LUFKIN

LUFKIN INDUSTRIES, INC.
ANNUAL REPORT 2000

CORPORATE PROFILE

C O R P O R A T E P R O F I L E

PROFILE

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

NOTICE OF ANNUAL MEETING

N O T I C E O F A N N U A L M E E T I N G

MEETING

The Annual Meeting of Shareholders of Lufkin Industries, Inc. will be held at the Museum of East Texas, 503 North Second Street, Lufkin, Texas on May 2, 2001, at 9:00 a.m. local time.

FINANCIAL HIGHLIGHTS FINANCIAL HIGHLIGHTS

(Thousands of dollars, except per share amounts)	December 31, 2000	1999
Sales	**$254,603**	$246,000
Operating expenses	**242,473**	246,183
Earnings (loss) before income taxes	**11,242**	(2,013)
Net earnings (loss)	**6,970**	(1,268)
Earnings (loss) per share:		
Basic	**$1.11**	$(0.20)
Diluted	**$1.11**	$(0.20)
Dividends per share	**$0.72**	$ 0.72
Total assets	**235,445**	221,366
Working capital	**45,201**	40,785
Long-term notes payable, net of current portion	**7,043**	9,103
Shareholders' equity	**152,651**	152,409

LUFKIN INDUSTRIES, INC.

LETTER TO SHAREHOLDERS L E T T E R T O S H A R E H O L D E R S

DOUGLAS V. SMITH
President and Chief Executive Officer

I am pleased to report that for the year ended December 31, 2000, Lufkin's financial results showed marked improvement compared with those of a year ago. Strong demand for Lufkin's oil field products and services due to the upturn in oil field activity resulted in increased sales in 2000 and more than offset lower sales in our other divisions. Sales of trailer products turned down sharply, reflecting soft market conditions associated with higher fuel costs and economic uncertainties while sales of our power transmission and foundry products were slightly below those of a year ago--although in line with our expectations for the year.

For 2000, net sales rose to $254.6 million compared with $246.0 million for the year ended December 31, 1999. Oil field products sales were $95.0 million compared with $45.6 million a year ago; trailer products sales were $73.6 million compared with $105.3 million last year; power transmission products sales were $62.9 million compared with sales of $71.5 million a year ago; and foundry products sales were $23.1 million compared with $23.6 million last year.

Net income for the year ended December 31, 2000, increased to $7.0 million, or $1.11 per share (diluted), compared with a net loss of $1.3 million, or $0.20 per share (diluted), a year ago. Results for the year ended December 31, 1999, include a non-recurring charge of $1.4 million after-tax, or $0.21 per share (diluted), related to relocation of facilities, staffing level reductions and unusual legal and warranty expenses incurred during the first quarter. The increase in net income for 2000 reflects higher oil field product sales, better margins, and an improved overall product mix compared with results for the previous year. On a quarterly basis, Lufkin showed sequential improvement in net income in each quarter in 2000.

SALES MIX

Lufkin's backlog at December 31, 2000, totaled $63.6 million compared with $73.6 million at December 31, 1999. The backlog for oil field equipment was $26.4 million compared with $4.0 million last year; the backlog for trailer products was $9.5 million compared with $42.2 million last year; for power transmission, the backlog was $20.8 million compared with $21.4 million at December 31, 1999; and for foundry products, the backlog was $6.9 million compared with $6.0 million a year ago.

In 2000, we continued to focus on those initiatives that improved our operations and strengthened our market position within each of our four divisions. In our oil field products division, we are now realizing some of the benefits from the acquisitions completed in 1998. These acquisitions in the oil and gas industries have expanded the role Lufkin plays in servicing those industries by allowing Lufkin to offer oil field-related products such as oil well automation services and many other technical support services. We believe there is significant opportunity for growth in oil field products in 2001 primarily in the markets of the United States, Canada, the Middle and Far East, and South America.

Historically, Lufkin's trailer operations have been tied to changes in domestic gross national product. Demand for our trailer products in 2000 was adversely affected by the slowing economy. In addition, other factors, such as increased interest rates, decreasing actual freight tonnage, and higher fuel costs, added to the overall weakness. We responded by bringing production and workforce in line with demand. While we have been successful in increasing our market share by targeting new trailer distribution channels and expanding our customer

base, our strategy for the future is to concentrate on expanding share in select market niches and focus on regional opportunities.

The results for power transmission products in 2000 were also negatively affected by slowing economic conditions in the industries that primarily use Lufkin's gear units. We continue to believe the long-term factors affecting demand for Lufkin's gears are positive and that the outlook for 2001 is showing signs of improvement. We are seeing investment in power generation, oil and gas exploration and production, pipeline construction for oil and gas transmission, and petroleum processing pick up--and are optimistic that these trends will continue to build throughout 2001. The products and services we offer position us to compete successfully in these markets as economic conditions improve.

As the demand for our oil field products has increased, the foundry division, which remains the smallest of Lufkin's four divisions, has shifted more of its capacity to meeting this internal need. While our efforts in 2000 were aimed at meeting our expanded internal demands, they are still focused on serving commercial customers, primarily those that have higher value-added engineered casting needs. We currently expect 2001 to be a year where capacity in the foundry division can be fully utilized.

While we are continuing to focus our strategic efforts on improving operational efficiencies, fully integrating acquisitions and capital investment into operations, and adjusting costs to demand levels, Lufkin remains in a very sound financial condition. At December 31, 2000, total assets increased to \$235.4 million, working capital to \$45.2 million, and shareholders' equity to \$152.7 million from levels of last year. At year-end, the book value of our common stock was \$24.57 per share. During 2000, pursuant to Lufkin's stock repurchase plan, the Company repurchased 110,314 shares of its common stock. This brought the total number of shares repurchased by the Company to over 826,000 shares, at an aggregate cost of approximately \$16.9 million. In addition, the Company paid cash dividends of \$0.72 per share in 2000.

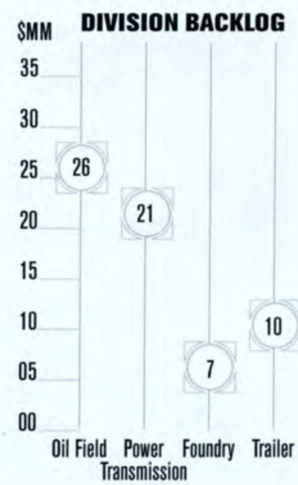
Although our outlook for growth in 2001 is somewhat dependent upon a reasonable price for oil and continued worldwide industrial growth, we are clearly focused on executing the things we do well and believe that there are many opportunities ahead. We anticipate that the successful implementation of our operating strategies and the continued efforts to enhance the competitive position of our four business divisions by a dedicated and loyal workforce position Lufkin to achieve financial improvement in 2001 compared with results achieved last year.

Thank you for your continued confidence, and we appreciate your ongoing interest in Lufkin Industries.

Sincerely,

Douglas V. Smith

Douglas V. Smith
President and Chief Executive Officer

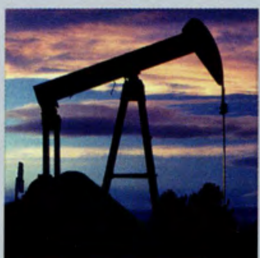


AT A GLANCE

LUFKIN AT A GLANCE

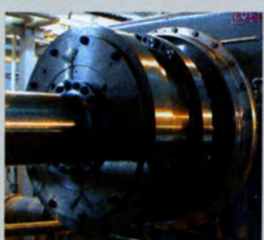
L U F K I N A T A G L A N C E

OIL FIELD EQUIPMENT AND SERVICE



Lufkin is one of the major suppliers worldwide of artificial lift oil field equipment and services. The Company's primary products include the Conventional, Mark II, Mobile, Low Profile and Air Balance beam-pumping units, which are extremely adaptable to meet customers' various production demands. In addition to Lufkin's high quality products, the Company provides a broad array of service including on-site installation, technical support, and automation technology services. The Company maintains a significant presence in all major oil markets.

POWER TRANSMISSION PRODUCTS



As a leading manufacturer of power transmission equipment, Lufkin's products are used in a diversified variety of industrial applications worldwide, including petrochemical, power generation, steel, marine and rubber. The Company's precision-made gears range in weights from 300 pounds to 250 tons, in power levels from 20 to 85,000 horsepower and in size up to 16 feet in diameter. They are primarily parallel shaft, enclosed gear drives precision-designed to meet all performance requirements. Lufkin's ongoing support and service is an important part of new equipment sales as well as in the after-market for installed power transmission equipment.

FOUNDRY PRODUCTS

Lufkin's foundry products include low-to-medium-volume ductile and gray iron castings used as components for numerous Company products as well as original equipment manufacturers. The Company maintains a diversified customer base which includes manufacturers in such industrial sectors as construction equipment, material handling equipment, machine tools, valve and water works, pump and compressor, and automotive and truck.

TRAILERS

Lufkin produces many different sizes and styles of vans; platforms; and high capacity, light-weight dump trailers. The Company's trailers are known for their quality construction, reliability, innovation of design, and competitive price. New products introduced in the last few years have expanded the market for the Company's trailers and provided additional growth opportunities.

QUESTIONS & ANSWERS Q U E S T I O N S & A N S W E R S

L.M. HOES
Vice President/ GM Oil Field and Foundry Divisions

HOW HAS THE STRENGTHENING IN THE OIL FIELD MARKET AFFECTED LUFKIN IN 2000?

Lufkin's service business was strong throughout 2000. As customers began drilling new wells and re-completing existing wells in response to higher oil prices, Lufkin experienced increased demand for repair and installation services. Sales of pumping units were slow in the first quarter of 2000 but grew steadily throughout the balance of the year. Recent efforts to enhance productivity and reduce our manufacturing overhead cost structure resulted in significant increases in operating margins as our sales volumes have increased.

The automation business also had a slow first quarter of 2000 but grew steadily during the balance of the year. This business supplies computer controls for pumping unit systems along with design and analysis software and field service and support. The recently announced introduction of a new controller that will set new standards in the well controller/monitoring market is being well received, and will strengthen Lufkin's presence in artificial lift.

Will the Oil Field Division have the capacity to meet increasing demand for its products in 2001?

Yes, Lufkin turned no customers away in 2000 and does not anticipate doing so in 2001. We expect to meet increased demand by activating equipment that has been mothballed and by utilizing capacity within the Power Transmission Division. No major capital improvements are expected. The most important issue in terms of capacity is people. Finding experienced field service crews is very important to successful operations.

What is the Oil Field Division doing to better position itself for the future?

A re-location of the main manufacturing facility to a site just outside of Lufkin was completed in the first quarter of 2000. The timing of this move could not have been better in that the market has improved dramatically, and we are now benefiting from the efficiency and utilization gains. The pumping unit manufacturing operations are located in one custom-designed facility, and all support staff are on site. In addition, the acquisitions of Fannie Lee Mitchell, Delta-X and Nabla have provided a strong, respected presence in the field service and well control/monitoring markets. This move of our manufacturing facility, along with our recent acquisitions, should continue to enhance Lufkin's reputation as an industry leader in providing the highest quality oil field products and services.

What is the status of Lufkin's Foundry operations?

The Foundry Division supplies castings to both the Oil Field and Power Transmission divisions in addition to supplying commercial castings to outside customers. We built the foundry to support our gear making operations and have refined our manufacturing processes over the years to supply gear castings that we believe are equal to or better than any you can find in the world. A captive foundry also gives us a competitive edge in reducing lead times for castings to a fraction of what they would be if we relied on outside sources. This efficiency enables us to respond quickly to customer requirements.

The Foundry Division has supplied commercial castings to outside customers for over 15 years. Due to continuing uncertainty in the capital goods market along with pricing pressure from foreign competition in the counterweights markets, we have not seen the growth in commercial castings volume during the past year that we would have liked. We are encouraged, however, that we have been able to maintain our third party volume, and the increase in demand from the Oil Field Division for gear castings has resulted in a significant increase in foundry utilization.

Recent decreases in interest rates and recent capital investments are expected to have a positive effect on the external market for commercial castings in 2001. We are also continuing to develop new opportunities to supply commercial castings to various markets in addition to the customers we currently serve. This will add to the utilization of the foundry.

Will the Foundry have adequate capacity to meet both its captive and commercial demand in 2001?

The Foundry division has an equally strong commitment to serve both its captive internal demand and that of its commercial customers. Our business strategy is to reserve capacity for the captive segment of our business while meeting demand from our outside customers. Although the Foundry experienced a significant increase in demand from the Oil Field Division in 2000, this captive demand currently represents less then 50% of the Foundry's available capacity. We believe that our existing capacity should be more than adequate to meet the needs of all of our customers.

WHAT IS THE BUSINESS OUTLOOK FOR THE POWER TRANSMISSION DIVISION?

J. F. GLICK
Vice President/ GM Power Transmission Division

After two years of uncertainty, the outlook is much more attractive for investment in sectors of industry that use Lufkin Industries' gear units. Specifically, investment in power generation, oil and gas exploration and production, pipeline construction for oil and gas transmission, and petroleum processing will spur the demand for Lufkin's gear products. The oil and gas sector uses gear drives for gas compression, high capacity pump applications and, in combination with gas turbines and electrical generators, for power generation.

Deregulation in the electricity markets, together with the increase in the price of natural gas, will drive investment in electrical cogeneration in industries that have yet to harness waste process energy. Most cogeneration processes use one or more gear units.

Environmental legislation aimed at lowering emissions from gasoline and diesel fuels will also likely drive significant investment in the refining sector in the near future.

How is Lufkin positioned to capitalize on these opportunities?

There are only three or four gear manufacturers in the world capable of producing turbo gears. Among these, Lufkin is recognized as the leader in gear design, manufacturing and testing technology. Our gear units have performed well in very demanding service applications. Lufkin's reputation was boosted further through the production of the largest gear drive ever used in a centrifugal compressor application for which a 66,000 HP gear drive was supplied. In addition, we

have manufactured a variety of gear units that have been used in power generation applications with gas turbines producing up to 114,000 HP.

We also have engineering and manufacturing facilities on two continents with the addition in November 1998 of our manufacturing facility in France. This global support is critical in enabling Lufkin Industries to support the needs of customers who are also becoming increasingly global. Lufkin Industries' short lead times and reputation for on time delivery make us the first choice for companies who recognize the huge financial advantages offered by reducing the life cycle of major projects.

Our Aftermarket Repair and Service organization provides global service support, combined with full service repair shops in the U.S. and Europe. The ability to support our customers with service and engineering support on two continents is unique among manufacturers of turbo gears.

We continue to develop new products and refine the performance of our traditional products. For our customers to realize the gains in efficiency and cost reduction that are essential for their future success, we must constantly advance the enabling gear technology. It is this focus on technology and service that differentiates Lufkin Industries from other gear manufacturers.

S. H. SEMLINGER
Vice President/ GM
Trailer Division

WHAT TYPE OF TRAILERS DOES LUFKIN'S TRAILER DIVISION PRODUCE?

Lufkin produces many different sizes and styles of vans; platforms; and high-capacity, lightweight dump trailers for the North American transportation market it serves. The Company's trailers--known for their quality construction, reliability, innovation of design, and competitive prices--are helping our customers gain a competitive advantage.

The Trailer Division continues to leverage its reputation for quality by introducing new types of trailers to its diverse product offering. New products, such as the double-wall van, composite-lined van, and open-top fruit van introduced in the last two years, continue to be well received by customers. Our business strategy is to selectively expand into market niches where there is a need for Lufkin's expertise in designing and building quality trailers suited for our customers' particular needs. In addition, Lufkin is focused on improving productivity and aggressively seeking opportunities to increase market share.

What is the 2001 outlook for Lufkin's trailer products?

After record demand in 1998 and 1999, the trailer market dropped sharply in the last half of 2000. Lufkin reacted to these conditions by adjusting production capability and workforce to meet demand. Increases in interest rates and overall decreases in tonnage shipped by freight carriers, as well as higher fuel costs, are some of the reasons for the decline in demand for new trailer equipment.

Currently, we expect a gradual easing in quarterly trailer shipments in the first half of 2001 and look for modest improvements in trailer demand in the second half of the year, which should set the stage for the next upward cycle in shipments beginning in 2002. Lufkin believes its plan to increase its penetration in the various trailer distribution channels and to expand its customer base is on track. By making a concerted effort to reach a greater number of users and dealers, Lufkin has positioned itself to better serve the changing needs of its customers while growing the trailer business in 2001 and beyond.

Common Stock Information

	2000			1999		
	Stock Price			Stock Price		
Quarter	High	Low	Dividend	High	Low	Dividend
First	**$17.063**	**$13.750**	**$.18**	$20.500	$14.500	$.18
Second	**20.000**	**14.000**	**.18**	20.000	14.375	.18
Third	**21.875**	**15.688**	**.18**	19.375	14.625	.18
Fourth	**22.500**	**13.750**	**.18**	17.000	12.563	.18

The Company's common stock is traded on the Nasdaq Stock Market (National Market) under the symbol LUFK and as of March 1, 2001, there were approximately 670 record holders of its common stock.

The Company has paid cash dividends for 61 consecutive years. Total dividend payments were $4,549,000 and $4,654,000 in 2000 and 1999, respectively.

Quarterly Financial Data (Unaudited)

In millions, except per share data	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2000				
Net sales	**$56.8**	**$67.8**	**$65.7**	**$64.3**
Gross profit	**8.3**	**12.1**	**11.6**	**12.2**
Net earnings	**0.2**	**2.1**	**2.3**	**2.4**
Basic earnings per share	**.03**	**.33**	**.36**	**.39**
Diluted earnings per share	**.03**	**.33**	**.36**	**.38**
1999				
Net sales	$58.5	$58.3	$66.1	$63.1
Gross profit	6.2	8.1	8.5	9.8
Net earnings (loss)	(2.7)	0.1	0.5	0.8
Basic earnings (loss) per share	(.42)	.01	.09	.13
Diluted earnings (loss) per share	(.42)	.01	.09	.13

Additional Financial Information

Shareholders may obtain additional information for the year ended December 31, 2000, from the Company's Form 10-K Report filed with the Securities and Exchange Commission. A copy of such report may be obtained without charge by written request to the Secretary, Lufkin Industries, Inc., P.O. Box 849, Lufkin, Texas 75902-0849.

Results of Operations

Net revenues for the year ended December 31, 2000, increased to $254.6 million from $246.0 million for the year ended December 31, 1999. Net revenues for 1998 were $287.5 million. Revenues for prior year periods have been restated to reflect the reclassification of freight charges billed to customers as revenue and the related expenses as cost of sales in accordance with the guidance specified by EITF Issue 00-10. The Company previously accounted for freight charged to customers as a reduction of cost of sales. Gross profit, operating income and net earnings for these periods were not affected by this reclassification.

The Company reported net earnings of $7.0 million or $1.11 per share (diluted) for the year ended December 31, 2000 compared to a net loss of $1.3 million or $0.20 per share (diluted) for the year ended December 31, 1999. Net earnings for 1998 totaled $13.6 million or $2.08 per share (diluted).

The sales mix of the Company's products for the three years ended December 31, 2000 was as follows:

	Percent of total sales		
	2000	1999	1998
Oil field pumping units	**37%**	19%	20%
Power transmission products	**25**	29	26
Foundry castings	**9**	9	11
Trailers	**29**	43	43
Total	**100%**	100%	100%

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999:

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

Year Ended December 31,	2000	1999	Increase (Decrease)	% Increase (Decrease)
Net Revenues				
Oil Field	$ 95,047	$ 45,611	$ 49,436	108.4
Power Transmission	62,923	71,475	(8,552)	(12.0)
Foundry Castings	23,050	23,577	(527)	(2.2)
Trailers	73,583	105,337	(31,754)	(30.1)
Total	$ 254,603	$ 246,000	$ 8,603	3.5
Gross Profit				
Oil Field	$ 20,568	$ 5,730	$ 14,838	259.0
Power Transmission	15,590	14,546	1,044	7.2
Foundry Castings	3,171	642	2,529	393.9
Trailers	4,921	11,724	(6,803)	(58.0)
Total	$ 44,250	$ 32,642	$ 11,608	35.6

Oil Field revenues for the year ended December 31, 2000 increased 108.4% to $95.0 million from $45.6 million in the year ended December 31, 1999. Increases in production activity among oil producers have resulted in significant increases in both new pumping unit sales and oil field service activity. Oil Field backlog reflects this increase in activity, increasing to $26.4 million at December 31, 2000 from $4.0 million at December 31, 1999.

Gross profit for the Oil Field Division increased to $20.6 million for the year ended December 31, 2000 compared to $5.7 million for 1999 due primarily to the increase in volumes noted above. Gross margin for the comparable periods improved to 21.6% in 2000 compared to 12.6% in 1999 due primarily to increased leverage on the Company's fixed costs and favorable product mix.

Results of Operations (continued)

Revenues for the Company's Power Transmission segment decreased 12.0% to $62.9 million for the year ended December 31, 2000 compared to $71.5 million for 1999 as uncertain economic conditions experienced in the second half of 1999 in many of the Company's domestic and international industrial markets have continued to exist in 2000. The Company's Power Transmission backlog at December 31, 2000 declined slightly to $20.8 million from $21.4 million at December 31, 1999.

Power Transmission gross profit and gross margin, however, increased to $15.6 million and 24.8%, respectively, for the year ended December 31, 2000 from $14.5 million and 20.4%, respectively, for 1999. This improvement was due primarily to improvements in product mix, along with increased absorption of overhead fixed costs in 2000 resulting from volume increases attributable to gearboxes supplied to the Company's Oil Field Division.

Foundry castings revenues for the year ended December 31, 2000 decreased 2.2% to $23.0 million compared to $23.6 million for the prior year as continuing pricing pressure from foreign competition in the counterweight markets offset increases in oil field activity. Foundry backlog at December 31, 2000 increased to $6.9 million from $6.0 million at December 31, 1999.

Foundry gross profit and gross margin increased to $3.2 million and 13.8%, respectively, for 2000 from $0.6 million and 2.7%, respectively, for 1999. The improvements in gross profit and gross margin are due primarily to increased absorption of fixed overhead costs resulting from volume increases attributable to castings supplied to the Company's Oil Field Division.

Trailer revenues for the year ended December 31, 2000 decreased 30.1% to $73.6 million from $105.3 million for the year ended December 31, 1999 due to the continuing adverse effect of higher fuel prices on the demand for new trailers. Backlog for the trailer segment totaled $9.5 million at December 31, 2000, compared to $42.2 million at December 31, 1999.

Trailer gross profit and gross margin decreased to $4.9 million and 6.7%, respectively, for the year ended December 31, 2000 from $11.7 million and 11.1%, respectively, for the prior year due to the volume declines noted above.

Selling, general and administrative ("SG&A") expenses for the year ended December 31, 2000 decreased slightly to $32.1 million from $32.8 million for 1999. SG&A expenses for 1999 include $1.4 million of non-recurring severance, relocation and legal expenses occurring in the first quarter of 1999. Excluding the effect of these non-recurring expenses, SG&A expenses decreased to 12.6% of consolidated net revenues in 2000 compared to 12.8% for 1999, due primarily to the Company's ability to leverage its SG&A expenses over a larger revenue base.

Interest expense for the year ended December 31, 2000 totaled $1.4 million compared to $1.2 million for the year ended December 31, 1999, due primarily to higher average short-term debt balances in 2000 compared to the prior year. Other income (expense) for 1999 includes a non-recurring charge of $228,000 recorded in the first quarter of 1999 related to the consolidation and relocation of the Company's primary Oil Field manufacturing facilities to the Company's Lufkin, Texas Buck Creek facility.

Year Ended December 31, 1999 Compared to Year Ended December 31, 1998:

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

Year Ended December 31,	1999	1998	Increase (Decrease)	% Increase (Decrease)
Net Revenues				
Oil Field	$ 45,611	$ 58,656	$ (13,045)	(22.2)
Power Transmission	71,475	73,603	(2,128)	(2.9)
Foundry Castings	23,577	31,184	(7,607)	(24.4)
Trailers	105,337	124,089	(18,752)	(15.1)
Total	$ 246,000	$ 287,532	$ (41,532)	(14.4)
Gross Profit				
Oil Field	$ 5,730	$ 11,739	$ (6,009)	(51.2)
Power Transmission	14,546	19,523	(4,977)	(25.5)
Foundry Castings	642	2,813	(2,171)	(77.2)
Trailers	11,724	14,501	(2,777)	(19.2)
Total	$ 32,642	$ 48,576	$ (15,934)	(32.8)

Results of Operations (continued)

Oil field revenues decreased 22.2% to $45.6 million in 1999 from $58.7 million in 1998. During 1999, the Company experienced its second year of significant decreases in demand for its oil field products world wide. In response to increasing oil prices throughout 1999, the service portion of the Company's Oil Field Division experienced increased revenue while new unit orders declined due to industry consolidations and the continued uncertainty as to long-term oil prices. To better position itself for longer term market recoveries, the Company relocated and consolidated its primary manufacturing facilities at its Lufkin, Texas Buck Creek facility. The Company booked new orders of $45.0 million for 1999, compared to $46.0 million in 1998. The decreased bookings are also a result of the above noted uncertainty of the worldwide oil field markets. The Company ended 1999 with a backlog for oil field products of $4.0 million as compared to $3.7 million at December 31, 1998.

Sales of power transmission products decreased 2.9% to $71.5 million from $73.6 million in 1998. The 1999 bookings for power transmission products were $54.1 million, which decreased from $74.4 million in 1998. The declines in Power Transmission's revenues and bookings reflect the uncertainties associated with both the U.S. and European capital goods markets. The Company brought its French acquisition on line at lower than expected volumes, also reflecting the soft European market. The 1999 backlog decreased to $21.4 million as compared to the 1998 backlog of $38.1 million.

Foundry castings revenues in 1999 decreased 24.4% to $23.6 million from $31.2 million in 1998. The declines in foundry revenues and bookings were due primarily to the decline in demand for domestically produced machine tool components as highlighted in the uncertain capital goods market and to price pressures resulting from foreign competition in the counterweight markets. New orders booked for foundry castings totaled $20.4 million in 1999 compared to $23.0 million in 1998. The Company ended 1999 with a backlog for foundry products of $6.0 million. The year end backlog for foundry products was $8.4 million for 1998.

Net revenues from trailer products for 1999 decreased 15.1% to $105.3 million from $124.1 million for 1998. The decrease in trailer revenues is due primarily to the tightening independent trailer market associated with the higher fuel costs as experienced in the last half of 1999. The 1999 backlog for trailer products reflects this tightening market, decreasing to $42.2 million from $44.7 million at year end 1998.

Consolidated gross profit margins declined to 13.3% for 1999 compared to 16.9% for 1998. The reduced profitability reflected the reduced volumes across all divisions and their impacts on absorption of fixed overhead costs along with reduced manufacturing efficiencies which resulted in manufacturing variances. Reduced oil field volumes also impacted the profitability of the captive portion of the Company's foundry operation resulting in under absorption of fixed overheads and reduced manufacturing efficiencies.

SG&A expenses were $32.8 million and 13.3% of revenues for 1999, increasing from 1998 when SG&A expenses were $28.2 million and 9.8% of revenues. The $4.6 million year-on-year increase of the Company's SG&A expenses between 1999 and 1998 reflected $1.4 million of non-recurring severance, relocation and legal expenses occurring in the first quarter of 1999, along with the full year impact of SG&A expenses associated with its power transmission division's French acquisition - Comelor and its Oil Field Division's purchase of Houston, Texas based Delta-X Corporation. Also contributing to this increase was the full year impact of the installation of the Company's information systems completed in August of 1998.

Investment income decreased to $29,000 in 1999 as compared to $1.3 million in 1998 due to a decrease in investment balances caused by the use of invested funds in 1998 for acquisition activities. Interest expense increased $0.5 million to $1.2 million in 1999 from $0.7 million in 1998. The increase is primarily due to the increase in long-term debt related to the Company's acquisition activities. Other income decreased $1.4 million to expense of $0.7 in 1999 compared to income of $0.7 million in 1998 due primarily to losses on asset retirements in 1999 associated with the relocation of facilities discussed above.

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 purchases.

The Company's cash balance totaled $2.0 million at December 31, 2000, compared to $1.1 million at December 31, 1999. For the year ended December 31, 2000, net cash flows provided by operating activities were $14.1 million, cash used in investing activities totaled $6.3 million and cash used in financing activities amounted to $6.7 million. Significant components of cash provided by operating activities include net earnings adjusted for non-cash expenses, offset in part by a $0.4 million net increase in working capital items. Cash used in investing activities included capital expenditures totaling approximately $6.2 million for, among other things, ongoing additions and modifications to certain of the Company's production facilities along with purchases and replacements of production equipment and operating vehicles. Significant components of cash used in financing activities include (i) dividend payments totaling approximately $4.5 million or $0.72 per share; (ii) payments on long-term debt totaling $2.7 million; and (iii) stock repurchases totaling $2.0 million, offset in part by a net increase of approximately $2.6 million in short-term debt.

Liquidity and Capital Resources (continued)

Total debt balances at December 31, 2000, including current maturities of long-term debt, include $3.2 million outstanding under the Company's discretionary short-term demand facilities, $4.6 million outstanding under the Bank Facility discussed below and $8.8 million of notes payable to various banks and individuals. Total debt decreased to $16.6 million at December 31, 2000, compared to $17.1 million at December 31, 1999. This decrease was due primarily to principal payments on long-term notes payable totaling approximately $2.7 million during 2000 along with a $0.4 million decrease in the Company's foreign currency denominated debt as a result of changes in exchange rates, offset in part by net short-term demand borrowings totaling approximately $2.6 million.

The Company currently has short-term credit facilities in place with three domestic banks totaling $35.0 million. These facilities consist of $15.0 million in discretionary demand facilities, with $5.0 million available from each of the three domestic banks and a $20.0 million committed facility available from one of the three banks. At December 31, 2000, the Company had borrowed $7.8 million against the $15.0 million demand facilities and no amounts had been borrowed under the $20.0 million committed facility. One of these three facilities, consisting of the $20.0 million committed facility and one of the $5.0 million demand facilities, expires September 1, 2002. The remaining two $5.0 million demand facilities are annual agreements which the Company expects to successfully renew during 2001. Weighted average interest rates on these demand facilities were 7.0% and 5.9% at December 31, 2000 and 1999, respectively.

The Company currently has a stock repurchase plan under which the Company is authorized to spend up to $17.1 million for purchases of its common stock. Pursuant to this plan, the Company has purchased a total of 826,870 shares of its common stock at an aggregate purchase price of $16.9 million, including 110,314 shares at an aggregate cost of approximately $2.0 million during the year ended December 31, 2000. Purchased shares are added to treasury stock and are available for general corporate purposes including the funding of the Company's stock option plans. As of December 31, 2000, the Company held 679,360 shares of treasury stock at an aggregate cost of approximately $14.0 million. Authorizations of approximately $0.2 million remained at December 31, 2000.

The Company believes that its cash flows from operations and its available borrowing capacity under its credit agreements will be sufficient to fund its operations, including planned capital expenditures, dividend payments and stock purchases, through December 31, 2001.

Recently Issued Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement establishes accounting and reporting standards for derivative instruments, including derivative instruments embedded in other contracts, and hedging activities. In June 1999, the FASB issued SFAS 137, which delayed the effective adoption date of SFAS 133. In June, 2000, the FASB issued SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities, an Amendment of FASB Statement No. 133" to address a number of issues causing implementation difficulties for entities that apply SFAS 133. SFAS 138, among other things, amends the accounting and reporting requirements of SFAS 133 for certain derivative instruments and hedging activities. SFAS 133, as amended, is effective for the Company's quarter ending March 31, 2001 and is to be applied prospectively. The Company has performed an analysis of the effects of the accounting and disclosure requirements of SFAS 133 on its operating activities and does not expect implementation of this statement, as amended, to have a material adverse effect on its financial position or results of operations.

On December 3, 1999 the United States Securities and Exchange Commission ("SEC") staff released Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition", to provide guidance on the recognition, presentation and disclosure of revenue in financial statements. The Company reviewed its revenue recognition procedures and is satisfied that it is in compliance with this SAB.

The Emerging Issues Task Force of the Financial Accounting Standards Board reached a consensus on September 21, 2000, regarding Issue 00-10, "Accounting for Shipping and Handling Fees and Costs." This guidance requires companies to report shipping and handling charges to customers as revenues and related expenses as part of cost of goods sold or selling and general administration expenses. The Company previously accounted for shipping and handling charges incurred and billed to customers as components of cost of goods sold. The Company implemented this guidance in the fourth quarter of 2000, and, as required, has restated prior years presented in the Consolidated Statements of Earnings to conform to the current year presentation. The effect of the implementation of this guidance on the Company's results of operations for prior years was to increase both Sales and Cost of Sales by $3.5 million and $3.8 million for 1999 and 1998, respectively.

Legal Proceedings

A class action complaint was filed in the United States District Court for the Eastern District of Texas on March 7, 1997 by an employee and a former employee that alleged race discrimination in employment. Certification hearings were conducted in Beaumont, Texas in February of 1998 and in Lufkin, Texas in August of 1998. The District Court in April of 1999 issued a decision that certified a class for this case which includes all persons of a certain minority employed by the Company from March 6, 1994 to the present. The Company appealed this class certification decision by the District Court to the 5th Circuit United States Courts of Appeals in New Orleans, Louisiana. This appeal was denied on June 23, 1999.

The Company is defending this action vigorously. Furthermore, the Company believes that the facts and the law in this action support its position and is confident that it will prevail if this case is tried on the merits.

The Company is often subject to routine litigation arising in the normal course of its business. While the outcome of these proceedings cannot be predicted with certainty, management does not expect these matters to have a material adverse effect on the Company's financial position or results of operations.

Forward-Looking Statements and Assumptions

This Annual Report contains forward-looking statements and information 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" and similar expressions are intended to identify 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, (i) oil prices, (ii) capital spending levels of oil producers, (iii) availability and prices for raw materials and (iv) general industry and economic conditions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, believed, estimated or expected. The Company does not intend to update these forward-looking statements and information.

Quantitative and Qualitative Disclosures About Market Risk

The Company does not utilize financial instruments for trading purposes and does not hold any derivative financial instruments that could expose the Company to significant 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. The Company believes the carrying values of its long-term debt obligations approximate fair values because the interest rates on these obligations are comparable to what the Company believes it could currently obtain for debt with similar terms and maturities. The Company's accounts receivable are not concentrated in one customer or industry and are not viewed as an unusual credit risk.

CONSOLIDATED BALANCE SHEETS

December 31, 2000 and 1999
(Thousands of dollars, except share and per share data)

Assets	2000	1999
Current assets:		
Cash	$ 2,003	$ 1,065
Invested funds	759	584
Receivables, net	40,413	34,526
Income taxes receivable	1,239	2,564
Inventories	35,146	32,761
Deferred income tax assets	6,082	1,228
Total current assets	85,642	72,728
Property, plant and equipment, net	85,004	89,959
Prepaid pension costs	43,492	37,105
Invested funds	5,106	5,281
Goodwill, net	8,841	8,951
Other assets, net	7,360	7,342
Total assets	$ 235,445	$ 221,366

Liabilities and Shareholders' Equity	2000	1999
Current liabilities:		
Short-term debt	$ 7,790	$ 5,200
Current portion of long-term notes payable	1,809	2,750
Accounts payable	13,216	9,895
Accrued liabilities:		
Payroll and benefits	5,701	4,731
Accrued warranty expenses	2,194	1,493
Taxes payable	4,130	3,189
Commissions and other	5,601	4,685
Total current liabilities	40,441	31,943
Deferred income tax liabilities	24,338	16,795
Postretirement benefits	10,972	11,116
Long-term notes payable, net of current portion	7,043	9,103
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value, 2,000,000 shares authorized, none issued or outstanding	-	-
Common stock, par $1 per share; 60,000,000 shares authorized; 6,892,381 shares issued	6,892	6,892
Capital in excess of par	18,069	18,066
Retained earnings	143,912	141,491
Treasury stock, 679,360 shares and 571,880 shares, respectively, at cost	(13,977)	(12,019)
Accumulated other comprehensive income:		
Cumulative translation adjustment	(2,245)	(2,021)
Total shareholders' equity	152,651	152,409
Total liabilities and shareholders' equity	$ 235,445	$ 221,366

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF EARNINGS

Years ended December 31, 2000, 1999, and 1998
(Thousands of dollars, except per share data)

	2000	1999	1998
Net sales	**$254,603**	$246,000	$287,532
Cost of sales	**210,353**	213,358	238,956
Gross profit	**44,250**	32,642	48,576
Selling, general and administrative expenses	**32,120**	32,825	28,203
Operating income (loss)	**12,130**	(183)	20,373
Investment income	**412**	29	1,307
Interest expense	**(1,413)**	(1,176)	(730)
Other income (expense), net	**113**	(683)	677
Earnings (loss) before income taxes	**11,242**	(2,013)	21,627
Income tax provision (benefit)	**4,272**	(745)	8,001
Net earnings (loss)	**$ 6,970**	$ (1,268)	$ 13,626
Net earnings (loss) per share:			
Basic	**$ 1.11**	$ (0.20)	$ 2.11
Diluted	**$ 1.11**	$ (0.20)	$ 2.08

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Years ended December 31, 2000, 1999 and 1998
(Thousands of dollars, except share and per share data)

	Common Stock		Capital In Excess Of Par	Retained Earnings	Treasury Stock	Cumulative Translation Adjustment	Comprehensive Income (Loss)
	Shares	Amount					
Balance, December 31, 1997	6,792,381	$6,792	$15,381	$138,539	$(4,244)	$(1,163)	
Comprehensive income (loss):							
Net earnings (loss)				13,626			$13,626
Other comprehensive income, net of tax Foreign currency translation adjustment						(312)	(312)
Comprehensive income (loss)							13,314
Common stock issued for acquisitions	100,000	100	2,170				
Cash dividends, $.72 per share				(4,752)			
Purchases of treasury stock (199,726 shares)					(5,554)		
Exercise of stock options (83,795 shares)			529		1,784		
Balance, December 31, 1998	6,892,381	6,892	18,080	147,413	(8,014)	(1,475)	
Comprehensive income (loss):							
Net earnings (loss)				(1,268)			(1,268)
Other comprehensive income, net of tax Foreign currency translation adjustment						(546)	(546)
Comprehensive income (loss)							(1,814)
Cash dividends, $.72 per share				(4,654)			
Purchases of treasury stock (259,800 shares)					(4,072)		
Exercise of stock options (3,250 shares)			(14)		67		
Balance, December 31, 1999	6,892,381	6,892	18,066	141,491	(12,019)	(2,021)	
Comprehensive income (loss):							
Net earnings (loss)				6,970			6,970
Other comprehensive income, net of tax Foreign currency translation adjustment						(224)	(224)
Comprehensive income (loss)							$6,746
Cash dividends, $.72 per share				(4,549)			
Purchases of treasury stock (110,314 shares)					(2,009)		
Stock grant (1,334 shares)			3		27		
Exercise of stock options (1,500 shares)					24		
Balance, December 31, 2000	6,892,381	$6,892	$18,069	$143,912	$(13,977)	$(2,245)	

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2000, 1999, and 1998
(Thousands of dollars)

	2000	1999	1998
Cash flows from operating activities:			
Net earnings (loss)	**$ 6,970**	$ (1,268)	$ 13,626
Adjustments to reconcile net earnings (loss) to net cash provided by operating activities:			
Depreciation and amortization	**10,895**	10,746	9,213
Deferred income tax provision	**2,691**	1,409	2,481
Pension income	**(6,387)**	(5,491)	(3,925)
Postretirement benefits	**(144)**	(265)	(917)
(Gain) loss on disposition of property, plant and equipment	**468**	1,032	(199)
Increase (decrease) in cash flows from changes in working capital excluding effects of acquisitions:			
Receivables, net	**(5,947)**	4,259	5,504
Income taxes receivable	**1,322**	1,006	(3,566)
Inventories	**(2,683)**	15,083	(10,843)
Accounts payable	**3,437**	(2,299)	2,237
Accrued liabilities	**3,480**	(2,439)	(2,256)
Net cash provided by operating activities	**14,102**	21,773	11,355
Cash flows from investing activities:			
Additions to property, plant and equipment	**(6,225)**	(7,172)	(19,830)
Acquisitions of other companies, net of cash acquired	**-**	-	(9,979)
Proceeds from (cash used for) disposition of property, plant and equipment	**448**	(146)	604
Decrease in invested funds	**-**	282	-
(Increase) decrease in other assets	**(557)**	(2,129)	1,843
Net cash used in investing activities	**(6,334)**	(9,165)	(27,362)
Cash flows from financing activities:			
Proceeds from (payments of) short term debt, net	**2,590**	(3,300)	14,500
Long-term notes payable issued	**-**	1,079	-
Payments of long-term notes payable	**(2,725)**	(2,166)	(742)
Dividends paid	**(4,549)**	(4,654)	(4,752)
Proceeds from exercise of stock options	**24**	53	2,314
Purchases of treasury stock	**(2,009)**	(4,072)	(5,554)
Net cash provided by (used in) financing activities	**(6,669)**	(13,060)	5,766
Effect of translation on cash and cash equivalents	**(161)**	(100)	(312)
Net increase (decrease) in cash and cash equivalents	**938**	(552)	(10,553)
Cash and cash equivalents at beginning of year	**1,065**	1,617	12,170
Cash and cash equivalents at end of year	**$ 2,003**	$ 1,065	$ 1,617

See notes to consolidated financial statements.

(1) Corporate Organization and Summary of Major Accounting Policies

Lufkin Industries, Inc. and its consolidated subsidiaries (collectively, the "Company") manufactures and sells oil field pumping units, power transmission products, foundry castings and highway trailers throughout the world.

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

Use of estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities 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.

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

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

Invested funds: The Company's invested funds, consisting of government securities, are classified as held-to-maturity securities, which are carried at cost, net of accumulated amortization. Substantially all of the Company's invested funds at December 31, 2000 and 1999 were restricted for payment of certain of the Company's long-term notes payable.

Receivables: The following is a summary of the Company's receivable balances:

(Thousands of dollars)	**2000**	1999
Accounts receivable	**$40,899**	$34,568
Notes receivable	**119**	563
	41,018	35,131
Allowance for doubtful accounts	**(605)**	(605)
Net receivables	**$40,413**	$34,526

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. In July, 1998, the Company began capitalizing certain maintenance and supplies inventories to better match the estimated cost of such inventories with the related equipment produced. Such inventories were capitalized and will be amortized over the three years of their estimated use and had the effect of increasing net earnings by $0.7 million ($0.12 per diluted share), $1.2 million ($0.19 per diluted share) and $0.8 million ($0.13 per diluted share) in 2000, 1999 and 1998, respectively.

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 periodically reviews its properties for possible impairment whenever events or changes in circumstance indicate that the carrying amount of an asset may not be recoverable. Depreciation for financial reporting purposes is provided on a straight-line method based upon the estimated useful lives of the assets. Accelerated depreciation methods are used for tax purposes. The following is a summary of the Company's property, plant and equipment (P. P. & E.) balances and useful lives:

(Thousands of dollars)	Useful Life (In Years)	**2000**	1999
Land	-	**$ 2,354**	$ 2,264
Land improvements	10-25	**6,669**	5,093
Buildings	12.5-40	**57,689**	58,776
Machinery and equipment	3-12.5	**167,457**	165,482
Furniture and fixtures	5-12.5	**5,488**	5,408
Computer equipment	3-7	**15,393**	17,804
Total property, plant and equipment		**255,050**	254,827
Less accumulated depreciation		**(170,046)**	(164,868)
Total property, plant and equipment, net		**$ 85,004**	$ 89,959

(1) Corporate Organization and Summary of Major Accounting Policies (continued)

Goodwill and Other assets: The cost over fair value of net tangible assets of acquired businesses ("Goodwill") is amortized on a straight-line method over forty years. Management periodically evaluates recorded Goodwill balances, net of accumulated amortization, for impairment based on undiscounted cash flows. Management believes that there have been no events or circumstances that warrant revision to the remaining useful life or affect the recoverability of Goodwill in any of its business units. Other assets, which include covenants not to compete, are amortized using the straight-line method over their estimated lives. Amortization expense related to Goodwill and other assets was $364,000, $277,000 and $290,000 in 2000, 1999 and 1998, respectively.

Earnings per share: Earnings per share amounts are based on the weighted average number of shares of common stock and common stock equivalents outstanding during the period. The weighted average number of shares used to compute basic and diluted earnings per share for 2000, 1999 and 1998 is illustrated below:

(Thousands of dollars, except share and per share data)	**2000**	1999	1998
Numerator:			
Numerator for basic and diluted earnings per share — net earnings (loss)	**$ 6,970**	$ (1,268)	$ 13,626
Denominator:			
Denominator for basic earnings per share — weighted-average shares	**6,256,974**	6,462,890	6,464,680
Effect of dilutive securities: Employee stock options	**32,748**	-	100,080
Denominator for diluted earnings per share--adjusted weighted-average shares and assumed conversions	**6,289,722**	6,462,890	6,564,760
Basic earnings (loss) per share	**$1.11**	$(0.20)	$2.11
Diluted earnings (loss) per share	**$1.11**	$(0.20)	$2.08

Options to purchase a total of 562,874 shares, 916,793 shares and 182,701 shares of the Company's common stock were excluded from the calculation of diluted earnings per share for 2000, 1999 and 1998, respectively, because their effect was antidilutive.

Income taxes: The Company follows Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes." Under SFAS No. 109, deferred income tax assets or liabilities are recorded based on the difference between the financial statement and income tax bases of assets and liabilities using enacted tax rates.

Fair value of financial instruments: The Company's financial instruments include cash, accounts receivable, accounts payable and debt obligations. 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. The Company believes the carrying value of its long-term debt approximates fair value because the interest rates of this debt are comparable to what the Company believes it could currently obtain for debt with similar terms and maturities.

Recently issued accounting pronouncements: In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities." This statement establishes accounting and reporting standards for derivative instruments, including derivative instruments embedded in other contracts, and hedging activities. In June 1999, the FASB issued SFAS 137, which delayed the effective adoption date of SFAS 133. In June, 2000, the FASB issued SFAS 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities, an Amendment of FASB Statement No. 133" to address a number of issues causing implementation difficulties for entities that apply SFAS 133. SFAS 138, among other things, amends the accounting and reporting requirements of SFAS 133 for certain derivative instruments and hedging activities. SFAS 133, as amended, is effective for the Company's quarter ending March 31, 2001 and is to be applied prospectively. The Company has performed an analysis of the effects the accounting and disclosure requirements of SFAS 133 on its operating activities and does not expect implementation of this statement, as amended, to have a material adverse effect on its financial position or results of operations.

On December 3, 1999 the United States Securities and Exchange Commission ("SEC") staff released Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition", to provide guidance on the recognition, presentation and disclosure of revenue in financial statements. The Company reviewed its revenue recognition procedures and is satisfied that it is in compliance with this SAB.

(1) Corporate Organization and Summary of Major Accounting Policies (continued)

The Emerging Issues Task Force of the FASB reached a consensus on September 21, 2000, regarding Issue 00-10, "Accounting for Shipping and Handling Fees and Costs." This guidance requires companies to report shipping and handling charges to customers as revenues and related expenses as part of cost of goods sold or selling and general administration expenses. The Company previously accounted for shipping and handling charges incurred and billed to customers as components of cost of goods sold. The Company implemented this guidance in the fourth quarter of 2000, and, as required, has restated prior years presented in the Consolidated Statements of Earnings to conform to the current year presentation. The effect of the implementation of this guidance on the Company's results of operations for prior years was to increase both Sales and Cost of Sales by $3.5 million and $3.8 million for 1999 and 1998, respectively.

Other: Certain prior year amounts have been reclassified to conform with the current year presentation.

(2) Income Taxes

Net deferred income tax assets and liabilities are comprised of the following:

(Thousands of dollars)	**2000**	1999
Current deferred income tax assets		
Gross assets	**$ 6,451**	$ 1,228
Gross liabilities	**(369)**	-
Total, net	**6,082**	1,228
Noncurrent deferred income tax liabilities		
Gross assets	**5,803**	6,469
Gross liabilities	**(30,141)**	(23,264)
Total, net	**(24,338)**	(16,795)
Net deferred income tax liabilities	**$(18,256)**	$(15,567)

The tax effects of significant temporary differences representing deferred income tax assets and liabilities are as follows:

(Thousands of dollars)	**2000**	1999
Inventories	**$ (1,283)**	$ 213
Prepaid pension costs	**(15,929)**	(12,954)
Payroll and benefits	**966**	789
Accrued warranty expenses	**680**	560
Postretirement benefits	**4,019**	4,113
Tax credit carryforwards	**253**	258
Depreciation	**(10,769)**	(9,626)
Net operating loss	**2,463**	-
Other, net	**1,344**	1,080
Net deferred income tax liabilities	**$(18,256)**	$(15,567)

The income tax provision for 2000, 1999 and 1998 consisted of the following:

(Thousands of dollars)	**2000**	1999	1998
Current	**$1,583**	$(2,154)	$ 5,520
Deferred	**2,689**	1,409	2,481
Total	**$4,272**	$ (745)	$ 8,001

(2) Income Taxes (continued)

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)	**2000**	1999	1998
Tax provision computed at statutory rate	**$3,935**	$ (704)	$7,570
Tax effect of:			
Expenses for which no benefit was realized	**353**	158	206
Other, net	**(16)**	(199)	225
Provision for income taxes	**$4,272**	$ (745)	$8,001

Cash payments for income taxes totaled $597,000, $2,164,000 and $9,615,000 for 2000, 1999 and 1998, respectively.

For income tax reporting purposes at December 31, 2000, the Company has foreign tax credit carryforwards totaling $253,000 which expire in 2003 and a net operating loss carry forward of $6,967,000 which expires in 2018.

(3) Inventories

Inventories used in determining cost of sales were as follows:

(Thousands of dollars)	**2000**	1999
Finished goods	**$ 6,191**	$ 3,193
Work in process	**2,624**	8,285
Raw materials	**26,331**	21,283
Total	**$35,146**	$32,761

Inventories accounted for on a LIFO basis were $23,893,000 and $22,036,000 and on a FIFO basis were $11,253,000 and $10,725,000 at December 31, 2000 and 1999, respectively. Had the FIFO method been used in determining all inventory values, inventories would have been $19,449,000 and $20,419,000 higher at December 31, 2000 and 1999, respectively.

During 2000 and 1999, LIFO inventories were reduced in certain LIFO pools and these reductions resulted in a liquidation of LIFO inventory quantities carried at lower costs in prior years. The impact of these reductions did not have a material effect on net income for 2000, but decreased the net loss in 1999 by approximately $283,000, net of taxes ($0.04 per diluted share).

(4) Debt Obligations

The Company's short-term debt obligations at December 31, 2000 and 1999 consist of the following:

(Thousands of dollars)	**2000**	1999
Bank Facility (discussed below), interest at bank's borrowing rate plus applicable margin, (6.41% at December 31, 2000), unsecured	**$ 4,550**	$ -
Revolving line of credit with a domestic bank, interest at LIBOR plus 1.00%, (7.82%, at December 31, 2000) unsecured (discussed below)	**3,240**	-
Discretionary line of credit with a domestic bank, payable daily, floating interest rate agreed to by Company and bank, renewable annually, unsecured	**-**	5,200
Total	**$ 7,790**	$ 5,200

(4) Debt Obligations (continued)

The Company completed an agreement in the first quarter of 2000 with a domestic bank (the "Bank Facility") for a $25.0 million credit facility that includes a committed line of credit of up to $20.0 million of borrowings outstanding at any one time expiring September 1, 2002, along with an additional $5.0 million demand facility. Borrowings under the Bank Facility bear interest, at the Company's option, at either (i) the prime rate or (ii) the London Interbank Offered Rate ("LIBOR") plus an applicable margin, depending on certain ratios as defined in the agreement. The amount noted in the table above is comprised of borrowings under the demand facility. As of December 31, 2000, the entire $20.0 million committed portion of the line of credit was available for borrowings under the terms of the Bank Facility.

In September 2000, the Company completed an agreement with a domestic bank for a revolving line of credit that provides for up to $5.0 million of borrowings outstanding at any one time, at the bank's discretion, expiring September 22, 2001. Borrowings under this revolving line of credit bear interest at LIBOR + 1.00% per annum.

The Company's long-term notes payable at December 31, 2000 and 1999 consist of the following:

(Thousands of dollars, except payment amounts)	**2000**	1999
Notes payable to individuals, interest ranging from 6.50% to 6.65%, due in quarterly installments ranging from $9,000 to $55,000 with balloon payments at maturity ranging from $996,000 to $2,162,000 maturing August 2000 to July 2002, unsecured	**$5,281**	$5,756
Notes payable to individuals, stated interest rate of 0% with an imputed interest rate of 6.50%, due in annual installments totaling $167,000, maturing August 2000, unsecured	-	167
Notes payable to banks denominated in French francs, interest ranging from 3.58% to 4.9%, due in quarterly installments ranging from $7,000 to $40,853 secured by certain assets	**1,111**	1,662
Note payable to bank denominated in Euros, discussed below	**2,460**	4,268
Less-current maturities of long-term notes payable	**(1,809)**	(2,750)
Total	**$7,043**	$9,103

In January 1999, the Company refinanced $6,000,000 of its short-term discretionary line of credit into a long-term note denominated in Euros, with interest equal to the current Euro currency borrowing rate (4.88% at December 31, 2000) plus 1.75% per annum. This unsecured note is payable in sixteen quarterly installments of Euros (approximately US $326,000) plus interest beginning in March 1999 and maturing on the last business day of December, 2002. The Company has designated this note as a hedge against its investment in its French operations.

Under the terms of certain notes payable, invested funds in the amount of $5,281,000 at December 31, 2000 are restricted for the payment of these notes.

Related party notes payable included in long-term notes payable at December 31, 2000 and 1999 consist of the following:

(Thousands of dollars)	**2000**	1999
Note payable to current employee, interest at 6.50% with principal and interest payable quarterly	**$ -**	$ 135
Note payable to current employee, stated interest rate of 0% with an imputed interest rate of 6.50%, with principal and interest payable annually	-	83
Less current maturities of long-term, related party notes payable	-	(218)
Total	**$ -**	$ -

(4) Debt Obligations (continued)

Principal payments of long-term notes payable as of December 31, 2000 are as follows:

(Thousands of dollars)	
Year ending December 31,	
2001	$ 1,809
2002	6,657
2003	207
2004	179
2005	-
Total	$ 8,852

Cash payments for interest totaled $1,347,000, $1,279,000 and $347,000 in 2000, 1999 and 1998, respectively.

(5) Stock Option Plans

The Company has stock option plans currently in effect that provide for the granting of options to outside directors and key employees to purchase an aggregate of not more than 1,050,000 shares of the Company's common stock at fair market value on the date of grant. One third to one fourth of granted options generally become exercisable after one year and each year thereafter. The options may not be exercised after ten years from the date of grant. Outstanding options may be canceled and reissued under terms specified in the plans.

In May 2000, the shareholders of the Company approved the Incentive Stock Compensation Plan 2000 (the "2000 Plan") to replace the Company's 1990 Stock Option Plan (the "1990 Plan") which terminated in August 2000. The 2000 Plan provides for the granting of cash or various stock-based compensation awards to key employees and directors of the Company. Subject to certain adjustments as outlined in the Plan, grants or options to purchase up to 900,000 shares of the Company's common stock may be awarded under the 2000 Plan. The 1990 Plan will remain in effect until all awards granted under this plan have been satisfied or expire.

The following table summarizes activity under the Company's stock option plans:

	2000	1999	1998
Options outstanding, beginning of year	**916,793**	745,510	671,766
Granted (per share)			
1998 ($21.750 to $35.250)			164,726
1999 ($14.000 to $18.125)		230,833	
2000 ($14.625 to $18.250)	**139,175**		
Exercised (per share)			
1998 ($15.875 to $30.00)			(83,795)
1999 ($15.875)		(3,250)	
2000 ($15.875)	**(1,500)**		
Forfeited (per share)			
1998 ($15.875 to $38.00)			(7,187)
1999 ($15.875 to $38.00)		(56,300)	
2000 ($14.00 to $38.00)	**(56,615)**		
Options outstanding, end of year	**997,853**	916,793	745,510

The following table summarizes information about stock options outstanding at December 31, 2000:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 12/31/00	Wtd. Avg. Remaining Contractual Life	Wtd. Avg. Exercise Price	Number Exercisable at 12/31/00	Wtd. Avg. Exercise Price
$14.000-$18.625	510,679	7.3 years	$15.98	259,467	$16.39
$19.000-$21.750	345,138	6.0 years	$21.20	284,013	$21.08
$22.750-$33.375	56,938	6.3 years	$28.59	55,023	$28.54
$35.250-$39.875	85,098	6.8 years	$37.76	66,073	$37.67
$14.000-$39.875	997,853	6.7 years	$20.36	664,576	$21.52

(5) Stock Option Plans (continued)

The Company accounts for its stock option plans under APB Opinion No. 25 under which no compensation cost has been recognized. Had compensation cost for these plans been accounted for consistent with SFAS 123, "Accounting for Stock-Based Compensation", the Company's net earnings and earnings per share would have been reduced to the following pro forma amounts, (in thousands except per share data):

		2000	1999	1998
Net earnings (loss)	As reported	**$6,970**	$(1,268)	$13,626
	Pro forma	**$6,230**	$(2,007)	$12,994
Basic earnings (loss) per share	As reported	**$1.11**	$(0.20)	$2.11
	Pro forma	**$1.00**	$(0.31)	$2.01
Diluted earnings (loss) per share	As reported	**$1.11**	$(0.20)	$2.08
	Pro forma	**$0.99**	$(0.31)	$1.98

The effects of applying SFAS 123 to the pro forma disclosure amounts may not be indicative of future amounts. SFAS 123 does not apply to options awarded prior to 1995, and additional awards in future years are anticipated. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

Expected dividend yield	4.00% - 4.90%
Expected stock price volatility	34.81% - 35.55%
Risk free interest rate	5.60% - 6.92%
Expected life of options	10 years

Options granted during 2000 had a weighted average fair value of $5.01 per option and a weighted average exercise price of $16.69 per option. At December 31, 2000, 901,300 options authorized remained available to be granted.

(6) Stock Repurchase Plan

The Company has a stock repurchase plan under which the Company has been authorized to spend up to $17,100,000 for purchases of its common stock. The Company repurchased 110,314 shares at an aggregate cost of $2,009,000 in 2000, 259,800 shares at an aggregate cost of $4,072,000 in 1999 and 199,726 shares at an aggregate cost of $5,554,000 in 1998. Repurchased shares are added to treasury stock and are available for general corporate purposes including the funding of the Company's stock option plans. Authorizations of approximately $152,000 remained at December 31, 2000.

(7) Capital Stock

The Board of Directors adopted a "Shareholder Rights Plan" (the "Plan") designed to protect against unsolicited attempts to acquire control of the Company that the Board believes are not in the best interest of the shareholders. The Plan provides for the possible issuance of a dividend of one common stock purchase right for each outstanding share of common stock. Under certain conditions, each right may be exercised to purchase one share of common stock at an exercise price of $75, subject to adjustment. Under certain circumstances, the rights entitle holders to purchase the common stock of the Company or an acquiring company having a value of twice the exercise price of the rights. The rights would become exercisable, or transferable apart from the common stock, ten days after a person or group acquired 20% or more, or announced or made a tender offer for 30% or more, of the outstanding common stock. Under certain circumstances, all rights owned by an acquiring person would be null and void. The rights expire on May 31, 2006, and may be redeemed by the Company at any time prior to the occurrence of certain events at $.05 per right.

The Company is also 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.

(8) Retirement Benefits

The Company has noncontributory pension plans covering substantially all employees. The benefits provided by these plans are measured by length of service, compensation and other factors, and are currently funded by trusts established under the plans. Funding of retirement costs for these plans complies with the minimum funding requirements specified by the Employee Retirement Income Security Act, as amended. Plan investment assets are invested primarily in equity securities, United States government securities and cash equivalents.

The following tables illustrate the change in benefit obligation, change in plan assets and funded status of the pension plans:

(Thousands of dollars)	**2000**	1999	1998
Change in projected benefit obligation:			
Projected benefit obligation, beginning of year	**$113,060**	$118,045	$108,266
Service cost	**2,942**	3,772	3,391
Interest cost	**8,071**	7,733	7,430
Amendments	**1,252**	-	-
Actuarial (gain) loss	**227**	(10,481)	4,541
Benefits paid	**(6,229)**	(6,009)	(5,583)
Projected benefit obligation, end of year	**$119,323**	$113,060	$118,045
Change in plan assets:			
Fair value of plan assets, beginning of year	**$181,438**	$179,426	$156,421
Actual return on plan assets	**13,312**	8,021	28,588
Benefits paid	**(6,229)**	(6,009)	(5,583)
Fair value of plan assets, end of year	**$188,521**	$181,438	$179,426
Funded status:			
Excess of fair value of plan assets over projected benefit obligation	**$ 69,198**	$ 68,378	$ 61,381
Unrecognized net actuarial gain	**(20,670)**	(24,152)	(21,735)
Unrecognized prior service cost	**2,088**	929	945
Unrecognized net transition asset	**(7,124)**	(8,050)	(8,977)
Prepaid pension costs	**$ 43,492**	$ 37,105	$ 31,614
Components of net periodic pension cost (income):			
Service cost	**$ 2,942**	$ 3,772	$ 3,391
Interest cost	**8,071**	7,733	7,430
Expected return on plan assets	**(16,005)**	(15,845)	(13,796)
Amortization of unrecognized (gain) loss	**(1,395)**	(1,151)	(950)
Net periodic pension cost (income)	**$ (6,387)**	$ (5,491)	$ (3,925)
Weighted-average assumptions at year end:			
Discount rate	**7.25%**	7.5%	6.75%
Expected return on plan assets	**9.0%**	9.0%	9.0%
Rate of compensation increase	**5.0%**	5.0%	5.0%

The Company also has defined contribution retirement plans covering substantially all of its employees. The Company makes contributions of 75% of employee contributions up to a maximum employee contribution of 6% of employee earnings. Employees may contribute up to an additional 6% (in 1% increments) which is not subject to match by the Company. All obligations of the Company are funded through December 31, 2000. The Company's expense for these plans totaled $1,715,000, $1,817,000 and $1,994,000 in 2000, 1999 and 1998, respectively.

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. Under SFAS 106 "Employers' Accounting for Post Retirement Benefits Other than Pensions," the Company accrues the estimated costs of the plans over the employee's service periods.

(8) Retirement Benefits (continued)

The following tables illustrate the change in benefit obligation, change in plan assets and funded status of the postretirement plans:

(Thousands of dollars)	**2000**	1999	1998
Accumulated postretirement benefit obligation:			
Retirees	**$ 5,748**	$ 5,921	$ 7,295
Fully eligible active plan participants	**1,073**	1,351	1,647
Other active plan participants not yet eligible	**2,722**	2,777	3,522
Total accumulated postretirement benefit obligation	**$ 9,543**	$10,049	$12,464
Change in accumulated postretirement benefit obligation:			
Accumulated postretirement benefit obligation, beginning of year	**$10,049**	$12,464	$11,320
Service cost	**159**	214	247
Interest cost	**677**	701	817
Participant contributions	**1,069**	1,067	859
Actuarial (gain) loss	**(432)**	(2,436)	1,472
Benefits paid	**(1,979)**	(1,961)	(2,251)
Accumulated postretirement benefit obligation, end of year	**$ 9,543**	$10,049	$12,464
Fair value of plan assets	**$ -**	$ -	$ -
Funded status:			
Excess of total accumulated postretirement benefit obligation over fair value of plan assets	**$ 9,543**	$10,049	$12,464
Unrecognized net actuarial (gain) loss	**1,429**	1,067	(1,083)
Accrued postretirement benefit cost	**$10,972**	$11,116	$11,381
Components of net periodic postretirement benefit cost:			
Service cost	**$ 159**	$ 214	$ 247
Interest cost	**677**	701	817
Amortization of net actuarial gain	**(71)**	-	-
Net periodic postretirement benefits cost	**$ 765**	$ 915	$ 1,064
Weighted average assumptions at year end:			
Discount rate	**7.25%**	7.50%	6.75%

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.

(9) Commitments and Contingencies

Legal proceedings: A class action complaint was filed in the United States District Court for the Eastern District of Texas on March 7, 1997 by an employee and a former employee which alleged race discrimination in employment. Certification hearings were conducted in Beaumont, Texas in February of 1998 and in Lufkin, Texas in August of 1998. The District Court in April of 1999 issued a decision that certified a class for this case, which includes all persons of a certain minority employed by the Company from March 6, 1994 to the present. The Company appealed this class certification decision by the District Court to the 5th Circuit United States Court of Appeals in New Orleans, Louisiana. This appeal was denied on June 23, 1999.

The Company is defending this action vigorously. Furthermore, the Company believes that the facts and the law in this action support its position and is confident that it will prevail if this case is tried on the merits.

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. It is management's opinion that the Company's liability, if any, under such claims or proceedings would not materially affect its financial position or results of operations.

(10) Business Segment Information

The Company operates with four business segments — oil field, power transmission, foundry and trailer. In keeping with the Company's strategic objective of vertical integration, the Company's foundry segment also provides its oil field and power transmission segments with commercial castings. The four 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 significant accounting policies. Corporate expenses and assets are allocated to the operating segments primarily based upon third party revenues. The following is a summary of key business segment and product group information:

(Thousands of dollars)	**2000**	1999	1998
Sales:			
Oil field	**$ 95,047**	$ 45,611	$ 58,656
Power transmission	**62,923**	71,475	73,603
Foundry	**23,050**	23,577	31,184
Trailer	**73,583**	105,337	124,089
Total sales	**$254,603**	$246,000	$287,532
Sales by geographic region:			
United States	**$194,221**	$204,199	$246,079
Europe	**10,642**	15,742	7,042
Canada	**12,664**	6,421	10,994
Latin America	**26,476**	7,589	11,198
Other	**10,600**	12,049	12,219
Total sales	**$254,603**	$246,000	$287,532
Earnings (loss) before income taxes:			
Oil field	**$ 10,030**	$ (4,855)	$ 2,467
Power transmission	**1,171**	(1,388)	7,105
Foundry	**1,151**	(1,606)	1,072
Trailer	**(610)**	6,543	9,764
Corporate	**(500)**	(707)	1,219
Total earnings (loss) before income taxes	**$ 11,242**	$ (2,013)	$ 21,627
Assets:			
Oil field	**$ 73,349**	$ 55,960	51,318
Power transmission	**57,957**	57,977	70,950
Foundry	**27,407**	22,751	24,958
Trailer	**22,096**	23,608	31,108
Corporate	**54,636**	61,070	64,461
Total assets	**$235,445**	$221,366	$242,795
Capital expenditures:			
Oil field	**$ 3,846**	$ 3,836	$ 5,485
Power transmission	**1,004**	963	2,368
Foundry	**767**	1,352	4,657
Trailer	**471**	682	755
Corporate	**137**	339	5,214
Total capital expenditures	**$ 6,225**	$ 7,172	$ 18,479
Depreciation/Amortization:			
Oil field	**$ 2,595**	$ 2,263	$ 2,140
Power transmission	**4,447**	4,681	4,014
Foundry	**1,459**	1,355	1,213
Trailer	**759**	809	823
Corporate	**1,635**	1,638	1,023
Total depreciation/amortization	**$ 10,895**	$ 10,746	$ 9,213

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of Lufkin Industries, Inc.:

We have audited the accompanying consolidated balance sheets of Lufkin Industries, Inc. (a Texas corporation) and subsidiaries (collectively, the Company) as of December 31, 2000 and 1999, and the related consolidated statements of earnings, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lufkin Industries, Inc., and subsidiaries as of December 31, 2000 and 1999, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

Arthur Andersen LLP

Houston, Texas
February 9, 2001

DIRECTORS AND OFFICERS

DIRECTORS AND OFFICERS

BOARD OF DIRECTORS

Front Row left to right:

H. H. King, W. W. Trout, Jr., L. R. Jalenak, Jr.

Back Row left to right:

M. E. Kurth, Jr., D. V. Smith, J. H. Lollar, T. E. Wiener, H. J. Trout, Jr., S. W. Henderson III, B. H. O'Neal

OFFICERS

D. V. Smith
President
Chief Executive Officer

P. G. Perez
Vice President, Secretary

R. D. Leslie
Vice President,
Treasurer, CFO

S. H. Semlinger
Vice President,
GM Trailer Division

J. F. Glick
Vice President.GM Power
Transmission Division

L. M. Hoes
Vice President,GM Oil
Field and Foundry
Divisions