



# FORM 10-K

## LUFKIN INDUSTRIES INC - LUFK

Exhibit:

**Filed: March 16, 2005 (period: December 31, 2004)**

Annual report which provides a comprehensive overview of the company for the past year

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549  
FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended December 31, 2004

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-2612

**LUFKIN INDUSTRIES, INC.**  
(Exact name of registrant as specified in its charter)

Texas	75-0404410
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
601 South Raguet, Lufkin, Texas	75904
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code 936/634-2211

Securities registered pursuant to Section 12(b) of the Act: None  
Securities registered pursuant to Section 12(g) of the Act:

**Common Stock, Par Value \$1 Per Share**  
**Common Stock Purchase Rights**  
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the Company's voting stock held by non-affiliates as of the last business day of the Company's most recently completed second fiscal quarter, June 30, 2004, was \$216,199,767.

There were 7,039,303 shares of Common Stock, \$1.00 par value per share, outstanding as of March 7, 2005, not including 245,639 shares classified as Treasury Stock.

**DOCUMENTS INCORPORATED BY REFERENCE**

The information called for by Items 10, 11, 12, 13 and 14 of Part III of this annual report on Form 10-K are incorporated by reference from the registrant's definitive proxy statement to be filed pursuant to Regulation 14A.

**Item 1. Business**

Lufkin Industries, Inc. (the "Company") was incorporated under the laws of the State of Texas on March 4, 1902, and since that date has maintained its principal office and manufacturing facilities in Lufkin, Texas. The Company employed approximately 2,300 people at December 31, 2004, including approximately 1,600 that were paid on an hourly basis. The Company is divided into three operating segments: Oil Field, Power Transmission and Trailer.

**Oil Field**

Products:

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

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

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

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

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

Raw Materials:

Oil Field purchases a variety of raw materials in manufacturing its products. The principal raw materials are structural and plate steel, round alloy steel and iron castings from both its own foundry and third-party foundries. Casting costs are subject to change from raw material prices on scrap iron and pig iron in addition to natural gas and electricity prices. Due to the many configurations of its products and thus sizes of raw material used, Oil Field does not enter into long-term contracts for raw materials but generally does not experience shortages of raw materials. However, during 2004, Oil Field experienced rapid raw material price increases due to increased global demand for metal commodities but did not experience any material shortages. Raw material prices are not expected to decline in the short-term nor are shortages expected. Raw material prices may continue to increase and availability may decrease with little notice

Markets:

Demand for pumping unit equipment primarily depends on the level of onshore oil well drilling activity as well as the depth and fluid conditions of that drilling. Drilling activity is driven by the available cash flow of the Company's customers as well as their long-term perceptions of the level and stability of the price of oil. Also, the availability of used pumping unit equipment impacts the North American market.

Competition:

The primary global competitor for new pumping units and automation equipment is Weatherford. Used pumping units are also an important factor in the North American market, as customers will generally attempt to satisfy requirements through used equipment before purchasing new equipment. While the Company believes that it is one of the larger manufacturers of sucker rod pumping units in the world, manufacturers of other types of units (submersibles and hydraulics) have a significant share of the total artificial lift market. While Weatherford is the Company's single largest competitor in the service market, small independent operators provide significant competitive pressures.

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

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### **Power Transmission**

#### Products:

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

**High-Speed Gearboxes-** Gearboxes where revolutions per minute (RPM) exceed 4,000 and range up to 60,000. These gearboxes require extremely high precision manufacturing and testing due to the stresses on the gearing. The ratio of increasers to reducers is fairly even. These gearboxes more typically service the energy related markets of petrochemicals, refineries, offshore production and transmission of oil and gas.

**Low-Speed Gearboxes-** Gearboxes where RPM are below 4,000. The majority of low-speed gearboxes are reducers. While still requiring close tolerances, these gearboxes do not require the same precision of manufacturing and testing. These gearboxes more typically service commodity-related industries like rubber, sugar, paper, steel, plastics, mining and cement as well as marine propulsion.

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

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

#### Raw Materials:

Power Transmission purchases a variety of raw materials in manufacturing its products. The principal raw materials are steel plate, round alloy steel, iron castings and steel forgings. Due to the customized nature of its products, Power Transmission generally does not enter into long-term contracts for raw materials. Though raw material shortages are infrequent, lead times can be long due to the custom nature of many of its orders. However, during 2004, Power Transmission experienced rapid raw material price increases due to increased global demand for metal commodities but did not experience any material shortages. Raw material prices are not expected to decline in the short-term and may continue to increase with little notice. Raw material and component part shortages are not expected in the short-term, but availability has been decreasing as supplier lead-times have grown.

#### Markets:

As noted above, Power Transmission services many diverse markets, each of which has its own unique set of drivers. Favorable conditions for one market may be unfavorable for another market. Generally, if general global industrial capacity utilizations are not high, then spending on new equipment lags. Also impacting demand are government regulations involving safety and environmental issues that can require capital spending.

#### Competition:

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

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### **Trailer**

#### Products:

The Trailer segment manufactures and services various highway trailers for the freight-hauling market.

**Vans-** General-purpose dry-freight vans. These are the highest production trailer in the segment.

**Floats-** Flat-bed style trailers used in hauling heavier loads that do not require protection from outdoor elements.

**Dumps-** Trailers designed to haul bulk materials like gravel or sand.

**Parts-** Through a network of company-owned branches, both trailers produced by the Company and by others are supported by replacement parts.

#### Raw Materials:

Trailer purchases a variety of raw materials in manufacturing its products. The principal raw materials are aluminum, structural and plate steel, axles, suspensions, tires, plywood and hardwood flooring. Trailer has annual contracts for aluminum in order to mitigate price fluctuations, but due to the configurable nature of its products, Trailer does not have long-term purchase contracts on its other raw material purchases. Raw material shortages have been infrequent. However, during 2004, Trailer experienced rapid raw material price increases due to increased global demand for metal commodities and experienced periodic material shortages. Raw material prices are not expected to decline in the short-term and may continue to increase with little notice. Raw material shortages are expected to reduce in the short-term, but periodic shortages may still occur.

#### Markets:

The Company primarily sells its products in the United States to small and medium size fleet freight-hauling companies. Demand in this market is driven by the available cash flow or financing capabilities of the industry, age of the trailer fleets, changes in government regulations, availability of quality used trailers and the medium-term outlook for freight volumes. The profitability of the freight-hauling market is driven by freight volumes, fuel prices, wage levels and insurance costs.

In the last several years, the freight-hauling market has been severely depressed due to low freight volumes and higher operating costs. This led freight haulers to significantly lower orders for new trailers and extend the life of existing trailers. During 2004, the freight market improved as freight-hauling demand and pricing increased and aging trailers required replacement.

#### Competition:

The trailer market is highly competitive with relatively low barriers to entry. The majority of the cost of a new trailer comes from purchased materials of aluminum, steel, tires, axles and wood flooring. Since there is minimal product differentiation in this market, price is the key driver. The companies with the highest market share are Great Dane and Wabash, along with several other large manufacturers like Utility, Fontaine and Hyundai. The Company does not have a significant market share in the trailer market.

For financial information about the Company's business segments and geographic areas, see Note 16 in Notes to Consolidated Financial Statements included in this report.

The Company makes available, free of charge, through our website, [www.lufkin.com](http://www.lufkin.com), its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practicable after it electronically files such material with, or furnishes such material to, the Securities and Exchange Commission.

### **Item 2. Properties**

The Company's major manufacturing facilities are located in and near Lufkin, Texas are owned in fee and include approximately 150 acres, a foundry, machine shops, structural shops, assembly shops and warehouses. Also, the Company has numerous service centers throughout the U.S. to support the Oil Field, Power transmission and Trailer segments. The majority of these locations are owned in fee, with some leased. None of these leases qualify as capital leases. Internationally, the Company also has facilities in Canada, Egypt and Argentina for the production and servicing of pumping units and has a plant in France that manufactures, assembles and services industrial gears and power transmission products throughout Europe.

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

A class action complaint was filed in the U.S. 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 1998 and in Lufkin, Texas in August 1998. In April 1999, the District Court issued a decision that certified a class for this case, which included all 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 U.S. Court of Appeals for the Fifth Circuit in New Orleans, Louisiana. This appeal was denied on June 23, 1999. The case was closed from 2001 to 2003 while the parties unsuccessfully attempted mediation. Trial for this case began in December 2003, but was postponed by the District Court and was completed in November 2004. The only claims made at trial were those of discrimination in initial assignments, promotions and compensation.

On January 13, 2005 the District Court entered its decision finding that the Company discriminated against African-American employees when awarding initial assignments and promotions. The District Court also concluded that the discrimination resulted in a shortfall in income for those employees and ordered that the Company pay those employees back pay to remedy such shortfall, together with pre-judgment interest in the amount of 10%, compounded annually. The Company's preliminary estimate is that the total amount of back pay that it would be required to pay to the class of affected employees could total up to \$6 million (including interest). In addition to back pay with interest, the Court (i) enjoined and ordered the Company to cease and desist all racially biased assignment and promotion practices, (ii) ordered the Company to pay court costs and (iii) agreed to consider a request for awarding plaintiffs' attorneys' fees against the Company. On January 27, 2005, the plaintiffs moved for an interim award of attorney fees and costs, which they estimated to be \$6.5 million, but to date the District Court has not ruled on this request.

The Company has reviewed this decision with its outside counsel and intends to appeal the decision to the U.S. Court of Appeals for the Fifth Circuit. The Company believes that after a full and fair review by the appeals court of the evidence, the Court of Appeals will determine that the plaintiffs have not established their claims of discrimination by the Company against the plaintiffs and will enter a decision to that effect and will dismiss the case against the Company. At this time, the Company has concluded that an unfavorable ultimate outcome is not probable. If the District Court's decision is reversed and remanded for a new trial, the Company will vigorously defend itself on retrial. While the ultimate outcome and impact of these claims against the Company cannot be predicted with certainty, the Company believes that the resolutions of these proceedings will not have a material adverse effect on its consolidated financial position. However, should the Company be unsuccessful in its appeal, the final determination could have a material impact on the Company's reported earnings and cash flows in a future reporting period.

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 consolidated financial position, results of operations or cash flow.

### **Item 4. Submission of Matters to a Vote of Security Holders**

None

PART II

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

**Common Stock Information**

The Company’s common stock is traded on the NASDAQ Stock Market (National Market) under the symbol LUFK. References to the Company’s common stock herein include the associated common stock purchase rights issued under the Company’s Rights Agreement. See Note 12 to the Consolidated Financial Statements for a discussion of the Rights Agreement. As of February 28, 2005, there were approximately 534 record holders of its common stock. This number does not include any beneficial owners for whom shares of common stock may be held in “nominee” or “street” name. The following table sets forth, for each quarterly period during fiscal 2004 and 2003, the high and low sales price per share of the Company’s common stock and the dividends paid per share on the Company’s common stock.

Quarter	2004			2003		
	Stock Price			Stock Price		
	High	Low	Dividend	High	Low	Dividend
First	\$32.950	\$28.130	\$ 0.18	\$25.560	\$18.500	\$ 0.18
Second	34.470	27.500	0.18	27.000	18.810	0.18
Third	37.490	30.850	0.18	27.000	22.580	0.18
Fourth	41.750	33.220	0.18	29.460	22.690	0.18

The Company has paid cash dividends for 65 consecutive years. Total dividend payments were \$4,905,000, \$4,714,000 and \$4,670,000 in 2004, 2003 and 2002, respectively.

**Equity Compensation Plan Information**

The following table sets forth securities of the Company authorized for issuance under equity compensation plans at December 31, 2004.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (a)
Equity compensation plans approved by security holders (b)	696,222	\$ 25.41	319,340
Equity compensation plans not approved by security holders	—	—	—
<b>Total</b>	<b>696,222</b>	<b>\$ 25.41</b>	<b>319,340</b>

(a) Excludes securities reflected in the first column, “Number of securities to be issued upon exercise of outstanding options, warrants and rights”.

(b) Issued under the 1990 Stock Option Plan, the 1996 Nonemployee Director Stock Option Plan and the Incentive Stock Option Plan 2000.

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(In millions, except per share data)	2004	2003	2002	2001	2000
Sales	\$356.3	\$262.3	\$228.7	\$278.9	\$254.6
Net earnings	14.4	9.7	8.5	19.5	7.0
Net earnings per share:					
Basic	2.12	1.49	1.29	3.12	1.11
Diluted	2.07	1.46	1.26	3.03	1.11
Total assets	300.3	263.7	248.4	246.1	233.6
Long-term notes payable, net of current	0.0	0.0	0.2	0.3	7.0
Cash dividends per share	0.72	0.72	0.72	0.72	0.72

**Quarterly Financial Data (Unaudited)**

(In millions, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
<b>2004</b>				
Sales	\$ 68.6	\$ 84.5	\$ 95.8	\$ 107.4
Gross profit	12.0	15.1	17.0	18.0
Net earnings	1.7	3.5	4.9	4.3
Basic earnings per share	0.26	0.52	0.71	0.63
Diluted earnings per share	0.25	0.50	0.70	0.61
<b>2003</b>				
Sales	\$ 55.1	\$ 61.1	\$ 71.5	\$ 74.6
Gross profit	9.3	11.0	16.2	15.5
Net earnings	0.8	2.2	3.4	3.3
Basic earnings per share	0.12	0.34	0.52	0.51
Diluted earnings per share	0.12	0.33	0.51	0.50

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

#### **Overview**

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

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

In support of the above strategy, during the third quarter of 2003, the Company completed two strategic acquisitions that expanded its Oil Field segment. The Company purchased the remaining shares of Lufkin Argentina S.A., its 1992 Argentina joint venture with Baker Hughes, Inc, effective July 1, 2003. Lufkin Argentina manufactures and services oil field pumping units and automation equipment for use in Argentina and other South American countries. The Company also purchased the operating assets of Basin Technical Services in Midland, Texas on July 30, 2003. This acquisition enhanced Oil Field's product and service offerings in the oil field automation marketplace. During the fourth quarter of 2003, the Company completed the acquisition on December 9, 2003, of the operating assets and commercial operations of D&R Oilfield Services located in Drayton Valley, Alberta, Canada. This acquisition within the Oilfield segment strengthened the Company's presence in Canada's oil field service business.

Also, on November 1, 2004, the Company completed the acquisition of the operating assets and commercial operations of Black Widow Oilfield Services located in Medicine Hat, Alberta, Canada to further expand its service presence in Canada.

In addition, in 2003 the Company expanded its Power Transmission capabilities through a new gear repair facility in Alabama that will service the Southeast U.S. and through new high-speed gearbox manufacturing capabilities in its French operation. In 2004, the Company continued to expand its gear repair network by opening facilities in Ohio to serve the Midwest and in Pennsylvania to serve the Northeast.

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

Overall, sales for the year ended December 31, 2004, increased to \$356.3 million from \$262.3 million for the year ended December 31, 2003, or 35.9%. Sales for 2002 were \$228.7 million. This growth in 2004 was primarily driven by increased sales of new oil field equipment, new van trailers and acquisitions. Additional segment data on sales is provided later in this section.

Gross margin for the year ended December 31, 2004, decreased to 17.4% from 19.8% for the year ended December 31, 2003, and 20.5% for year ended December 31, 2002. This overall gross margin decline was primarily due to rapidly increasing raw material prices in all segments and the inability to pass on these increases to customers at the same rate. Additional segment data on gross margin is provided later in this section.

The changes in sales and gross margin primarily drove the changes in net earnings. The Company reported net earnings of \$14.4 million or \$2.07 per share (diluted) for the year ended December 31, 2004, compared to net earnings of \$9.7 million or \$1.46 per share (diluted) for the year ended December 31, 2003. Net income of \$8.5 million or \$1.26 per share (diluted) was reported for the year ended December 31, 2002.

Debt/equity (long-term debt net of current portion as a percentage of total equity) levels were 0.0% for December 31, 2004, and December 31, 2003. Short-term debt and the current portion of long-term debt was \$2.0 million at December 31, 2004, up from \$0.7 million at December 31, 2003. Cash balances at December 31, 2004, were \$17.1 million, down from \$19.4 million at December 31, 2003, due to higher capital expenditures, acquisitions and working capital in support of the Company's strategies as well as certain volume-related working capital requirements.

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### Other Events

In the second quarter of 2003, the Company incurred a one-time severance expense of \$354,000 for the lay-offs and early-retirements of certain employees. These employee reductions were related to modifying the strategy of the Trailer branch facilities to focus primarily on parts from parts and service and other targeted cost reductions in areas not achieving profitability goals. The Oil Field segment incurred \$89,000, Power Transmission incurred \$144,000, Trailer incurred \$104,000 and Corporate incurred \$17,000 of this severance expense.

### Year Ended December 31, 2004 Compared to Year Ended December 31, 2003:

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

<u>Year Ended December 31,</u>	<u>2004</u>	<u>2003</u>	<u>Increase (Decrease)</u>	<u>% Increase (Decrease)</u>
<b>Sales</b>				
Oil Field	\$216,025	\$144,082	\$ 71,943	49.9
Power Transmission	79,498	74,625	4,873	6.5
Trailer	60,758	43,548	17,210	39.5
<b>Total</b>	<b>\$356,281</b>	<b>\$262,255</b>	<b>\$ 94,026</b>	<b>35.9</b>
<b>Gross Profit</b>				
Oil Field	\$ 41,780	\$ 32,532	\$ 9,248	28.4
Power Transmission	19,234	19,428	(194)	(1.0)
Trailer	1,070	57	1,013	1,777.2
<b>Total</b>	<b>\$ 62,084</b>	<b>\$ 52,017</b>	<b>\$ 10,067</b>	<b>19.4</b>

Oil Field sales increased to \$216.0 million, or 49.9%, for the year ended December 31, 2004, from \$144.1 million for the year ended December 31, 2003. The added sales of acquisitions and the benefit of the stronger Canadian dollar in 2004 contributed 7.4 percentage points of this increase. Increased sales of new pumping units account for a majority of the balance of the increase of 42.5 percentage points. Sales of new pumping units in the U.S. and Canada, and related service, increased from higher drilling and production activity associated with higher energy prices and from higher use of pumping units to pump water from gas fields. In addition, sales of automation equipment continued to increase as it grows market share from new product offerings. Commercial casting sales from the foundry operation grew significantly from the prior year as general economic levels in the U.S. improved, especially in the machine tool market. Oil Field's backlog increased to \$61.6 million as of December 31, 2004, from \$24.9 million at December 31, 2003. This backlog increase was from increased bookings of new pumping units in the U.S. and Argentina markets and from foundry machine tool casting orders.

Gross margin (gross profit as a percentage of revenue) for the Oil Field segment decreased to 19.3% for year ended December 31, 2004, compared to 22.6% for the year ended December 31, 2003, or 3.3 percentage points. This decline was caused by higher raw material prices, especially steel and raw scrap iron, and the related LIFO reserve impact, higher fuel prices and legal costs in the service operations and plant inefficiencies in the foundry operation associated with rapid production ramp-up for the volume increases, offsetting the benefit of higher plant utilization on fixed cost coverage in the pumping unit manufacturing operations.

Direct selling, general and administrative expenses for Oil Field increased to \$10.5 million, or 25.6%, for the year ended December 31, 2004, from \$8.4 million for the for year ended December 31, 2003. The additional expenses of Lufkin Argentina contributed 8.3 percentage points of this increase, with the balance of the increase primarily associated with higher employee-related expenses in support of higher sales volumes.

Sales for the Company's Power Transmission segment increased to \$79.5 million, or 6.5%, for the year ended December 31, 2004, compared to \$74.6 million for the year ended December 31, 2003. The benefit of the stronger euro on the sales of the French division contributed 2.0 percentage points of this increase. The net 4.5 percentage points of increase was the result of increased sales from the gear repair expansion in the Southeast U.S and increased sales of new low speed units to the metal processing and mining industries, partially offset by lower sales of high-speed units to the oil and gas development market from

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customer project delays and reduced orders for oil pipeline projects. The Company's Power Transmission backlog at December 31, 2004, increased to \$40.1 million from \$24.8 million at December 31, 2003. This backlog increase was from increased orders for high-speed units for the power generation market, low-speed units for the metal processing and mining industries and higher orders in the repair sector from the Southeast U.S expansion.

Gross margin for the Power Transmission segment decreased to 24.2% for the year ended December 31, 2004, compared to 26.0% for the year ended December 31, 2003, or 1.8 percentage points. This decline was from lower margins on new units for the power generation market from price competition and production inefficiencies. In addition, margins on longer lead-time orders have been impacted by rapidly rising raw material pricing, and the related LIFO reserve impact, not being reflected in the original selling price.

Direct selling, general and administrative expenses for Power Transmission increased to \$12.5 million, or 4.9%, for the year ended December 31, 2004, compared to \$11.9 million for the year ended December 31, 2003. The impact of the stronger euro on the French operation and higher employee-related expenses in support of higher sales volumes were partially offset by lower third-party commissions and bad debt expense.

Trailer sales for the year ended December 31, 2004, increased to \$60.8 million, or 39.5%, from \$43.5 million for the year ended December 31, 2003. This increase resulted from higher sales of all models of new trailers. Freight industry demand has continued to improve due to replacement trailer demand and from increases in freight volume levels. The freight industry delayed new purchases for several years due to poor economic conditions. This increase was partially offset by the 3.4 percentage point impact of the change of strategy, implemented in the second quarter of 2003, of its branch locations to focus primarily on parts sales instead of parts and service. Backlog for the Trailer segment increased to \$11.5 million at December 31, 2004, compared to \$11.1 million at December 31, 2003. The backlog increase was primarily from orders for new van trailers for the reasons mentioned above.

Trailer gross margin increased to 1.8% for the year ended December 31, 2004, from 0.1% for the year ended December 31, 2003, or 1.7 percentage points. This increase was from the benefit of higher plant utilization on fixed cost coverage and from some improvements in pricing levels. These gains were partially offset by the impact of higher raw material prices, especially steel, and the related LIFO reserve impact.

Direct selling, general and administrative expenses for Trailer increased to \$2.6 million, or 24.7%, for the year ended December 31, 2004, from \$2.1 million for the year ended December 31, 2003, primarily from employee-related expenses and third-party commissions in support of the sales volume growth and higher general liability insurance claims.

Corporate administrative expenses, which are allocated to the segments primarily based on third-party revenues, decreased to \$13.8 million, or 9.3%, for the year ended December 31, 2004, from \$15.2 million for the year ended December 31, 2003, primarily from lower expenses for litigation and other legal matters.

Investment income, interest expense and other income and expense for the year ended December 31, 2004, totaled \$0.0 million of expense compared to income of \$1.2 million for the year ended December 31, 2003. In the second quarter of 2003, a one-time gain of \$1.0 million from the sale of the Company's aircraft was recorded. The additional decrease was due primarily from certain other miscellaneous finance charges.

Pension income, which is reported as a reduction of cost of sales, increased to \$3.4 million for the year ended December 31, 2004, or 89%, compared to \$1.8 million for the year ended December 31, 2003. This increase was due to higher expected returns on plan assets due to the higher fair market value of the plan assets. Pension income in 2005 is expected to decrease to approximately \$2.6 million primarily due to the reduction of the expected long-term rate of return on assets assumption from 8.50% to 8.00% from the Company's annual assessment of expected future returns on the different asset classes. Also, in deriving this forecast, the Company reviewed its other assumptions for 2005 and lowered the discount rate to 6.00% from 6.25%.

The effective tax rate for the year ended December 31, 2004, was 36.5% compared to 38.0% for the year ended December 31, 2003. This decrease was primarily from the favorable impact of certain tax benefits on export sales.

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### Year Ended December 31, 2003 Compared to Year Ended December 31, 2002:

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

Year Ended December 31,	2003	2002	Increase (Decrease)	% Increase (Decrease)
<b>Sales</b>				
Oil Field	\$144,082	\$118,700	\$ 25,382	21.4
Power Transmission	74,625	70,455	4,170	5.9
Trailer	43,548	39,569	3,979	10.1
Total	\$262,255	\$228,724	\$ 33,531	14.7
<b>Gross Profit</b>				
Oil Field	\$ 32,532	\$ 24,953	\$ 7,579	30.4
Power Transmission	19,428	19,566	(138)	(0.1)
Trailer	57	2,319	(2,262)	(97.5)
Total	\$ 52,017	\$ 46,838	\$ 5,179	11.1

Oil Field sales increased to \$144.1 million, or 21.4%, for the year ended December 31, 2003, from \$118.7 million for the year ended December 31, 2002. The added sales of the acquisitions and the benefit of the stronger Canadian dollar in 2003 contributed 10.4 percentage points of this increase. The balance of the increase, 11.0 percentage points, is accounted for by increased sales of new pumping units in the U.S. from higher drilling and production activity associated with higher energy prices and increased sales of automation equipment from new product offerings. This increase was partially offset by a decline in sales of new pumping units into Canada from new drilling activity in Canada focusing on shallow wells, which use other forms of artificial lift. Oil Field's backlog increased to \$25.0 million as of December 31, 2003, from \$12.6 million at December 31, 2002. This backlog increase was primarily from a \$5.8 million benefit from the Argentina acquisition, increased bookings of new pumping units in the U.S. small independent market, increasing deep-well drilling activity in Canada and Foundry machine tool orders from a general improvement in the U.S. industrial markets.

Gross margin (gross profit as a percentage of revenue) for the Oil Field segment increased to 22.6% for year ended December 31, 2003, compared to 21.1% for the year ended December 31, 2002, or 1.5 percentage points. This margin improvement was primarily the result of higher utilization of manufacturing facilities and continued cost containment efforts. This was partially offset by the 1.4 percentage point impact of reduced pension income, which is discussed at the end of this section, and severance expenses.

Direct selling, general and administrative expenses for Oil Field increased to \$8.4 million, or 10.7%, for year ended December 31, 2003, from \$7.6 million for the for year ended December 31, 2002. The additional expenses of Lufkin Argentina contributed 7.9% percentage points of this increase.

Sales for the Company's Power Transmission segment increased to \$74.6 million, or 5.9%, for the year ended December 31, 2003, compared to \$70.5 million for the year ended December 31, 2002. The benefit of the stronger euro on the sales of the French division contributed 3.8 percentage points of this increase. The additional 2.1 percentage points of growth was the result of increased sales in the French operation, in euros, due to the addition of the high-speed product line and increased sales in the U.S. from new high-speed units to the oil and gas markets and the gear repair expansion in the Southeast U.S. These gains were partially offset by a drop in sales in new low-speed units to the rubber market due to capital spending restraints from poor market conditions in the tire industry. The Company's Power Transmission backlog at December 31, 2003, decreased to \$24.8 million from \$30.9 million at December 31, 2002. This backlog decline was from lower orders of new high-speed units in the oil and gas market due to short-term project delays and price competition and lower orders in the power generation market from limited capital expansion activity.

Gross margin for the Power Transmission segment decreased to 26.0% for the year ended December 31, 2003, compared to 27.8% for the year ended December 31, 2002, or 1.8 percentage points. This decline was due to lower margins on new high-speed units in the U.S. from several large project orders comprising multiple units, which are typically more competitive and price-sensitive and the 1.4 percentage point impact of reduced pension income and severance expenses.

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Direct selling, general and administrative expenses for Power Transmission increased to \$11.9 million, or 17.0%, for the year ended December 31, 2003, from \$10.2 million for the year ended December 31, 2002. Of this increase, the stronger euro contributed 7.2 percentage points. The balance of the increase was due to higher third-party commissions in the U.S. associated with the above-mentioned large project orders, higher engineering expenses in France in support of the new high-speed product line and increased selling effort in the gear repair market.

Trailer sales for the year ended December 31, 2003, increased to \$43.5 million, or 10.1%, from \$39.6 million for the year ended December 31, 2002. This growth was negatively impacted by 5.8 percentage points from the change of strategy, implemented in the second quarter of 2003, of its branch locations to focus primarily on parts sales instead of parts and service. The 15.9 percentage point increase in other trailer sales was primarily from increased sales of new vans as higher U.S. freight tonnage has led to more orders from freight-haulers and increased sales of floats due to the introduction of a new model. These increases were partially offset by a decline in sales of dump trailers as orders from the construction market have been weak. Backlog for the Trailer segment totaled \$11.1 million at December 31, 2003, compared to \$10.1 million at December 31, 2002. The backlog increase was primarily from floats due to the growth in demand for the new model.

Trailer gross margin declined to 0.1% for the year ended December 31, 2003, from 5.9% for the year ended December 31, 2002, or 5.8 percentage points. This margin decline was due to continued pricing pressure on all models of trailers in the depressed freight-hauling market and the 3.1 percentage point impact of reduced pension income and severance expenses.

Direct selling, general and administrative expenses for Trailer increased to \$2.1 million, or 36.1%, for the year ended December 31, 2003, from \$1.5 million for the year ended December 31, 2002, due to an increase in general liability insurance claims. While insurance claim filings cannot be accurately forecasted, this increase is not expected to recur on an ongoing and regular basis.

Corporate administrative expenses, which are allocated to the segments primarily based on sales, increased to \$15.2 million, or 7.3%, for the year ended December 31, 2003, from \$14.2 million for the year ended December 31, 2002, primarily due to higher legal expenses associated with the Echometer trial in September of 2003 and the class action trial in December of 2003.

Investment income, interest expense and other income and expense for the year ended December 31, 2003, totaled \$1.2 million of income compared to income of \$0.4 million for the year ended December 31, 2002. The increase was due primarily to the one-time gain of almost \$1.0 million on the sale of the Company's twenty-year old aircraft, partially offset by lower interest income from lower cash balances.

Pension income, which is reported as a reduction of cost of sales, declined to \$1.8 million for the year ended December 31, 2003, or 65.1%, compared to \$5.3 million for the year ended December 31, 2002. This decline was primarily due to lower expected returns on plan assets due to the lower fair market value of the plan assets. Pension income in 2004 is expected to increase to approximately \$3.0 million due to higher fair market value of the plan assets increasing the expected return. In deriving this forecast, the Company reviewed its assumptions for 2004 and lowered the discount rate to 6.25% from 6.75%, the expected long-term return on assets to 8.50% from 8.75% and the compensation rate increase to 4.25% from 4.50%.

## **Liquidity and Capital Resources**

The Company has historically relied on cash flows from operations and third-party borrowings to finance its operations, including acquisitions, dividend payments and stock repurchases.

The Company's cash balance totaled \$17.1 million at December 31, 2004, compared to \$19.4 million at December 31, 2003. For the year ended December 31, 2004, net cash provided by operating activities was \$6.4 million, cash used in investing activities totaled \$12.2 million, cash provided by financing activities amounted to \$3.9 million and the unfavorable effect of foreign currency translation amounted to \$0.4 million. Significant components of cash provided by operating activities include net earnings adjusted for non-cash expenses of \$26.0 million, offset by a net increase in working capital of \$19.6 million. This increase was primarily due to higher accounts receivable and inventory, which consumed \$17.3 million and \$14.3 million, respectively. Inventory increased in support of higher sales volumes in all segments and from price increases on raw materials. Accounts receivable increased primarily from higher sales volume in all segments. Higher accounts payable balances, related to higher activity and inventory levels, partially offset these items by \$9.2 million. Cash used in investing activities included net capital expenditures totaling \$11.5 million, an increase in other long-term assets of \$0.4 million and spending on acquisitions of \$0.3 million. Capital expenditures in 2004 were primarily for additions to and replacements of production equipment, facility expansion and operating vehicles in the Oil Field segment. Capital expenditures for 2005 are projected to be in the

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range of \$20.0 million to \$22.0 million, primarily for the expansion of manufacturing capacity and efficiency improvement in its Oil Field segment. Significant components of cash provided by financing activities included proceeds from short-term notes payable of \$1.5 million, payments on long-term debt of \$0.2 million, proceeds from the exercise of stock options of \$7.5 million and dividend payments of \$4.9 million or \$0.72 per share.

Total debt balances at December 31, 2004, including current maturities of long-term debt, consisted of \$2.0 million of short-term notes payable. This debt is associated with the Company's French operations. As of December 31, 2004, the Company had no outstanding debt associated with the Bank Facility discussed below. During 2004, total debt increased by \$1.3 million, consisting of short-term borrowings of \$1.5 million and payments on long-term notes payable of \$0.2 million.

The Company has a three-year \$27.5 million credit facility with a domestic bank (the "Bank Facility") consisting of an unsecured revolving line of credit that provides for up to \$17.5 million of committed borrowings along with an additional \$10.0 million discretionary line of credit. This Bank Facility expires on June 30, 2007. Borrowings under the Bank Facility bear interest, at the Company's option, at either the greater of (i) the prime rate, (ii) the base CD rate plus an applicable margin or (iii) the Federal Funds Effective Rate plus an applicable margin or the London Interbank Offered Rate plus an applicable margin, depending on certain ratios as defined in the Bank Facility. As of December 31, 2004, no amounts were outstanding on the \$27.5 million revolving line of credit and the Company was in compliance with all financial covenants under the terms of the Bank Facility.

In addition, the Company has short-term borrowing capabilities with a French bank for the working capital needs of its French operation. Specific accounts receivable are provided as security, with repayment due 15 days after the date the accounts receivable are due from the customer. Interest is calculated at the three-month EURIBOR rate plus an applicable margin. As of December 31, 2004, \$2.0 million was outstanding under this borrowing arrangement.

The Company currently has a stock repurchase plan under which the Company is authorized to spend up to \$19.1 million for repurchases of its common stock. In the second quarter of 2003, the Board of Directors of the Company authorized an additional \$2.0 million of stock repurchases to the plan. Pursuant to this plan, the Company has repurchased a total of 828,370 shares of its common stock at an aggregate purchase price of \$17.0 million. No shares were repurchased during 2004. Repurchased 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, 2004, the Company held 245,639 shares of treasury stock at an aggregate cost of approximately \$5.1 million. Authorizations of approximately \$2.1 million remained at December 31, 2004.

The following table summarizes the Company's expected cash outflows by period from financial contracts and commitments as of December 31, 2004. Information on recurring purchases of materials for use in manufacturing and service operations have not been included. These amounts are not long-term in nature (less than three months) and are generally consistent from year to year.

(Thousands of dollars)	Payments due by period				
	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Operating lease obligations	\$1,409	\$ 395	\$ 515	\$ 334	\$ 165
Contractual commitments for capital expenditures	1,129	1,129	—	—	—
Long-term debt obligations	—	—	—	—	—
<b>Total</b>	<b>\$2,538</b>	<b>\$1,524</b>	<b>\$ 515</b>	<b>\$ 334</b>	<b>\$ 165</b>

Since the Company has no significant tax loss carryforwards, the Company expects to make quarterly estimated tax payments in 2005 based on taxable income levels. Also, the Company has various retirement plans for which the Company has committed a certain level of benefit. The defined benefit plan is overfunded and no contributions are expected in the short-term. The Company expects to make contributions to its defined contribution and post-retirement health and life plans of approximately \$2.7 million annually, depending on participation levels in these plans.

The Company believes that its cash flows from operations and its available borrowing capacity under its credit agreements will be sufficient to fund its operations, including planned capital expenditures, dividend payments and stock repurchases, through December 31, 2005.

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### **Recently Issued Accounting Pronouncements**

In November 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 151 ("SFAS 151"), "Inventory Costs, an amendment of ARB No. 43, Chapter 4." This Statement amends ARB 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage) should be recognized as current-period charges. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005, but early application is permitted during fiscal years after the date this Statement is issued. The Company is currently in the process of evaluating the impact of SFAS 151 on the Company's consolidated financial position or results of operations.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 152 ("SFAS 152"), "Accounting for Real Estate Time-Sharing Transactions." This Statement provides that real estate time-sharing transactions should be accounted for as non-retail land sales as discussed in the recently issued SOP 04-02, "Accounting for Real Estate Time-Sharing Transactions." SFAS 152 amends FASB Statement No. 66, "Accounting for Sales of Real Estate," to reference SOP 04-02 and amends FASB Statement No. 67, "Accounting for Costs and Initial Rental Operations of Real Estate Projects" to state that the guidance for incidental operations and costs incurred to sell real estate projects does not apply to real estate time-sharing transactions. SFAS 152 is effective for financial statements for fiscal years beginning after June 15, 2005. Restatement of previously issued financial statements is not permitted. The Company does not expect the adoption of SFAS 152 to impact the Company's consolidated financial position or results of operations.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 153 ("SFAS 153"), "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29." This Statement addresses the measurement of exchanges of nonmonetary assets. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, "Accounting for Nonmonetary Transactions," and replaces it with an exception for exchanges that do not have commercial substance. This Statement specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for nonmonetary asset exchanges occurring in fiscal years beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date this Statement is issued. The Company does not expect the adoption of SFAS 153 to impact the Company's consolidated financial position or results of operations.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123-Revised 2004 ("SFAS 123R"), "Share-Based Payment," a revision of SFAS No. 123 "Accounting for Stock-Based Compensation," and supersedes APB No. 25, "Accounting for Stock Issued to Employees." This Statement requires that the cost of employee services received in exchange for stock based on the grant-date fair value be measured and that the cost be recognized over the period during which the employee is required to provide service in exchange for the award. The fair value will be estimated using an option-pricing model. Excess tax benefits, as defined in SFAS 123R, will be recognized as an additional paid-in-capital. SFAS 123R is as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. The Company is currently in the process of evaluating the impact of SFAS 123R on the Company's consolidated financial position and results of operations. As noted in the Company's significant accounting policies, the Company does not record compensation expense for stock-based compensation. Note 10 to the Consolidated Financial Statements illustrates the effect on net income and earnings per share had the Company applied the fair value recognition provisions of SFAS 123.

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

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

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

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

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

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

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

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

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

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

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

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The Company offers a defined benefit plan and other benefits upon the retirement of its employees. Assets and liabilities associated with these benefits are calculated by third-party actuaries under the rules provided by various accounting standards, with certain estimates provided by management. These estimates include the discount rate, expected rate of return of assets and the rate of increase of compensation and health claims. On a regular basis, management reviews these estimates by comparing them to actual experience and those used by other companies. If a change in an estimate is made, the carrying value of these assets and liabilities may have to be adjusted. Differences in the discount rate and expected long-term rate of return on plan assets within reasonably likely ranges would have had the following estimated impact on 2004 results:

(Thousands of dollars)	<u>.25 Percentage Point Increase</u>	<u>.25 Percentage Point Decrease</u>
Effect of change in discount rate on net periodic benefit cost (income)	\$ (100)	\$ 102
Effect of change in long-term rate of return on plan assets on net periodic benefit cost (income)	\$ (464)	\$ 464

### Forward-Looking Statements and Assumptions

This Annual Report on Form 10-K contains forward-looking statements and information, within the meaning of the Private Securities Litigation Reform Act of 1995, that are based on management's beliefs as well as assumptions made by and information currently available to management. When used in this report, the words "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, (iv) currency exchange rate fluctuations in the markets in which the Company operates, (v) changes in the laws, regulations, policies or other activities of governments, agencies and similar organizations where such actions may affect the production, licensing, distribution or sale of the Company's products, the cost thereof or applicable tax rates, (vi) costs related to legal and administrative proceedings, including adverse judgments against the Company if the Company fails to prevail in reversing such judgments and (vii) general industry, political and economic conditions in the markets where the Company's procures material, components and supplies for the production of the Company's principal products or where the Company's products are produced, distributed or sold. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, believed, estimated or expected. The Company undertakes no obligations to update or revise its forward-looking statements, whether as a result of new information, future events or otherwise.

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

The Company's financial instruments include cash, accounts receivable, accounts payable, invested funds and debt obligations. The book value of accounts receivable, short-term debt and accounts payable are considered to be representative of their fair market value because of the short maturity of these instruments. 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.

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

The Company is exposed to currency fluctuations with debt denominated in U.S. dollars owed to the Company's U.S. entity by its French and Canadian entities. As of December 31, 2004, this inter-company debt was comprised of 1.5 million euros and 4.5 million Canadian dollars. As of December 31, 2004, if the U.S. dollar strengthens by 10% over these currencies, the net income impact would be \$0.4 million of expense and if the U.S. dollar weakens by 10% over these currencies, the net income impact would be \$0.4 million of income. Also, certain assets and liabilities, primarily employee and tax related, denominated in the local currency of foreign operations whose functional currency is the U.S. dollar are exposed to fluctuations in currency rates.

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

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[Consolidated Statements of Cash Flows](#)

[Notes to Consolidated Financial Statements](#)

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

We have audited the accompanying consolidated balance sheets of Lufkin Industries, Inc. and subsidiaries (the "Company") as of December 31, 2004 and 2003, and the related consolidated statements of earnings, shareholders' equity and comprehensive income, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedules listed in the Index at Item 15. These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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, such consolidated financial statements present fairly, in all material respects, the financial position of Lufkin Industries, Inc. and subsidiaries at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 4, 2005 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

Houston, Texas  
March 4, 2005

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## CONSOLIDATED BALANCE SHEETS

December 31, 2004 and 2003  
(Thousands of dollars, except share and per share data)

	2004	2003
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 17,097	\$ 19,408
Receivables, net	61,038	42,908
Income taxes receivable	—	—
Inventories	54,637	39,460
Deferred income tax assets	2,447	1,472
Other current assets	1,117	1,051
<b>Total current assets</b>	<b>136,336</b>	<b>104,299</b>
Property, plant and equipment, net	89,555	89,000
Prepaid pension costs	59,950	56,563
Goodwill, net	11,790	11,539
Other assets, net	2,638	2,255
<b>Total assets</b>	<b>\$300,269</b>	<b>\$263,656</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Short-term notes payable	\$ 1,976	\$ 493
Current portion of long-term notes payable	—	196
Accounts payable	23,706	14,037
Accrued liabilities:		
Payroll and benefits	6,240	5,965
Accrued warranty expenses	2,729	1,698
Taxes payable	5,213	4,361
Other	9,241	6,718
<b>Total current liabilities</b>	<b>49,105</b>	<b>33,468</b>
Deferred income tax liabilities	31,584	31,349
Postretirement benefits	10,648	10,643
Long-term notes payable, net of current portion	—	—
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; 7,235,979 shares issued	7,236	6,892
Capital in excess of par	26,724	18,480
Retained earnings	177,374	167,862
Treasury stock, 245,639 shares and 302,239 shares, respectively, at cost	(5,075)	(6,244)
Accumulated other comprehensive income:		
Cumulative translation adjustment	2,673	1,206
<b>Total shareholders' equity</b>	<b>208,932</b>	<b>188,196</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$300,269</b>	<b>\$263,656</b>

See notes to consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF EARNINGS

Years ended December 31, 2004, 2003 and 2002  
(Thousands of dollars, except per share data)

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Sales	\$356,281	\$262,255	\$228,724
Cost of sales	294,197	210,238	181,886
Gross profit	62,084	52,017	46,838
Selling, general and administrative expenses	39,371	37,544	33,428
Operating income	22,713	14,473	13,410
Investment income	147	187	607
Interest expense	(139)	(125)	(285)
Other income (expense), net	(17)	1,171	35
Earnings before income taxes	22,704	15,706	13,767
Income tax provision	8,287	5,968	5,232
Net earnings	\$ 14,417	\$ 9,738	\$ 8,535
Net earnings per share:			
Basic	\$ 2.12	\$ 1.49	\$ 1.29
Diluted	\$ 2.07	\$ 1.46	\$ 1.26

See notes to consolidated financial statements.

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& COMPREHENSIVE INCOME**

Years ended December 31, 2004, 2003 and 2002  
(Thousands of dollars, except share and per share data)

	Common Stock		Capital In Excess Of Par	Retained Earnings	Treasury Stock	Cumulative Translation Adjustment	Compre- hensive Income (Loss)
	Shares	Amount					
Balance, Dec. 31, 2001	6,892,381	\$ 6,892	\$18,200	\$158,973	\$(10,350)	\$ (2,716)	
Comprehensive income:							
Net earnings				8,535			\$ 8,535
Other comprehensive income, net of tax							
Foreign currency translation adjustment						982	982
Comprehensive income							9,517
Cash dividends, \$.72 per share				(4,670)			
Exercise of stock options (137,886 treasury shares)			277		2,826		
Balance, Dec. 31, 2002	6,892,381	6,892	18,477	162,838	(7,524)	(1,734)	
Comprehensive income:							
Net earnings				9,738			9,738
Other comprehensive income, net of tax							
Foreign currency translation adjustment						2,940	2,940
Comprehensive income							12,678
Cash dividends, \$.72 per share				(4,714)			
Treasury stock purchases (1,500 shares)					(31)		
Exercise of stock options (64,962 treasury shares)			3		1,311		
Balance, Dec. 31, 2003	6,892,381	6,892	18,480	167,862	(6,244)	1,206	
Comprehensive income:							
Net earnings				14,417			14,417
Other comprehensive income, net of tax							
Foreign currency translation adjustment						1,467	1,467
Comprehensive income							\$15,884
Cash dividends, \$.72 per share				(4,905)			
Exercise of stock options (56,600 treasury shares)	343,598	344	8,244		1,169		
Balance, Dec. 31, 2004	7,235,979	\$ 7,236	\$26,724	\$177,374	\$(5,075)	\$ 2,673	

See notes to consolidated financial statements.

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## CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2004, 2003 and 2002  
(Thousands of dollars)

	2004	2003	2002
Cash flows from operating activities:			
Net earnings	\$ 14,417	\$ 9,738	\$ 8,535
Adjustments to reconcile net earnings to net cash Provided by operating activities:			
Depreciation and amortization	11,823	11,653	11,417
Deferred income tax provision	3,146	2,153	1,789
Pension income	(3,387)	(1,843)	(5,283)
Postretirement benefits	4	(313)	(67)
(Gain) loss on disposition of property, plant and equipment	(59)	(1,018)	(22)
Increase (decrease) in cash flows from changes in working capital excluding effects of acquisitions:			
Receivables, net	(17,396)	(5,165)	2,674
Income taxes receivable	—	47	(39)
Inventories	(14,308)	(3,102)	3,576
Other current assets	(20)	(354)	298
Accounts payable	9,158	177	399
Accrued liabilities	2,967	1,544	(941)
Net cash provided by operating activities	6,345	13,517	22,336
Cash flows from investing activities:			
Additions to property, plant and equipment	(11,723)	(13,006)	(10,410)
Proceeds from disposition of property, plant and equipment	229	1,212	293
Acquisition of other companies	(313)	(5,798)	—
Decrease in invested funds	—	—	5,863
Increase in other assets	(380)	(859)	(8)
Net cash used in investing activities	(12,187)	(18,451)	(4,262)
Cash flows from financing activities:			
Proceeds from (payments of) short-term debt, net	1,474	493	—
Payments of long-term notes payable	(193)	(260)	(6,731)
Dividends paid	(4,905)	(4,714)	(4,670)
Proceeds from exercise of stock options	7,543	1,179	2,628
Purchases of treasury stock	—	(31)	—
Net cash used in financing activities	3,919	(3,333)	(8,773)
Effect of translation on cash and cash equivalents	(388)	67	220
Net increase (decrease) in cash and cash equivalents	(2,311)	(8,200)	9,521
Cash and cash equivalents at beginning of year	19,408	27,608	18,087
Cash and cash equivalents at end of year	\$ 17,097	\$ 19,408	\$ 27,608

See notes to consolidated financial statements.

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

Lufkin Industries, Inc. and its consolidated subsidiaries (collectively, the “Company”) manufacture and sell oil field pumping units, power transmission products 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 inter-company accounts and transactions.

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

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

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

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

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

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

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

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

**Inventories:** The Company reports its inventories by using the last-in, first-out (LIFO) and the first-in, first-out (FIFO) methods less reserves necessary to report inventories at the lower of cost or estimated market. Inventory costs include material, labor and factory overhead. On a routine basis, the Company uses estimates in determining the level of reserves required to state inventory at the lower of cost or market. Management’s estimates are primarily influenced by market activity levels, production requirements, the physical condition of products and technological innovation. Changes in any of these factors may result in adjustments to the carrying value of inventory.

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

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

	<b>Useful Life (In Years)</b>
Land	—
Land improvements	10.0 – 25.0
Buildings	12.5 – 40.0
Machinery and equipment	3.0 – 15.0
Furniture and fixtures	5.0 – 12.5
Computer equipment and software	3.0 – 7.0

**Goodwill and other intangible assets:** In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (“SFAS”) No. 142, “Goodwill and Other Intangible Assets.” SFAS No. 142 eliminated the amortization of goodwill and intangible assets with indefinite lives and requires that such assets be tested for impairment at least annually. During the first quarter of 2004, the Company completed its annual impairment evaluation by comparing the fair value of each reporting unit to its carrying amount. Since the fair value of each reporting unit exceeded the carrying value, no impairment was recorded.

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

**Income taxes:** 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. See Note 6 for more detail.

**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, all current, 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.

The Company adopted Statement of Financial Accounting Standards (“SFAS”) No. 133, “Accounting for Derivative Instruments and Hedging Activities,” and SFAS No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities,” an amendment of SFAS No. 133, as of the quarter ended March 31, 2001. These statements establish accounting and reporting standards that require every derivative instrument, including certain derivative instruments embedded in other contracts, to be recorded on the balance sheet as either an asset or a liability measured at its fair value. As of December 31, 2004, the Company had no reportable derivatives.

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

**Stock-based compensation:** The Company has elected to follow the accounting provisions of APB No. 25, "Accounting for Stock Issued to Employees," for stock-based compensation and to furnish the pro-forma disclosures required under SFAS No. 148, "Accounting for Stock-Based Compensation- Transition and Disclosures." 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 No. 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):

		2004	2003	2002
Net earnings, as reported		\$14,417	\$9,738	\$8,535
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects		(838)	(740)	(750)
Pro forma net earnings		\$13,579	\$8,998	\$7,785
Earnings per share:				
Basic earnings per share	As reported	\$ 2.12	\$ 1.49	\$ 1.29
	Pro forma	\$ 2.00	\$ 1.38	\$ 1.18
Diluted earnings per share	As reported	\$ 2.07	\$ 1.46	\$ 1.26
	Pro forma	\$ 1.95	\$ 1.35	\$ 1.15

The effects of applying SFAS No. 123 to the pro forma disclosure amounts may not be indicative of future amounts. SFAS No. 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:

	2004 Grants	2003 Grants	2002 Grants
Expected dividend yield	1.95% - 2.35%	2.96% - 3.28%	2.49% - 3.19%
Expected stock price volatility	38.78% - 38.82%	37.23% - 38.68%	38.31% - 38.59%
Risk free interest rate	4.10% - 4.57%	3.69% - 4.46%	4.08% - 5.06%
Expected life of options	10 years	10 years	10 years

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

**Recently issued accounting pronouncements:** In November 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 151 ("SFAS 151"), "Inventory Costs, an amendment of ARB No. 43, Chapter 4." This Statement amends ARB 43, Chapter 4, to clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage) should be recognized as current-period charges. In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005, but early application is permitted during fiscal years after the date this Statement is issued. The Company is currently in the process of evaluating the impact of SFAS 151 on the Company's consolidated financial position or results of operations.

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

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 152 ("SFAS 152"), "Accounting for Real Estate Time-Sharing Transactions." This Statement provides that real estate time-sharing transactions should be accounted for as non-retail land sales as discussed in the recently issued SOP 04-02, "Accounting for Real Estate Time-Sharing Transactions." SFAS 152 amends FASB Statement No. 66, "Accounting for Sales of Real Estate," to reference SOP 04-02 and amends FASB Statement No. 67, "Accounting for Costs and Initial Rental Operations of Real Estate Projects" to state that the guidance for incidental operations and costs incurred to sell real estate projects does not apply to real estate time-sharing transactions. SFAS 152 is effective for financial statements for fiscal years beginning after June 15, 2005. Restatement of previously issued financial statements is not permitted. The Company does not expect the adoption of SFAS 152 to impact the Company's consolidated financial position or results of operations.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 153 ("SFAS 153"), "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29." This Statement addresses the measurement of exchanges of nonmonetary assets. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, "Accounting for Nonmonetary Transactions," and replaces it with an exception for exchanges that do not have commercial substance. This Statement specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for nonmonetary asset exchanges occurring in fiscal years beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date this Statement is issued. The Company does not expect the adoption of SFAS 153 to impact the Company's consolidated financial position or results of operations.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123-Revised 2004 ("SFAS 123R"), "Share-Based Payment," a revision of SFAS No. 123 "Accounting for Stock-Based Compensation," and supersedes APB No. 25, "Accounting for Stock Issued to Employees." This Statement requires that the cost of employee services received in exchange for stock based on the grant-date fair value be measured and that the cost be recognized over the period during which the employee is required to provide service in exchange for the award. The fair value will be estimated using an option-pricing model. Excess tax benefits, as defined in SFAS 123R, will be recognized as an additional paid-in-capital. SFAS 123R is as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. The Company is currently in the process of evaluating the impact of SFAS 123R on the Company's consolidated financial position and results of operations. As noted in the Company's significant accounting policies, the Company does not record compensation expense for stock-based compensation. Note 10 illustrates the effect on net income and earnings per share had the Company applied the fair value recognition provisions of SFAS 123.

### **(2) Acquisitions**

During the third quarter of 2003, the Company completed two strategic acquisitions that will expand its Oil Field segment. The Company purchased the remaining shares of Lufkin Argentina S.A., its 1992 Argentina joint venture with Baker Hughes, Inc, effective July 1, 2003. Lufkin Argentina manufactures and services oil field pumping units and automation equipment for use in Argentina and other South American countries. The Company also purchased the operating assets of Basin Technical Services in Midland, Texas on July 30, 2003. This acquisition enhances Oil Field's product and service offerings in the oil field automation marketplace. The aggregate purchase price for these acquisitions was \$3.9 million in cash.

During the fourth quarter of 2003, the Company completed the acquisition on December 9, 2003, of the operating assets and commercial operations of D&R Oilfield Services located in Drayton Valley, Alberta, Canada. This acquisition within the Oil Field segment strengthens the Company's presence in Canada's oil field service business. The aggregate purchase price for this acquisition was \$1.9 million in cash.

The Company has completed the purchase allocation process for these three acquisitions. As part of the purchase allocation process, certain goodwill and intangible balances were recorded in 2003, as seen in Note 8.

During the fourth quarter of 2004, the Company completed the acquisition on November 1, 2004, of the operating assets and commercial operations of Black Widow Oilfield Services located in Medicine Hat, Alberta, Canada to further expand its service presence in Canada. The aggregate purchase price for this acquisition was \$0.3 million in cash.

The Company has substantially completed the purchase allocation process for this acquisition, but additional adjustments may be made in 2005 as final valuations and analysis of fair values are completed. As part of the purchase allocation process, certain goodwill and intangible balances were recorded in 2004, as seen in Note 8.

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### (3) Receivables

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

(Thousands of dollars)	2004	2003
Accounts receivable	\$61,182	\$43,154
Notes receivable	32	45
	<u>61,214</u>	<u>43,199</u>
Allowance for doubtful accounts	(176)	(291)
Net receivables	<u>\$61,038</u>	<u>\$42,908</u>

Bad debt expense/(recovery) related to receivables was \$0.3 million, \$0.1 million and (\$0.1) million in 2004, 2003 and 2002, respectively.

### (4) Property, Plant & Equipment

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

(Thousands of dollars)	2004	2003
Land	\$ 3,231	\$ 3,060
Land improvements	7,042	6,864
Buildings	69,232	65,197
Machinery and equipment	187,741	186,361
Furniture and fixtures	4,095	3,978
Computer equipment and software	12,959	12,892
	<u>284,300</u>	<u>278,352</u>
Less accumulated depreciation	(194,745)	(189,352)
Total property, plant and equipment, net	<u>\$ 89,555</u>	<u>\$ 89,000</u>

Depreciation expense related to property, plant and equipment was \$11.7 million, \$11.6 million and \$11.3 million in 2004, 2003 and 2002, respectively.

### (5) 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 2004, 2003 and 2002 is illustrated below:

(Thousands of dollars, except share and per share data)	2004	2003	2002
<b>Numerator:</b>			
Numerator for basic and diluted earnings per share-net earnings	\$ 14,417	\$ 9,738	\$ 8,535
<b>Denominator:</b>			
Denominator for basic earnings per share-weighted-average shares	6,785,170	6,542,436	6,610,312
Effect of dilutive securities: employee stock options	174,885	105,380	150,328
Denominator for diluted earnings per share-adjusted weighted-average shares and assumed conversions	<u>6,960,055</u>	<u>6,647,816</u>	<u>6,760,640</u>
Basic earnings per share	\$ 2.12	\$ 1.49	\$ 1.29
Diluted earnings per share	<u>\$ 2.07</u>	<u>\$ 1.46</u>	<u>\$ 1.26</u>

Options to purchase a total of 1,548, 305,311 and 312,896 shares of the Company's common stock were excluded from the calculation of fully diluted earnings per share for 2004, 2003 and 2002, respectively, because their effect on fully diluted earnings per share for the period were antidilutive.

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### (6) Income Taxes

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

(Thousands of dollars)	2004	2003
Current deferred income tax assets		
Gross assets	\$ 6,549	\$ 4,872
Gross liabilities	(4,102)	(3,400)
Total current deferred income tax assets, net	2,447	1,472
Noncurrent deferred income tax liabilities		
Gross assets	12,469	12,021
Gross liabilities	(44,053)	(43,370)
Total noncurrent deferred income tax liabilities, net	(31,584)	(31,349)
Net deferred income tax liabilities	\$(29,137)	\$(29,877)

In 2003, noncurrent deferred income tax liabilities were increased by \$891,000 from the preliminary purchase accounting for the Argentina acquisition and did not impact the income tax provision. The final fair value analysis of the deferred tax balances completed during 2004 determined these noncurrent deferred income tax liabilities were not required and were reclassified to other balance sheet accounts as part of the fair value allocation and did not impact the income tax provision.

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

(Thousands of dollars)	2004	2003
Inventories	\$ (701)	\$ (803)
Prepaid pension costs	(21,406)	(20,330)
Payroll and benefits	932	963
Accrued warranty expenses	915	520
Postretirement benefits	4,003	4,119
Prepaid expenses	(433)	(170)
Depreciation	(13,676)	(13,893)
Accrued liabilities	2,261	1,342
Other, net	(1,032)	(1,625)
Net deferred income tax liabilities	\$(29,137)	\$(29,877)

The income tax provision for 2004, 2003 and 2002 consisted of the following:

(Thousands of dollars)	2004	2003	2002
Current	\$8,410	\$3,505	\$3,187
Deferred	(123)	2,463	2,044
Total	\$8,287	\$5,968	\$5,231

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)	2004	2003	2002
Tax provision computed at statutory rate	\$7,947	\$5,497	\$4,818
Tax effect of:			
Expenses for which no benefit was realized	160	114	447
Change in effective state tax rate	—	411	—
State taxes net of federal benefit	472	225	236
Benefit of export incentives	(504)	(347)	(564)
Other, net	212	68	294
Provision for income taxes	\$8,287	\$5,968	\$5,231

Cash payments for income taxes totaled \$6,484,000, \$2,278,000 and \$3,787,000 for 2004, 2003 and 2002, respectively.



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### **(7) Inventories**

Inventories used in determining cost of sales were as follows:

<u>(Thousands of dollars)</u>	<u>2004</u>	<u>2003</u>
Gross inventories @ FIFO:		
Finished goods	\$ 7,770	\$ 3,475
Work in process	10,604	7,411
Raw materials & component parts	58,399	47,967
Total gross inventories @ FIFO	<u>76,773</u>	<u>58,853</u>
Less reserves:		
LIFO	20,985	17,778
Valuation	1,151	1,615
Total inventories as reported	<u>\$54,637</u>	<u>\$39,460</u>

Gross inventories on a FIFO basis shown above that were accounted for on a LIFO basis were \$57.3 million and \$40.2 million at December 31, 2004 and 2003, respectively.

During 2004 and 2003, 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. There were no reductions in 2004 and the impact of reductions in 2003 increased net income by approximately \$2,000, net of taxes (\$0.00 per diluted share).

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

Balances and related amortization expense for goodwill and acquired intangible assets are as follows:

#### Acquired Intangible Assets

<u>(Thousands of dollars)</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Amortized intangible assets:		
Non-Compete Agreements		
As of December 31, 2003	\$ 463	\$ (8)
As of December 31, 2004	\$ 500	\$ (108)
Unamortized intangible assets:		
None		
Aggregate Amortization Expense:		
For the year ended 12/31/02	\$ 76	
For the year ended 12/31/03	\$ 46	
For the year ended 12/31/04	\$ 93	
Estimated Amortization Expense:		
For the year ended 12/31/05	\$ 100	
For the year ended 12/31/06	\$ 100	
For the year ended 12/31/07	\$ 100	
For the year ended 12/31/08	\$ 92	
For the year ended 12/31/09	\$ —	

The Company also has multi-year non-compete agreements with certain individuals that are paid and expensed on an annual basis and thus are not recorded as pre-paid assets. Expenses related to these non-compete agreements were \$79,000, \$81,000 and \$64,000 for the years 2004, 2003 and 2002, respectively. Estimated expenses for these agreements are \$75,000 for the years 2005 through 2006 and \$44,000 in 2007.

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### (8) Goodwill & Acquired Intangible Assets (Continued)

#### Goodwill

The changes in the carrying amount of goodwill for the year ended December 31, 2004, are as follows:

(Thousands of dollars)	Oil	Power	Trailer	Total
	Field	Transmission		
Balance as of 12/31/03	\$9,348	\$ 2,191	\$ —	\$11,539
Goodwill acquired during year	79	—	—	79
Impairment losses	—	—	—	—
Goodwill written off related to sale of business unit	—	—	—	—
Foreign currency translation	—	172	—	172
Balance as of 12/31/04	\$9,427	\$ 2,363	\$ —	\$11,790

Goodwill impairment tests were performed in the first quarter of 2004 and no impairment losses were recorded.

#### (9) Debt Obligations

During the third quarter of 2004, the Company renewed its \$27.5 million credit facility with a domestic bank (the "Bank Facility") consisting of an unsecured revolving line of credit that provides for up to \$17.5 million of committed borrowings along with an additional \$10.0 million discretionary line of credit for an additional three years. The Bank Facility expires on June 30, 2007. Borrowings under the Bank Facility bear interest, at the Company's option, at either the greater of (i) the prime rate, (ii) the base CD rate plus an applicable margin or (iii) the Federal Funds Effective Rate plus an applicable margin or the London Interbank Offered Rate ("LIBOR") plus an applicable margin, depending on certain ratios as defined in the agreement. The Bank Facility includes customary affirmative and negative covenants, including a minimum tangible net worth, a maximum leverage ratio and a minimum current ratio. As of December 31, 2004, no amounts were outstanding of the \$27.5 million of the revolving line of credit and all financial covenants were in compliance under the terms of the Bank Facility.

In addition, the Company has short-term borrowing capabilities with a French bank for the working capital needs of its French operation. Specific accounts receivable are provided as security, with repayment due 15 days after the date the accounts receivable are due from the customer. Interest is calculated at the three-month EURIBOR rate plus an applicable margin. As of December 31, 2004, \$2.0 million was outstanding under this borrowing arrangement.

The Company's long-term notes payable at December 31, 2004 and 2003 consisted of the following:

(Thousands of dollars, except payment amounts)	2004	2003
Notes payable to banks denominated in euros, interest ranging from 3.7% to 4.9%, due in quarterly installments ranging from \$10,000 to \$52,000 secured by certain assets, maturing through 2004	—	196
Less-current maturities of long-term notes payable	—	—
Total	\$ —	\$ 196

Principal payments of long-term notes payable as of December 31, 2004 are as follows:

(Thousands of dollars)	
Year ending December 31,	
2005	\$ —
2006	—
2007	—
2008	—
2009	—
Total	\$ —

Cash payments for interest totaled \$17,000, \$13,000 and \$315,000 in 2004, 2003 and 2002, respectively.

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### (10) Stock Option Plans

The Company has two stock option plans, the 2000 plan for employees and the 1996 plan for non-employee directors, 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. Options become exercisable from the initial grant date to four years after the grant date. The options expire ten years from the date of grant. Outstanding options may be canceled and reissued under terms specified in the plans. The 1990 plan, which originally was authorized to grant 1,100,000 options, will remain in effect until all awards granted under this plan have been satisfied or expire. As of December 31, 2004, 102,912 options remained outstanding and exercisable from the 1990 plan.

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

	2004	2003	2002
Options outstanding, beginning of year	1,058,914	963,048	949,691
Granted (per share)			
2002 (\$22.575 to \$28.900)			154,404
2003 (\$21.920 to \$25.750)		179,203	
2004 (\$30.600 to \$37.000)	117,431		
Exercised (per share)			
2002 (\$14.000 to \$25.455)			(137,886)
2003 (\$14.000 to \$22.750)		(64,962)	
2004 (\$14.000 to \$38.000)	(400,198)		
Forfeited (per share)			
2002 (\$17.500 to \$39.375)			(3,161)
2003 (\$14.000 to \$38.000)		(18,375)	
2004 (\$14.000 to \$38.000)	(79,925)		
Options outstanding, end of year	696,222	1,058,914	963,048

The following table summarizes information about stock options outstanding at December 31, 2004:

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Number Outstanding at 12/31/04	Wtd. Avg. Contractual Remaining Life	Wtd. Avg. Exercise Price	Number Exercisable at 12/31/04	Wtd. Avg. Contractual Remaining Life	Wtd. Avg. Exercise Price
\$14.000-\$18.375	112,886	5.6 years	\$ 16.99	112,886	5.6 years	\$ 16.99
\$20.000-\$22.575	102,042	5.5 years	\$ 22.05	102,042	5.5 years	\$ 22.05
\$22.750-\$33.375	389,896	7.6 years	\$ 26.01	195,279	6.8 years	\$ 26.54
\$35.250-\$39.875	91,398	8.6 years	\$ 37.03	16,098	2.9 years	\$ 37.16
\$14.000-\$39.875	696,222	7.1 years	\$ 25.41	426,305	6.0 years	\$ 23.34

Options granted during 2004 had a weighted average fair value of \$14.57 per option and a weighted average exercise price of \$34.76 per option, options granted during 2003 had a weighted average fair value of \$8.52 per option and a weighted average exercise price of \$23.59 per option and options granted during 2002 had a weighted average fair value of \$9.41 per option and a weighted average exercise price of \$25.15 per option. At December 31, 2004, 319,340 options authorized remained available to be granted.

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### **(11) Stock Repurchase Plan**

The Company currently has a stock repurchase plan under which the Company is authorized to spend up to \$19.1 million for repurchases of its common stock. In the second quarter of 2003, the Board of Directors of the Company authorized an additional \$2.0 million of stock repurchases to the plan. Pursuant to this plan, the Company has repurchased a total of 828,370 shares of its common stock at an aggregate purchase price of \$17.0 million. Repurchased 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, 2004, the Company held 249,639 shares of treasury stock at an aggregate cost of approximately \$5.1 million. Authorizations of approximately \$2.1 million remained at December 31, 2004.

### **(12) Capital Stock**

The Company has 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. As of December 31, 2004, no shares of preferred stock had been issued.

### **(13) 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.

The Company sponsors two defined benefit postretirement plans that cover both salaried and hourly employees. One plan provides medical benefits, and the other plan provides life insurance benefits. Both plans are contributory, with retiree contributions adjusted periodically. The Company accrues the estimated costs of the plans over the employee's service periods. The Company's postretirement health care plan is unfunded. For measurement purposes, the submitted claims medical trend was assumed to be 9.25% in 1997. Thereafter, the Company's obligation is fixed at the amount of the Company's contribution for 1997.

The Company also has qualified defined contribution retirement plans covering substantially all of its 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, 2004. The Company's expense for these plans totaled \$2.2 million, \$1.9 million and \$1.9 million in 2004, 2003 and 2002, respectively.

On December 8, 2003, the "Medicare Prescription Drug, Improvement and Modernization Act of 2003" (the "Act") was signed into law. The Act introduces a prescription drug benefit under Medicare as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Measures of the accumulated postretirement benefit obligation and net periodic postretirement benefit cost do not reflect any amount associated with the subsidy because the Company's plan is not actuarially equivalent to Medicare Part D and is not expected to receive any subsidy.

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(13) Retirement Benefits (Continued)

Obligations and Funded Status

At December 31 (Thousands of dollars)	Pension Benefits		Other Benefits	
	2004	2003	2004	2003
<b>Change in benefit obligation</b>				
Benefit obligation at beginning of year	\$148,476	\$131,206	\$ 11,781	\$ 9,527
Service cost	4,063	3,870	220	201
Interest cost	8,931	8,852	677	727
Plan participants' contributions	—	—	1,449	1,342
Amendments	—	3,273	—	—
Actuarial loss (gain)	2,974	8,271	80	2,567
Benefits paid	(7,091)	(6,996)	(2,342)	(2,583)
Benefit obligation at end of year	157,353	148,476	11,865	11,781
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year	189,370	167,325	—	—
Actual return on plan assets	18,094	29,041	—	—
Employer contribution	—	—	—	—
Plan participants' contributions	—	—	—	—
Benefits paid	(7,091)	(6,996)	—	—
Fair value of plan assets at end of year	200,373	189,370	—	—
Funded status	43,020	40,894	(11,865)	(11,781)
Unrecognized net actuarial loss (gain)	15,786	15,141	1,217	1,138
Unrecognized prior service cost (benefit)	4,561	4,872	—	—
Unrecognized net transition asset	(3,417)	(4,344)	—	—
Net amount recognized	\$ 59,950	\$ 56,563	\$ (10,648)	\$ (10,643)

Amounts recognized in the statement of financial position consist of:

(Thousands of dollars)	Pension Benefits		Other Benefits	
	2004	2003	2004	2003
Prepaid pension costs	\$59,950	\$56,563	\$ —	\$ —
Postretirement benefits	—	—	(10,648)	(10,643)
Net amount recognized	\$59,950	\$56,563	\$ (10,648)	\$ (10,643)

The accumulated benefit obligation for all defined benefit pension plans was \$146.1 million and \$137.5 million at December 31, 2004, and 2003, respectively.

**Components of Net Periodic Benefit Cost**

(Thousands of dollars)	Pension Benefits		Other Benefits	
	2004	2003	2004	2003
Service cost	\$ 4,063	\$ 3,870	\$220	\$201
Interest cost	8,931	8,852	677	727
Expected return on plan assets	(15,766)	(14,320)	—	—
Amortization of prior service cost	311	311	—	—
Amortization of unrecognized net (gain) loss	—	370	—	—
Amortization of unrecognized transition asset	(926)	(926)	—	—
Net periodic benefit cost (income)	\$ (3,387)	\$ (1,843)	\$897	\$928

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(13) Retirement Benefits (Continued)

Additional Information

(Thousands of dollars)	Pension Benefits		Other Benefits	
	2004	2003	2004	2003
	Increase in minimum liability included in other comprehensive income	\$ —	\$ —	\$ —

Assumptions

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

	Pension Benefits		Other Benefits	
	2004	2003	2004	2003
	Discount rate	6.00%	6.25%	5.75%
Rate of compensation increase	4.25%	4.25%	N/A	N/A

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

	Pension Benefits		Other Benefits	
	2004	2003	2004	2003
	Discount rate	6.25%	6.75%	6.25%
Expected long-term return on plan assets	8.50%	8.75%	N/A	N/A
Rate of compensation increase	4.25%	4.50%	N/A	N/A

For 2004, the Company assumed a long-term asset rate of return of 8.50%. In developing the 8.50% expected long-term rate of return assumption, the Company evaluated input from its third-party pension plan asset manager, including their review of asset class return expectations and long-term inflation assumptions. The Company also considered its historical 10-year and 13-year compounded return (period ended December 31, 2003), which were in-line to higher than the Company's long-term rate of return assumption.

Assumed health care cost trend rates at December 31

Since the Company's costs for the retiree medical was fixed as of January 1, 1997, no health care cost inflation has been assumed.

	2004	2003
Health care cost trend rate assumed for next year	0.00%	0.00%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	0.00%	0.00%
Year that the rate reaches the ultimate trend rate	0.00%	0.00%

**Table of Contents****(13) Retirement Benefits (Continued)**

Assumed health care cost trend rates can have a significant effect on the amounts reported for health care plans. However, since the Company's costs for the retiree medical was fixed as of January 1, 1997, the 1% change in medical trend assumptions do not have any impact on the plan's service cost, interest cost or benefit obligation.

<u>(Thousands of dollars)</u>	<u>1-Percentage- Point Increase</u>	<u>1-Percentage- Point Decrease</u>
Effect on total of service and interest cost	\$ —	\$ —
Effect on postretirement benefit obligation	\$ —	\$ —

**Plan Assets**

The Company's pension plan weighted-average asset allocations at December 31, 2004, and 2003, by asset category are as follows:

	<u>Target Allocation</u>	<u>Plan Assets At December 31,</u>	
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Equity securities	40% - 70%	60%	58%
Debt securities	30% - 60%	31%	37%
Real estate / Other	0% - 15%	9%	5%
<b>Total</b>		<b>100%</b>	<b>100%</b>

The Company invests in a diversified portfolio consisting of an array of assets classes that attempts to maximize returns while minimizing volatility. These asset classes include U.S. domestic equities, developed market equities, fixed income and real estate. During 2003, the Company positioned the portfolio to take advantage of the improved equity markets. Concurrently, the Company diversified its fixed income allocation and expanded its real estate investments.

No equity or debt securities of the Company were held by the plan at December 31, 2004, or 2003.

The postretirement benefit plan of the Company is unfunded and thus had no plan assets as of December 31, 2004, and 2003.

**Cash Flows****Contributions**

The Company does not expect to make any contributions to the pension plan in 2005 and expects to make contributions of \$450,000 to its other postretirement plan in 2005.

**Estimated Future Benefit Payments**

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

<u>(Thousands of dollars)</u>	<u>Pension Benefits</u>	<u>Other Benefits</u>
2005	\$ 8,024	\$ 869
2006	8,286	872
2007	8,713	887
2008	9,096	898
2009	9,612	909
2010 - 2014	56,384	4,823

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### (14) Commitments and Contingencies

**Legal proceedings:** A class action complaint was filed in the U.S. 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 1998 and in Lufkin, Texas in August 1998. In April 1999, the District Court issued a decision that certified a class for this case, which included all 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 U.S. Court of Appeals for the Fifth Circuit in New Orleans, Louisiana. This appeal was denied on June 23, 1999. The case was closed from 2001 to 2003 while the parties unsuccessfully attempted mediation. Trial for this case began in December 2003, but was postponed by the District Court and was completed in November 2004. The only claims made at trial were those of discrimination in initial assignments, promotions and compensation.

On January 13, 2005 the District Court entered its decision finding that the Company discriminated against African-American employees when awarding initial assignments and promotions. The District Court also concluded that the discrimination resulted in a shortfall in income for those employees and ordered that the Company pay those employees back pay to remedy such shortfall, together with pre-judgment interest in the amount of 10%, compounded annually. The Company's preliminary estimate is that the total amount of back pay that it would be required to pay to the class of affected employees could total up to \$6 million (including interest). In addition to back pay with interest, the Court (i) enjoined and ordered the Company to cease and desist all racially biased assignment and promotion practices, (ii) ordered the Company to pay court costs and (iii) agreed to consider a request for awarding plaintiffs' attorneys' fees against the Company. On January 27, 2005, the plaintiffs moved for an interim award of attorney fees and costs, which they estimated to be \$6.5 million, but to date the District Court has not ruled on this request.

The Company has reviewed this decision with its outside counsel and intends to appeal the decision to the U.S. Court of Appeals for the Fifth Circuit. The Company believes that after a full and fair review by the appeals court of the evidence, the Court of Appeals will determine that the plaintiffs have not established their claims of discrimination by the Company against the plaintiffs and will enter a decision to that effect and will dismiss the case against the Company. At this time, the Company has concluded that an unfavorable ultimate outcome is not probable. If the District Court's decision is reversed and remanded for a new trial, the Company will vigorously defend itself on retrial. While the ultimate outcome and impact of these claims against the Company cannot be predicted with certainty, the Company believes that the resolutions of these proceedings will not have a material adverse effect on its consolidated financial position. However, should the Company be unsuccessful in its appeal, the final determination could have a material impact on the Company's reported earnings and cash flows in a future reporting period.

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 consolidated financial position, results of operations or cash flow.

**Product warranties:** The change in the aggregate product warranty liability for the year ended December 31, 2004, is as follows:

(Thousands of dollars)

Beginning balance	\$ 1,698
Claims paid	(1,958)
Additional warranties issued	2,723
Revisions in estimates	251
Currency	15
Ending Balance	\$ 2,729

### (15) Concentrations of Credit Risk

The Company's concentration with respect to trade accounts receivable is limited. The large number of customers and diversified customer base across the three segments significantly reduces the Company's credit risk. The Company also has strict policies regarding the granting of credit to customers and does not offer credit terms to those customers that do not meet certain financial criteria and other guidelines.

**Table of Contents****(16) Business Segment Information**

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

(Thousands of dollars)	2004	2003	2002
<b>Sales:</b>			
Oil Field	\$216,025	\$144,802	\$118,700
Power Transmission	79,498	74,625	70,455
Trailer	60,758	43,548	39,569
<b>Total sales</b>	<b>\$356,281</b>	<b>\$262,255</b>	<b>\$228,724</b>
<b>Sales by geographic region:</b>			
United States	\$262,606	\$175,631	\$167,719
Europe	15,278	23,506	12,704
Canada	19,544	12,619	12,368
Latin America	43,349	33,052	23,941
Other	15,504	17,447	11,992
<b>Total sales</b>	<b>\$356,281</b>	<b>\$262,255</b>	<b>\$228,724</b>
<b>Earnings (loss) before income taxes:</b>			
Oil Field	\$ 25,089	\$ 17,657	\$ 11,131
Power Transmission	2,332	2,748	5,001
Trailer	(5,079)	(5,879)	(2,861)
Corporate	362	1,180	496
<b>Total earnings (loss) before income taxes</b>	<b>\$ 22,704</b>	<b>\$ 15,706</b>	<b>\$ 13,767</b>
<b>Assets:</b>			
Oil Field	\$154,315	\$130,513	\$111,915
Power Transmission	75,562	70,230	69,210
Trailer	38,346	28,831	30,288
Corporate	32,046	34,082	36,942
<b>Total assets</b>	<b>\$300,269</b>	<b>\$263,656</b>	<b>\$248,355</b>
<b>Property, plant &amp; equipment, net, by geographic region:</b>			
United States	\$ 70,290	\$ 74,257	\$ 72,559
Europe	8,483	8,755	7,751
Canada	5,746	3,079	856
Latin America	4,867	2,790	—
Other	169	119	65
<b>Total P, P &amp; E, net, by geographic region</b>	<b>\$ 89,555</b>	<b>\$ 89,000</b>	<b>\$ 81,231</b>
<b>Capital expenditures:</b>			
Oil Field	\$ 9,274	\$ 3,286	\$ 6,799
Power Transmission	2,095	2,438	3,265
Trailer	158	170	212
Corporate	196	7,112	134
<b>Total capital expenditures</b>	<b>\$ 11,723</b>	<b>\$ 13,006</b>	<b>\$ 10,410</b>
<b>Depreciation/Amortization:</b>			
Oil Field	\$ 5,627	\$ 5,146	\$ 4,620
Power Transmission	4,353	4,578	4,484
Trailer	481	529	629
Corporate	1,363	1,400	1,684
<b>Total depreciation/amortization</b>	<b>\$ 11,824</b>	<b>\$ 11,653</b>	<b>\$ 11,417</b>

**Table of Contents****(16) Business Segment Information (Continued)**

Additional key segment information is presented below:

**For the Year Ended December 31, 2004**

(Thousands of dollars)	Power				
	Oil Field	Transmission	Trailer	Corporate	Total
Gross sales	\$218,056	\$ 81,622	\$60,790	\$ —	\$360,468
Inter-segment sales	(2,031)	(2,124)	(32)	—	(4,187)
Net sales	<u>\$216,025</u>	<u>\$ 79,498</u>	<u>\$60,758</u>	<u>\$ —</u>	<u>\$356,281</u>
Operating income (loss)	\$ 25,545	\$ 2,243	\$(5,075)	\$ —	\$ 22,713
Other income (expense)	(456)	89	(4)	362	(9)
Earnings (loss) before tax provision	<u>\$ 25,089</u>	<u>\$ 2,332</u>	<u>\$(5,079)</u>	<u>\$ 362</u>	<u>\$ 22,704</u>

**For the Year Ended December 31, 2003**

	Power				
	Oil Field	Transmission	Trailer	Corporate	Total
Gross sales	\$145,522	\$ 76,282	\$43,603	\$ —	\$265,407
Inter-segment sales	(1,440)	(1,657)	(55)	—	(3,152)
Net sales	<u>\$144,082</u>	<u>\$ 74,625</u>	<u>\$43,548</u>	<u>\$ —</u>	<u>\$262,255</u>
Operating income (loss)	\$ 17,852	\$ 2,567	\$(5,946)	\$ —	\$ 14,473
Other income (expense)	(195)	181	67	1,180	1,233
Earnings (loss) before tax provision	<u>\$ 17,657</u>	<u>\$ 2,748</u>	<u>\$(5,879)</u>	<u>\$ 1,180</u>	<u>\$ 15,706</u>

**For the Year Ended December 31, 2002**

	Power				
	Oil Field	Transmission	Trailer	Corporate	Total
Gross sales	\$119,719	\$ 72,256	\$39,617	\$ —	\$231,592
Inter-segment sales	(1,019)	(1,801)	(48)	—	(2,868)
Net sales	<u>\$118,700</u>	<u>\$ 70,455</u>	<u>\$39,569</u>	<u>\$ —</u>	<u>\$228,724</u>
Operating income (loss)	\$ 11,510	\$ 4,770	\$(2,870)	\$ —	\$ 13,410
Other income (expense)	(379)	231	9	496	357
Earnings (loss) before tax provision	<u>\$ 11,131</u>	<u>\$ 5,001</u>	<u>\$(2,861)</u>	<u>\$ 496</u>	<u>\$ 13,767</u>

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

None

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**Item 9A. Controls and Procedures**

**Disclosure Controls and Procedures**

Based on their evaluation of the Company's disclosure controls and procedures as of December 31, 2004, the Chief Executive Officer of the Company, Douglas V. Smith, and the Chief Financial Officer of the Company, R. D. Leslie, have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934) are effective.

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

The management of Lufkin Industries, Inc. (the "Company"), is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) and Rule 15d-15(f) promulgated under the Securities Exchange Act of 1934, as amended). The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2004. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in "Internal Control- Integrated Framework."

Based on this assessment, management believes that, as of December 31, 2004, the Company's internal control over financial reporting is effective based on those criteria.

The Company's independent registered public accounting firm, Deloitte & Touche LLP, who has audited and reported on the consolidated financial statements of the Company included in this report, has issued an attestation report on management's assessment of the Company's internal control over financial reporting, which report is included at the end of this section.

**Changes in Internal Control over Financial Reporting**

There were no changes in the Company's internal controls over financial reporting during the quarter ended December 31, 2004, that have materially affected, or are reasonably likely to materially affect the Company's internal controls over financial reporting.

The Company does not expect that its disclosure controls and procedures or its internal controls will prevent all error or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

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

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Lufkin Industries, Inc. (the "Company") maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

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

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

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedules as of and for the year ended December 31, 2004 of the Company and our report dated March 4, 2005 expressed an unqualified opinion on those financial statements and financial statement schedules.

/s/ Deloitte & Touche LLP

Houston, Texas  
March 4, 2005

**Item 9B. Other Information**

None

**Item 10. Directors and Executive Officers of the Registrant**

The information required by Item 10 regarding directors is incorporated by reference from the information under the caption “Nominees for Director” and under the caption “Information About Current and Continuing Directors” in the section “Company Information” in the Company’s definitive Proxy Statement for the 2005 Annual Meeting of Stockholders (the “Proxy Statement”), which will be filed within 120 days after December 31, 2004. The information required by Item 10 regarding audit committee financial expert disclosure is incorporated by reference from the information under the caption “Report of the Audit Committee” in the Proxy Statement. The information required by Item 10 regarding the identification of the Company’s audit committee is incorporated by reference from the information under the caption “Report of the Audit Committee” in the Proxy Statement. The information required by Item 10 regarding the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is incorporated by reference from the information under the caption “Section 16(a) Beneficial Ownership Reporting Compliance” in the Proxy Statement. The information required by Item 10 regarding executive officers is incorporated by reference from the information under the caption “Information About Current Executive Officers” in the Proxy Statement.

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

**Item 11. Executive Compensation**

The information required by Item 11 is incorporated by reference from the information under the captions “Compensation of Executive Officers”, “Stock Option Plans”, “Retirement Plan”, “Compensation Committee Interlocks and Insider Participation”, “Employment Contract and Change in Control Arrangement” and “Directors’ Meetings and Compensation” in the Proxy Statement.

**Item 12. Security Ownership of Certain Beneficial Owners and Management**

The information required by Item 12 related to security ownership of certain beneficial owners and management is incorporated by reference from the information under the caption “Security Ownership of Certain Beneficial Owners and Management” in the Proxy Statement. Information concerning securities authorized for issuance under the Company’s equity compensation plans is set forth in Item 5 of this report and is incorporated in Item 12 of this report by reference.

**Item 13. Certain Relationships and Related Transactions**

During 2004, there were no transactions with management and others, no business relationships regarding directors or nominees for directors and no indebtedness of management required to be disclosed pursuant to this Item 13.

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

The information required by Item 14 is incorporated by reference from the information under the caption “Report of the Audit Committee” in the Proxy Statement.

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

(a) Documents filed as part of the report

1. Consolidated Financial Statements

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

2. Financial Statement Schedules

Schedule II- Valuation and Qualifying Accounts

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

3. Exhibits

- (3.1) Fourth Restated Articles of Incorporation, as amended, included as Exhibit 4.1 to the registrant's registration statement on Form S-8 (File No. 333-112890), which exhibit is incorporated herein by reference.
- (3.2) Articles of Amendment to Fourth Restated Articles of Incorporation, included as Exhibit 3.1 to Form 8-K of the registrant filed December 10, 1999, which exhibit is incorporated herein by reference.
- (3.3) Restated Bylaws, included as Exhibit 3.2 to Form 8-K of the registrant filed December 10, 1999, which exhibit is incorporated herein by reference.
- (4.1) Rights Agreement, dated as of May 15, 1996, between Lufkin Industries, Inc. and Lufkin National Bank, as rights agent (included as Exhibit 1 to Form 8-A (File No. 0-02612) of the registrant filed May 15, 1996, which exhibit is incorporated herein by reference.
- (10.1)\* Company's 1990 Stock Option Plan was included as Exhibit 4.3 to the Company's registration statement on Form S-8 dated August 23, 1995 (File No. 33-62021), which plan is incorporated herein by reference.
- (10.2)\* Company's 1996 Nonemployee Director Stock Option Plan was included as Exhibit 4.3 to the Company's registration statement on Form S-8 dated June 28, 1996 (File No. 333-07129), which plan is incorporated herein by reference.
- (10.3)\* Company's Incentive Stock Compensation Plan was included as Exhibit 4.4 to the Company's registration statement on Form S-8 filed February 17, 2004 (File No. 333-112890), which exhibit is incorporated herein by reference.
- (21) Subsidiaries of the registrant
- (23) Consent of Independent Registered Public Accounting Firm
- (31.1) Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer
- (31.2) Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer

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**Item 15. Exhibits and Financial Statement Schedules (Continued)**

(32.1) Section 1350 Certification of the Chief Executive Officer certification

(32.2) Section 1350 Certification of the Chief Financial Officer certification

\*Compensatory plan or arrangement

**SCHEDULE II**

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

Description	Balance at Beginning of Year	Additions		Deductions	Balance at End of Year
		Charged To Expense	Charged to Other Accounts		
<b>Allowance for Doubtful Accounts:</b>					
Year Ended December 31, 2004	\$ 291	272	—	387	\$ 176
Year Ended December 31, 2003	240	156	66	171	291
Year Ended December 31, 2002	818	—	—	578	240
<b>Inventory: Valuation Reserves:</b>					
Year Ended December 31, 2004	\$ 1,615	(195)	—	269	\$ 1,151
Year Ended December 31, 2003	725	268	690	68	1,615
Year Ended December 31, 2002	442	422	—	139	725
<b>Inventory: LIFO Reserves:</b>					
Year Ended December 31, 2004	\$ 17,778	3,207	—	—	\$20,985
Year Ended December 31, 2003	17,682	96	—	—	17,778
Year Ended December 31, 2002	17,565	117	—	—	17,682

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**SIGNATURES**

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

LUFKIN INDUSTRIES, INC.

BY /s/ R. D. Leslie

\_\_\_\_\_  
R. D. Leslie  
Vice President/Treasurer/Chief Financial Officer  
(Principal Financial and Accounting Officer)

Date: March 15, 2005

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

	Name	Title	Date
By	/s/ D. V. Smith _____ D. V. Smith	President and Chief Executive Officer (Principal Executive Officer)	March 15, 2005
By	/s/ R. D. Leslie _____ R. D. Leslie	Vice President/Treasurer/Chief Financial Officer (Principal Financial and Accounting Officer)	March 15, 2005
By	/s/ J. F. Anderson _____ J.F. Anderson	Director	March 15, 2005
By	/s/ S. W. Henderson, III _____ S. W. Henderson, III	Director	March 15, 2005
By	/s/ J. T. Jongebloed _____ J. T. Jongebloed	Director	March 15, 2005
By	/s/ J. H. Lollar _____ J. H. Lollar	Director	March 15, 2005
By	/s/ B. H. O'Neal _____ B. H. O'Neal	Director	March 15, 2005
By	/s/ H. J. Trout, Jr. _____ H. J. Trout, Jr.	Director	March 15, 2005
By	/s/ T. E. Wiener _____ T. E. Wiener	Director	March 15, 2005

## INDEX TO EXHIBITS

Exhibit Number	Description
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(3.2)	Articles of Amendment to Fourth Restated Articles of Incorporation, included as Exhibit 3.1 to Form 8-K of the registrant filed December 10, 1999, which exhibit is incorporated herein by reference.
(3.3)	Restated Bylaws, included as Exhibit 3.2 to Form 8-K of the registrant filed December 10, 1999, which exhibit is incorporated herein by reference.
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(32.1)	Section 1350 Certification of the Chief Executive Officer certification
(32.2)	Section 1350 Certification of the Chief Financial Officer certification

\*Compensatory plan or arrangement

**LUFKIN INDUSTRIES, INC. AND SUBSIDIARIES**  
**SUBSIDIARIES OF THE REGISTRANT**

Name of Subsidiary	Jurisdiction of Incorporation or Organization	Name Under Which such Subsidiary Does Business
Lufkin Industries Canada, Ltd.	Province of Alberta, Canada	Same
P. T. Lufkin Indonesia	Republic of Indonesia	Same
Lufkin Industries FSC, Corp	Barbados	Same
Lufkin Japan, L. L. C.	Japan	Same
Lufkin France, EURL	France	Same
Lufkin Argentina, S.A.	Argentina	Same
Lufkin Middle East	Egypt	Same

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in each of Registration Statements No. 33-36976, 33-62021, 333-112890 and No. 333-07129 on Form S-8 of our reports dated March 4, 2005, relating to the financial statements and financial statement schedules of Lufkin Industries, Inc., and management's report on the effectiveness of internal control over financial reporting, appearing in this Annual Report on Form 10-K of Lufkin Industries, Inc. for the year ended December 31, 2004.

/s/ Deloitte & Touche LLP

Houston, Texas  
March 14, 2005

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Douglas V. Smith, certify that:

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

Date: March 15, 2005

/s/ Douglas V. Smith

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Douglas V. Smith  
Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, R. D. Leslie, certify that:

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

Date: March 15, 2005

/s/ R. D. Leslie

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R. D. Leslie  
Chief Financial Officer

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

In connection with the Annual Report of Lufkin Industries, Inc. (the "Company") on Form 10-K for the period ended December 31, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Douglas V. Smith, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ Douglas V. Smith

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Douglas V. Smith  
Chief Executive Officer  
March 15, 2005

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

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

In connection with the Annual Report of Lufkin Industries, Inc. (the "Company") on Form 10-K for the period ended December 31, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, R.D. Leslie, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ R. D. Leslie

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R.D. Leslie  
Chief Financial Officer  
March 15, 2005

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

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