Executive Committee

Officers

R.L. Poland
President, Chief Executive

R.E. Barr
Executive Vice President

F.B. Stevenson
Senior Vice President

F.D. Griffin
Vice President

J.C. McKay
Vice President

B.M. Queen
Vice President

W.T. Pennington
Vice President

E.G. Pittman
Vice President

W.W. Trout, Jr.
Vice President

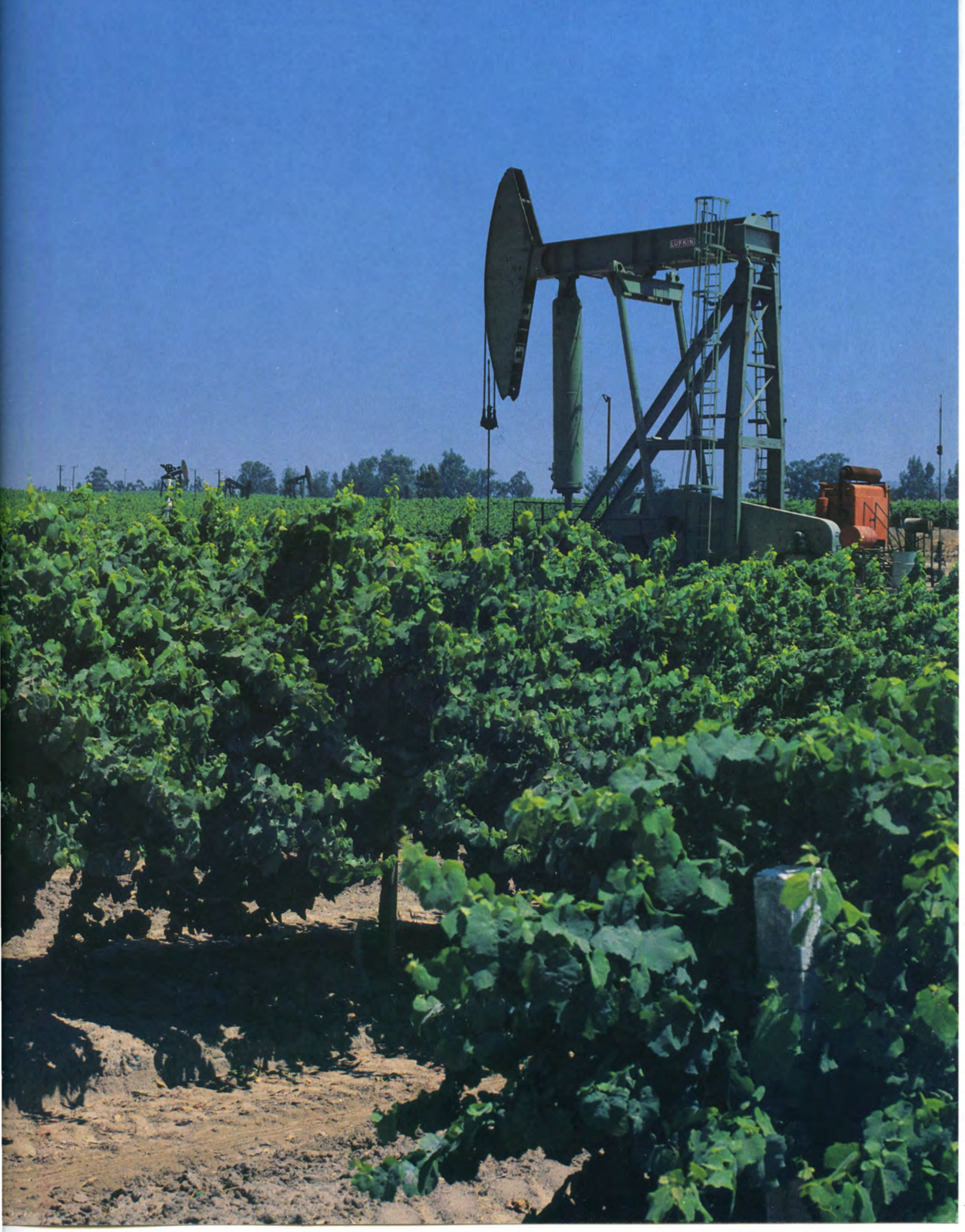
C.J. Haley, Jr.
Secretary-Treasurer

C. Trevathan
Assistant Secretary

J.T. Floyd
Assistant Secretary

J.B. Massingill
Assistant Treasurer

In a California vineyard near Santa Maria, a LUFKIN Air Balanced Unit works obligingly to the tune of environmentalists.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