

LUFKIN INDUSTRIES INC

FORM 10-Q (Quarterly Report)

Filed 11/09/09 for the Period Ending 09/30/09

Address	P O BOX 849 LUFKIN, TX 759020849
Telephone	9366342211
CIK	0000060849
Symbol	LUFK
SIC Code	3560 - General Industrial Machinery And Equipment
Industry	Constr. & Agric. Machinery
Sector	Capital Goods
Fiscal Year	01/07

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2009

or

() TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 0-02612

LUFKIN INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

TEXAS

(State or other jurisdiction of incorporation or organization)

75-0404410

(I.R.S. Employer Identification No.)

601 SOUTH RAGUET, LUFKIN, TEXAS

(Address of principal executive offices)

75904

(Zip Code)

(936) 634-2211

(Registrant's telephone number, including area code)

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

There were 14,877,607 shares of Common Stock, \$1.00 par value per share, outstanding as of November 5, 2009.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements.

LUFKIN INDUSTRIES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
(Thousands of dollars, except share and per share data)

	September 30, 2009	December 31, 2008
Assets		
Current Assets:		
Cash and cash equivalents	\$ 102,174	\$ 107,756
Receivables, net	82,989	139,144
Income tax receivable	844	978
Inventories	116,678	128,627
Deferred income tax assets	6,717	4,941
Other current assets	11,768	3,674
Current assets from discontinued operations	807	618
Total current assets	321,977	385,738
Property, plant and equipment, net	152,513	130,079
Goodwill, net	45,606	11,862
Intangible assets, net	14,000	-
Other assets, net	3,695	2,546
Long-term assets from discontinued operations	493	493
Total assets	\$ 538,284	\$ 530,718
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 23,381	\$ 38,543
Current portion of long-term debt	1,292	-
Accrued liabilities:		
Payroll and benefits	10,915	14,046
Warranty expenses	3,336	3,586
Taxes payable	4,802	5,894
Other	23,708	25,340
Current liabilities from discontinued operations	1,129	1,404
Total current liabilities	68,563	88,813
Long-term debt	2,020	-
Deferred income tax liabilities	9,368	9,219
Postretirement benefits	7,522	7,070
Other liabilities	26,171	11,618
Commitments and contingencies	-	-
Long-term liabilities from discontinued operations	37	61
Shareholders' equity:		
Common stock, \$1.00 par value per share; 60,000,000 shares authorized; 15,794,713 and 15,791,963 shares issued and outstanding, respectively	15,795	15,792
Capital in excess par	64,585	63,014
Retained earnings	422,069	414,748
Treasury stock, 931,168 and 931,168 shares, respectively, at cost	(34,907)	(34,917)
Accumulated other comprehensive loss	(42,939)	(44,700)
Total shareholders' equity	424,603	413,937
Total liabilities and shareholders' equity	\$ 538,284	\$ 530,718

See notes to consolidated financial statements.

LUFKIN INDUSTRIES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (UNAUDITED)
(In thousands of dollars, except per share and share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Sales	\$ 117,688	\$ 195,090	\$ 394,565	\$ 510,648
Cost of sales	<u>92,756</u>	<u>139,268</u>	<u>308,454</u>	<u>366,511</u>
Gross profit	24,932	55,822	86,111	144,137
Selling, general and administrative expenses	17,751	16,983	54,774	50,724
Litigation reserve	<u>-</u>	<u>-</u>	<u>5,000</u>	<u>-</u>
Operating income	7,181	38,839	26,337	93,413
Interest income	8	503	897	1,622
Interest expense	(150)	(48)	(452)	(183)
Other income (expense), net	<u>613</u>	<u>(396)</u>	<u>1,241</u>	<u>(447)</u>
Earnings from continuing operations before income tax provision and discontinued operations	7,652	38,898	28,023	94,405
Income tax provision	<u>2,597</u>	<u>13,937</u>	<u>9,134</u>	<u>32,681</u>
Earnings from continuing operations	5,055	24,961	18,889	61,724
Loss from discontinued operations, net of tax	<u>(63)</u>	<u>(149)</u>	<u>(422)</u>	<u>(51)</u>
Net earnings	<u>\$ 4,992</u>	<u>\$ 24,812</u>	<u>\$ 18,467</u>	<u>\$ 61,673</u>
Basic earnings per share:				
Earnings from continuing operations	\$ 0.34	\$ 1.68	\$ 1.27	\$ 4.18
Loss from discontinued operations	-	(0.01)	(0.03)	-
Net earnings	<u>\$ 0.34</u>	<u>\$ 1.67</u>	<u>\$ 1.24</u>	<u>\$ 4.18</u>
Diluted earnings per share:				
Earnings from continuing operations	\$ 0.34	\$ 1.66	\$ 1.27	\$ 4.14
Loss from discontinued operations	-	(0.01)	(0.03)	-
Net earnings	<u>\$ 0.34</u>	<u>\$ 1.65</u>	<u>\$ 1.24</u>	<u>\$ 4.14</u>
Dividends per share	<u>\$ 0.25</u>	<u>\$ 0.25</u>	<u>\$ 0.75</u>	<u>\$ 0.75</u>

See notes to condensed consolidated financial statements.

LUFKIN INDUSTRIES INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands of dollars)

	Nine Months Ended September 30,	
	2009	2008
Cash flows form operating activities:		
Net earnings	\$ 18,467	\$ 61,673
Adjustments to reconcile net earnings to cash provided by operating activities:		
Depreciation and amortization	13,326	11,466
Recovery of (provision for) losses on receivables	(524)	25
LIFO (benefit) expense	(440)	5,019
Deferred income tax benefit	(2,357)	(985)
Excess tax benefit from share-based compensation	(32)	(4,118)
Share-based compensation expense	1,510	2,595
Pension expense (income)	7,649	(1,587)
Postretirement obligation (benefit)	203	(89)
Gain on disposition of property, plant and equipment	(270)	(157)
Loss (income) from discontinued operations	422	(1,293)
Changes in:		
Receivables, net	65,114	(28,589)
Income tax receivable	(536)	-
Inventories	20,341	(38,456)
Other current assets	(1,568)	(1,601)
Accounts payable	(19,799)	18,792
Accrued liabilities	(13,740)	8,319
Net cash provided by continuing operations	<u>87,766</u>	<u>31,014</u>
Net cash used in discontinued operations	<u>-</u>	<u>(278)</u>
Net cash provided by operating activities	<u>87,766</u>	<u>30,736</u>
Cash flows from investing activities:		
Additions to property, plant and equipment	(27,588)	(17,808)
Proceeds from disposition of property, plant and equipment	714	367
(Increase) decrease in other assets	(1,177)	1,262
Acquisition of other companies	(51,658)	-
Net cash used in continuing operations	<u>(79,709)</u>	<u>(16,179)</u>
Net cash provided by discontinued operations	<u>-</u>	<u>278</u>
Net cash used in investing activities	<u>(79,709)</u>	<u>(15,901)</u>
Cash flows from financing activities:		
Payments of notes payable	(3,002)	-
Dividends paid	(11,146)	(11,092)
Excess tax benefit from share-based compensation	32	4,118
Proceeds from exercise of stock options	28	8,174
Refund of prior treasury stock purchases	11	-
Purchases of treasury stock	<u>-</u>	<u>(1,117)</u>
Net cash used in financing activities	<u>(14,077)</u>	<u>83</u>
Effect of translation on cash and cash equivalents	<u>438</u>	<u>(476)</u>
Net (decrease) increase in cash and cash equivalents	(5,582)	14,442
Cash and cash equivalents at beginning of period	<u>107,756</u>	<u>95,748</u>
Cash and cash equivalents at end of period	<u>\$ 102,174</u>	<u>\$ 110,190</u>

See notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Lufkin Industries, Inc. and its consolidated subsidiaries (the "Company") and have been prepared pursuant to the rules and regulations for interim financial statements of the Securities and Exchange Commission. Certain information in the notes to the consolidated financial statements normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America has been condensed or omitted pursuant to these rules and regulations for interim financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals unless specified, necessary for a fair presentation of the Company's financial position, results of operations and cash flows for the interim periods included in this report have been included. For further information, including a summary of major accounting policies, refer to the consolidated financial statements and related footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. The results of operations for the three and nine months ended September 30, 2009, are not necessarily indicative of the results that may be expected for the full fiscal year.

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's accounts receivable are not concentrated in one customer and are not viewed as an unusual credit risk.

2. Recently Issued Accounting Pronouncements

In December 2008, the Financial Accounting Standards Board amended "Employer's Disclosures about Postretirement Benefit Plan Assets" (ASC 715-20-65-2). This amendment expands the disclosure requirements about postretirement plan assets to include how investment allocations are made, including the factors that are pertinent to an understanding of investment policies and strategies, the major categories of plan assets, the input and valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the periods and significant concentration of risk with plan assets. Such required disclosures will be provided in our annual financial statements for the year ending December 31, 2009. Upon initial application, the disclosures of ASC 715-20-65-2 are not required for earlier periods that are presented for comparative purposes.

In May 2009, the Financial Accounting Standards Board issued "Subsequent Events" (ASC 855-10), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855-10 requires disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. The Company adopted this Statement in these interim financial statements. The Company has evaluated subsequent events through November 9, 2009, which represents the date that the financial statements were issued.

In October 2009, the FASB issued an update to existing guidance on revenue recognition for arrangements with multiple deliverables. This update will allow companies to allocate consideration received for qualified separate deliverables using estimated selling price for both delivered and undelivered items when vendor-specific objective evidence or third-party evidence is unavailable. Additional disclosures discussing the nature of multiple element arrangements, the types of deliverables under the arrangements, the general timing of their delivery, and significant factors and estimates used to determine estimated selling prices are required. The Company has not determined the impact on its condensed consolidated financial statements.

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

3. Acquisitions

On March 1, 2009, the Company completed the acquisition of International Lift Systems, LLC ("ILS"), a Louisiana limited partnership. ILS manufactures and services gas lift, plunger lift and completion equipment for the oil and gas industry.

On July 1, 2009 the Company completed the acquisition of Rotating Machinery Technology, Inc. ("RMT"), a New York corporation. RMT is a recognized leader in the turbo-machinery industry, specializing in the analysis design and manufacture of precision, custom-engineered tilting-pad bearings and related components for high-speed turbo equipment operating in critical duty applications. RMT also services, repairs and upgrades turbo-expander process units for air and gas separation, both on-site with its skilled field service team and at its repair facility in Wellsville, New York.

The ILS and RMT acquisitions have been recorded using the acquisition method of accounting and, accordingly, the acquired operations have been included in the results of operations since the date of acquisition. The preliminary purchase price consideration consists of the following (in thousands of dollars):

Cash paid at closing, net	\$ 51,658
Holdback consideration	4,500
Total consideration paid	<u>\$ 56,158</u>

The following table indicates (in thousands of dollars) the preliminary purchase price allocation to net assets acquired, which was based on

estimated fair values as of the acquisition date. The excess of the purchase price over the net assets acquired amount to \$33.6 million and has been recorded as goodwill in the accompanying September 30, 2009, condensed consolidated balance sheet. Based on the structure of the transaction, the majority of the goodwill related to the transaction is not expected to be deductible for tax purposes.

Purchase price	<u>\$ 51,658</u>
Receivables	5,799
Inventories	5,713
Other current assets	1,092
Deferred tax asset	110
Property, plant and equipment	5,794
Intangible assets	10,359
Accounts payable	(2,429)
Other short-term accrued liabilities	(576)
Other long-term accrued liabilities	(363)
Deferred tax liability	(1,144)
Long-term debt	<u>(6,314)</u>
Goodwill recorded	<u>\$ 33,617</u>

The Company also entered into a hold back agreement with the former owners of ILS. The total hold back is \$4.5 million payable in three equal installments of \$1.5 million each plus interest. Interest is calculated annually at 4% of the remaining balance of the hold back portion. The first installment is due March 1, 2010; the second and third installments, each plus interest to date, are payable on March 1, 2011 and 2012, respectively. These hold back payments are not contingent upon any subsequent events. At September 30, 2009, the liabilities for these hold back payments were included in the accrued liabilities and other liabilities section of the consolidated balance sheet.

Revenues and earnings to date on the afore mentioned acquisitions for all periods presented are not material. Pro forma schedules have not been included as the impact on the periods presented is not material.

The preliminary purchase price allocations, which are based on relevant facts and circumstances and discussions with an independent third-party consultant, are subject to change upon completion of the final valuation analysis by Lufkin management. The final valuations for ILS, which is required to be completed by March 2010, and RMT, which is required to be completed by July 2010, are not expected to result in material changes to the preliminary allocations.

4. Discontinued Operations

During the second quarter of 2008, the Trailer segment was classified as a discontinued operation.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Sales	<u>\$ 1</u>	<u>\$ 202</u>	<u>\$ 36</u>	<u>\$ 6,704</u>
Earnings (loss) before income tax provision	(97)	(38)	(649)	49
Income tax benefit (expense)	<u>34</u>	<u>(111)</u>	<u>227</u>	<u>(100)</u>
Loss from discontinued operations, net of tax	<u>\$ (63)</u>	<u>\$ (149)</u>	<u>\$ (422)</u>	<u>\$ (51)</u>

	September 30, 2009	December 31, 2008
Receivables, net	\$ 22	\$ 56
Income tax receivable	211	-
Deferred income tax assets	574	562
Other current assets	<u>-</u>	<u>-</u>
Current assets from discontinued operations	807	618
Property, plant and equipment, net	-	-
Deferred income tax assets	-	-

Other assets, net	493	493
Long-term assets from discontinued operations	493	493
Total assets from discontinued operations	<u>\$ 1,300</u>	<u>\$ 1,111</u>
Accounts payable	\$ -	\$ 154
Accrued liabilities:		
Payroll and benefits	98	104
Warranty expenses	319	410
Taxes payable	-	120
Other	712	616
Current liabilities from discontinued operations	1,129	1,404
Long-term liabilities	37	61
Total liabilities from discontinued operations	<u>\$ 1,166</u>	<u>\$ 1,465</u>

5. Receivables

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

	September 30, 2009	December 31, 2008
Accounts receivable	\$ 80,911	\$ 138,706
Notes receivable	243	157
Other receivables	2,709	1,015
Gross receivables	83,863	139,878
Allowance for doubtful accounts receivable	(874)	(734)
Net receivables	<u>\$ 82,989</u>	<u>\$ 139,144</u>

Bad debt expense related to receivables for the three and nine months ended September 30, 2009 resulted in a \$0.5 million recovery of certain receivables reserved in 2008. Bad debt expense related to receivables was negligible for the three and nine months ended September 30, 2008.

6. Inventories

Inventories used in determining cost of sales were as follows (in thousands of dollars):

	September 30, 2009	December 31, 2008
Gross inventories @ FIFO:		
Finished goods	\$ 8,860	\$ 2,643
Work in progress	21,137	28,230
Raw materials & component parts	107,227	122,604
Maintenance, tooling & supplies	14,050	12,611
Total gross inventories @ FIFO	151,274	166,088
Less reserves:		
LIFO	32,486	32,926
Valuation	2,110	4,535
Total inventories as reported	<u>\$ 116,678</u>	<u>\$ 128,627</u>

Gross inventories on a FIFO basis before adjustments for reserves shown above that were accounted for on a LIFO basis were \$84.4 million and \$109.2 million at September 30, 2009, and December 31, 2008, respectively.

7. Property, Plant & Equipment

The following is a summary of the Company's property, plant and equipment balances (in thousands of dollars):

	September 30, 2009	December 31, 2008
Land	\$ 5,919	\$ 6,525

Land improvements	11,164	10,219
Buildings	86,416	75,756
Machinery and equipment	263,508	245,014
Furniture and fixtures	5,926	5,616
Computer equipment and software	15,346	14,666
Total property, plant and equipment	388,279	357,796
Less accumulated depreciation	(235,766)	(227,717)
Total property, plant and equipment, net	\$ 152,513	\$ 130,079

Depreciation expense related to property, plant and equipment was \$4.3 million and \$3.9 million for the three months ended September 30, 2009 and 2008, respectively, and was \$12.4 million and \$11.4 million for the nine months ended September 30, 2009 and 2008, respectively.

8. Goodwill and Intangible Assets

Goodwill

The changes in the carrying amount of goodwill during the nine months ended September 30, 2009, are as follows (in thousands of dollars):

	Oil Field	Power Transmission	Total
Balance as of 12/31/08	\$ 9,428	\$ 2,434	\$ 11,862
Goodwill acquired during the period	29,115	4,502	33,617
Foreign currency translation	11	116	127
Balance as of 9/30/09	\$ 38,554	\$ 7,052	\$ 45,606

Goodwill impairment tests were performed in the first quarter of 2009 and no impairment losses were recorded.

Intangible Assets

The Company amortizes identifiable intangible assets on a straight-line basis over the periods expected to be benefitted. All of the below intangible assets relate to the ILS and RMT acquisitions. The components of these intangible assets are as follows (in thousands of dollars):

	September 30, 2009			Weighted Average Amortization Period (years)
	Gross Carrying Amount	Accumulated Amortization	Net	
Non-compete agreements and trademarks	\$ 2,064	\$ 171	\$ 1,893	7.2
Customer relationships and contracts	12,795	688	12,107	10.0
	\$ 14,859	\$ 859	\$ 14,000	7.0

Amortization expense of intangible assets was approximately \$0.4 million and \$0.9 million for the three and nine months ended September 30, 2009, respectively. Expected amortization expense by year is (in thousands of dollars):

For the year ended 12/31/10	\$ 1,630
For the year ended 12/31/11	1,630
For the year ended 12/31/12	1,531
For the year ended 12/31/13	1,511
For the year ended 12/31/14	1,399
Thereafter	\$ 5,892

9. Other Current Accrued Liabilities

The following is a summary of the Company's other current accrued liabilities balances (in thousands of dollars):

	September 30, 2009	December 31, 2008
Customer prepayments	\$ 9,535	\$ 12,925
Litigation reserves	5,187	6,000
Deferred compensation plans	5,119	4,046
Accrued professional services	624	1,097

Hold back consideration	1,605	-
Other accrued liabilities	1,638	1,272
Total other current accrued liabilities	<u>\$ 23,708</u>	<u>\$ 25,340</u>

10. Debt

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

	September 30, 2009	December 31, 2008
Long-term notes payable	\$ 3,312	\$ -
Less current portion of long-term debt	<u>(1,292)</u>	<u>-</u>
Long-term debt	<u>\$ 2,020</u>	<u>\$ -</u>

Principal payments of long-term debt by year are as follows (in thousands of dollars):

2010	\$ 375
2011	1,432
2012	213
Thereafter	<u>-</u>
	<u>\$ 2,020</u>

The Company's current debt at September 30, 2009, primarily consists of assumed notes from the ILS acquisition, which are described below. The current portion of long-term debt reflects scheduled principal payments due on or before September 30, 2010.

On March 1, 2009, the Company assumed from ILS several notes payable, associated with prior acquisitions undertaken by ILS, with a remaining aggregate principal balance of \$3.9 million at interest rates ranging from 0% to 6% with a weighted average of 4.5%. On the outstanding principal balance as of September 30, 2009, the Company has secured letters of credit for \$1.3 million and the remaining \$2.0 million is secured by collateral consisting of equipment, inventory, and accounts receivable. The fair market value of the outstanding debt as of September 30, 2009 is not materially different than its carrying value.

In connection with the ILS acquisition, the Company also assumed a note payable to a bank in the amount of \$0.8 million, which was paid in full at closing. In connection with the RMT acquisition, the Company also assumed several notes payable to individuals and banks in the amount of \$1.5 million, which were paid in full at closing.

The Company has a three-year credit facility with a domestic bank (the "Bank Facility") consisting of an unsecured revolving line of credit that provides up to \$40.0 million of aggregate borrowing. This Bank Facility expires on December 31, 2010. 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 September 30, 2009, no debt was outstanding under the Bank Facility and the Company was in compliance with all financial covenants under the terms of the Bank Facility. Deducting outstanding letters of credit of \$17.0 million, \$23.0 million of borrowing capacity was available at September 30, 2009.

11. Retirement Benefits

The Company has a qualified noncontributory pension plan covering substantially all U.S. 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. In addition, the Company has two unfunded non-qualified deferred compensation pension plans for certain U.S. employees. The Pension Restoration Plan provides supplemental retirement benefits. The benefit is based on the same benefit formula as the qualified pension plan except that it does not limit the amount of a participant's compensation or maximum benefit. The Company also provides a Supplemental Executive Retirement Plan that credits an individual with 0.5 years of service for each year of service credited under the qualified plan. The benefits calculated under the non-qualified pension plans are offset by the participant's benefit payable under the qualified plan. The liabilities for the non-qualified deferred compensation pensions plans are included in "Other current accrued liabilities" and "Other liabilities" in the Consolidated Balance Sheet.

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

The Company also has qualified defined contribution retirement plans covering substantially all of its U.S. and Canadian employees. For U.S. employees, the Company makes contributions of 75% of employee contributions up to a maximum employee contribution of 6% of employee earnings. Employees may contribute up to an additional 18% (in 1% increments), which is not subject to match by the Company. For Canadian employees, the Company makes contributions of 3%-8% of an employee's salary with no individual employee match required. All obligations of the Company are funded through September 30, 2009. In addition, the Company provides an unfunded non-qualified deferred compensation defined contribution plan for certain U.S. employees. The Company's and individual's contributions are based on the same formula as the qualified contribution plan except that it does not limit the amount of a participant's compensation or maximum benefit. The contribution calculated under the non-qualified defined contribution plan is offset by the Company's and participant's contributions under the qualified plan. The Company's expense for these plans totaled \$0.7 million and \$0.9 million in the three months ended September 30, 2009 and 2008, respectively, and \$2.4 million and \$2.6 million in the nine months ended September 30, 2009 and 2008, respectively. The liability for the non-qualified deferred defined contribution plan is included in "Other current accrued liabilities" in the Consolidated Balance Sheet.

Components of Net Periodic Benefit Cost (in thousands of dollars)

Three Months Ended September 30,	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Service cost	\$ 1,407	\$ 1,280	\$ 43	\$ 38
Interest cost	2,890	2,625	123	113
Expected return on plan assets	(3,136)	(4,282)	-	-
Amortization of prior service cost	225	141	15	-
Amortization of unrecognized net (gain) loss	1,336	45	(45)	(54)
Amortization of unrecognized transition asset	-	(159)	-	-
Net periodic benefit cost (income)	<u>\$ 2,722</u>	<u>\$ (350)</u>	<u>\$ 136</u>	<u>\$ 97</u>

Nine Months Ended September 30,	Pension Benefits		Other Benefits	
	2009	2008	2009	2008
Service cost	\$ 4,220	\$ 3,841	\$ 129	\$ 114
Interest cost	8,671	7,877	367	341
Expected return on plan assets	(9,406)	(12,849)	-	-
Amortization of prior service cost	674	424	45	-
Amortization of unrecognized net (gain) loss	4,008	135	(134)	(163)
Amortization of unrecognized transition asset	-	(479)	-	-
Net periodic benefit cost (income)	<u>\$ 8,167</u>	<u>\$ (1,051)</u>	<u>\$ 407</u>	<u>\$ 292</u>

Employer Contributions

The Company previously disclosed in its financial statements for the year ended December 31, 2008, that it expected to make contributions of \$0.3 million to \$2.3 million to its pension plans in 2009. The Company also disclosed that it expected contributions of \$0.6 million to be made to its postretirement plan in 2009. As of September 30, 2009, the Company has made contributions of \$0.2 million to its pension plans and has made contributions of \$0.6 million to its postretirement plan. The Company presently anticipates making additional contributions of \$0.1 million to its pension plans and \$0.2 million to its postretirement plan during the remainder of 2009. Due to changes in funding elections, the Company now does not expect to make contributions to its qualified pension plan in 2009.

12. Legal Proceedings

On March 7, 1997, a class action complaint was filed against Lufkin Industries, Inc. (the "Company") in the U.S. District Court for the Eastern District of Texas by an employee and a former employee of the Company who alleged race discrimination in employment. Certification hearings were conducted in Beaumont, Texas in February 1998 and in Lufkin, Texas in August 1998. In April 1999, the District Court issued a decision that certified a class for this case, which included all black employees employed by the Company from March 6, 1994, to the present. The case was administratively closed from 2001 to 2003 while the parties unsuccessfully attempted mediation. Trial for this case began in December 2003, and after the close of plaintiff's evidence, the court adjourned and did not complete the trial until October 2004. Although plaintiff's class certification encompassed a wide variety of employment practices, plaintiffs presented only disparate impact claims relating to discrimination in initial assignments and promotions at trial.

On January 13, 2005, the District Court entered its decision finding that the Company discriminated against African-American employees in initial assignments and promotions. The District Court also concluded that the discrimination resulted in a shortfall in income for those employees and ordered that the Company pay those employees back pay to remedy such shortfall, together with pre-judgment interest in the amount of 5%. On August 29, 2005, the District Court determined that the back pay award for the class of affected employees was \$3.4 million (including interest to January 1, 2005) and provided a formula for attorney fees that the Company estimates will result in a total not to exceed \$2.5 million. In addition to back pay with interest, the District Court (i) enjoined and ordered the Company to cease and desist all racially biased assignment and promotion practices and (ii) ordered the Company to pay court costs and expenses.

The Company reviewed this decision with its outside counsel and on September 19, 2005, appealed the decision to the U.S. Court of Appeals for the Fifth Circuit. On April 3, 2007, the Company appeared before the appellate court in New Orleans for oral argument in this case. The

appellate court subsequently issued a decision on Friday, February 29, 2008 that reversed and vacated the plaintiff's claim regarding the initial assignment of black employees into the Foundry Division. The court also denied plaintiff's appeal for class certification of a class disparate treatment claim. Plaintiff's claim on the issue of the Company's promotional practices was affirmed but the back pay award was vacated and remanded for recomputation in accordance with the opinion. The District Court's injunction was vacated and remanded with instructions to enter appropriate and specific injunctive relief. Finally, the issue of plaintiff's attorney's fees was remanded to the District Court for further consideration in accordance with prevailing authority.

On December 5, 2008, the U.S. District Court Judge Clark held a hearing in Beaumont, Texas during which he reviewed the 5th U.S. Circuit Court of Appeals class action decision and informed the parties that he intended to implement the decision in order to conclude this litigation. At the conclusion of the hearing Judge Clark ordered the parties to submit positions regarding the issues of attorney fees, a damage award and injunctive relief. Subsequently, the Company reviewed the plaintiff's submissions which described the formula and underlying assumptions that supported their positions on attorney fees and damages. After careful review of the plaintiff's submission to the court the Company continued to have significant differences regarding legal issues that materially impacted the plaintiff's requests. As a result of these different results, the court requested further evidence from the parties regarding their positions in order to render a final decision. The judge reviewed both parties arguments regarding legal fees, and awarded the plaintiffs an interim fee, but at a reduced level from the plaintiffs original request. The Company and the plaintiffs reconciled the majority of the differences and the damage calculations which also lowered the originally requested amounts of the plaintiffs on those matters. Due to the resolution of certain legal proceedings on damages during first half of 2009 and the District Court awarding the plaintiffs an interim award of attorney fees and cost totaling \$5.8 million, the Company recorded an additional provision of \$5.0 million in the first half of 2009 above the \$6.0 million recorded in fourth quarter of 2008. The plaintiffs have filed an appeal of the District Court's interim award of attorney fees with the U.S. Fifth Circuit Court of Appeals. The Company has filed a cross-appeal on the attorney fee issue. The Fifth Circuit subsequently dismissed these appeals on August 28, 2009 on the basis that an appealable final judgment in this case had not been issued. The court commented that this issue can be reviewed with an appeal of final judgment. On June 19, 2009, the District Court issued a damage award in favor of the plaintiffs totaling \$3.1 million for the period 2004 through 2007 plus annual interest 5%. The Company estimates that the total damage award will be \$5.0 million and, as a result, in the second quarter of 2009, the Company increased its damage provision in this case by an additional \$2.0 million, which represents the Company's best estimate of its ultimate exposure.

Additionally, during the first quarter of 2009, the court appointed an industrial expert to review the Company's promotional policies and practices and prepare a report for the court which would contain recommendations for injunctive relief in this case. The Company anticipates the District Court's injunctive relief award by the end of the fourth quarter of 2009.

There are various other claims and legal proceedings arising in the ordinary course of business pending against or involving the Company wherein monetary damages are sought. For certain of these claims, the Company maintains insurance coverage while retaining a portion of the losses that occur through the use of deductibles and retention limits. Amounts in excess of the self-insured retention levels are fully insured to limits believed appropriate for the Company's operations. Self-insurance accruals are based on claims filed and an estimate for claims incurred but not reported. While the Company does maintain insurance above its self-insured levels, a decline in the financial condition of its insurer, while not currently anticipated, could result in the Company recording additional liabilities. It is management's opinion that the Company's liability under such circumstances or involving any other non-insured claims or legal proceedings would not materially affect its consolidated financial position, results of operations, or cash flow.

13. Comprehensive Income

Comprehensive income includes net income and changes in the components of accumulated other comprehensive income during the periods presented. The Company's comprehensive income is as follows (in thousands of dollars):

	Three Months Ended September 30		Nine Months Ended September 30	
	2009	2008	2009	2008
Net earnings	\$ 4,992	\$ 24,812	\$ 18,467	\$ 61,673
Other comprehensive income, before tax:				
Foreign currency translation adjustments	2,822	(3,649)	3,869	(2,652)
Defined benefit pension plans:				
Amortization of prior service cost included in net periodic benefit cost	225	141	674	424
Amortization of unrecognized transition asset included in net periodic benefit cost	-	(159)	-	(479)
Amortization of unrecognized net loss included in net periodic benefit cost	1,336	45	4,008	135
Net income (loss) arising during period	-	2	(7,464)	(19,404)
Total defined benefit pension plans	1,561	29	(2,782)	(19,324)
Defined benefit postretirement plans:				

Amortization of prior service cost included in net periodic benefit cost	15	-	45	-
Amortization of unrecognized net gain included in net periodic benefit cost	(45)	(54)	(134)	(163)
Net gain (loss) arising during period	-	-	(474)	303
Total defined benefit postretirement plans	(30)	(54)	(563)	140
Total other comprehensive income (loss), before tax	4,353	(3,674)	524	(21,836)
Income tax (expense) benefit related to items of other comprehensive income	(566)	8	1,237	7,214
Total other comprehensive income (loss), net of tax	3,787	(3,666)	1,761	(14,622)
Total comprehensive income	<u>\$ 8,779</u>	<u>\$ 21,146</u>	<u>\$ 20,228</u>	<u>\$ 47,051</u>

Accumulated other comprehensive income (loss) in the consolidated balance sheet consists of the following (in thousands of dollars):

	Foreign Currency Translation	Defined Benefit Pension Plans	Defined Benefit Postretirement Plans	Accumulated Other Comprehensive Loss
Balance, Dec. 31, 2008	\$ 2,512	\$ (48,921)	\$ 1,709	\$ (44,700)
Current-period change	3,869	(1,753)	(355)	1,761
Balance, September 30, 2009	<u>\$ 6,381</u>	<u>\$ (50,674)</u>	<u>\$ 1,354</u>	<u>\$ (42,939)</u>

14. Net Earnings Per Share

A reconciliation of the number of weighted shares used to compute basic and diluted net earnings per share for the three and nine months ended September 30, 2009 and 2008, are illustrated below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Weighted average common shares outstanding for basic EPS	14,861,939	14,880,637	14,861,183	14,765,287
Effect of dilutive securities: employee stock options	40,518	132,228	36,783	150,948
Adjusted weighted average common shares outstanding for diluted EPS	<u>14,902,457</u>	<u>15,012,865</u>	<u>14,897,966</u>	<u>14,916,235</u>

Weighted options to purchase a total of 507,460 and zero shares of the Company's common stock for the three months ended September 30, 2009 and 2008, respectively, and 500,623 and 54,642 shares of the Company's common stock for the nine months ended September 30, 2009 and 2008, respectively, were excluded from the calculations of fully diluted earnings per share, in each case because the effect on fully diluted earnings per share for the period was antidilutive.

15. Stock Option Plans

The Company currently has three stock compensation plans. The 1990 Stock Option Plan, the 1996 Nonemployee Director Stock Option Plan and the 2000 Incentive Stock Compensation Plan provide for the granting of stock options to officers, employees and non-employee directors at an exercise price equal to the fair market value of the stock at the date of grant. The 2000 Incentive Stock Compensation Plan also provides for other forms of stock-based compensation such as restricted stock, but none have been granted to date. Options granted to employees vest over two to four years and are exercisable up to ten years from the grant date. Upon retirement, any unvested options become exercisable immediately. Options granted to directors vest at the grant date and are exercisable up to ten years from the grant date.

The following table is a summary of the stock-based compensation expense recognized for the three and nine months ended September 30, 2009 and 2008 (in thousands of dollars):

Three Months Ended September 30,		Nine Months Ended September 30,	
2009	2008	2009	2008

Stock-based compensation expense	\$ 557	\$ 752	\$ 1,510	\$ 2,595
Tax benefit	(206)	(278)	(559)	(960)
Stock-based compensation expense, net of tax	<u>\$ 351</u>	<u>\$ 474</u>	<u>\$ 951</u>	<u>\$ 1,635</u>

The fair value of each option grant during the first nine months of 2009 and 2008 was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	<u>2009</u>	<u>2008</u>
Expected dividend yield	2.18% - 2.80%	1.33% - 1.70%
Expected stock price volatility	46.8% - 54.0%	41.0% - 46.0%
Risk free interest rate	1.09% - 2.73%	1.90% - 3.27%
Expected life options	3 - 7 years	2 - 6 years
Weighted-average fair value per share at grant date	\$ 14.52	\$ 19.82

The expected life of options was determined based on the exercise history of employees and directors since the inception of the plans. The expected volatility is based upon the historical weekly and daily stock price for the prior number of years equivalent to the expected life of the stock option. The expected dividend yield was based on the dividend yield of the Company's common stock at the date of the grant. The risk free interest rate was based upon the yield of U.S. Treasuries which terms were equivalent to the expected life of the stock option.

A summary of stock option activity under the plans during the nine months ended September 30, 2009, is presented below:

Options	Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000's)
Outstanding at January 1, 2009	548,639	\$ 51.42		
Granted	63,500	38.35		
Exercised	(2,750)	10.14		
Forfeited or expired	-	-		
Outstanding at September 30, 2009	<u>609,389</u>	<u>\$ 50.25</u>	<u>7.6</u>	<u>\$ 4,141</u>
Exercisable at September 30, 2009	<u>323,284</u>	<u>\$ 47.46</u>	<u>6.9</u>	<u>\$ 3,404</u>

As of September 30, 2009, there was \$2.7 million of total unrecognized compensation expense related to non-vested stock options. That cost is expected to be recognized over a weighted-average period of 2.3 years. The intrinsic value of stock options exercised in the first nine months of 2009 was \$0.1 million.

16. Uncertain Tax Positions

As of January 1, 2009, the Company had approximately \$1.4 million of total gross unrecognized tax benefits. Of this total, \$1.4 million (net of the federal benefit on state issues) represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the net effective income tax rate in any future period. As of September 30, 2009, the Company had approximately \$1.5 million of total gross unrecognized tax benefits. Of this total, \$1.5 million (net of the federal benefit on state issues) represents the amount of unrecognized tax benefits that, if recognized, would favorably affect the net effective income tax rate in any future period. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

(Thousands of dollars)

Balance at December 31, 2008	\$ 1,368
Gross increases- current year tax positions	497
Gross increases- tax positions from prior periods	93
Gross decreases- tax positions from prior periods	(262)
Settlements	(173)
Balance at September 30, 2009	<u>\$ 1,523</u>

During the first quarter of 2009, the Company settled the examination of the 2006 tax year with the IRS. The Company does not expect any additional settlements of its ASC 740-10 liabilities within the next twelve months.

The Company's continuing practice is to recognize interest and penalties related to income tax matters in administrative costs. The Company had \$0.1 million accrued for interest and penalties at December 31, 2008. Negligible interest and penalties were recognized during the three

and nine months ended September 30, 2009 and 2008, respectively.

17. Segment Data

The Company operates with two business segments - Oil Field and Power Transmission. The two operating segments are supported by a common corporate group. Corporate expenses and certain assets are allocated to the operating segments based primarily 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 accounting policies of the segments are the same as those described in the summary of significant accounting policies in the footnotes to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008. The following is a summary of key segment information (in thousands of dollars):

Three Months Ended September 30, 2009

	<u>Oil Field</u>	<u>Power Transmission</u>	<u>Corporate & Other*</u>	<u>Adjustment</u>	<u>Total</u>
Gross sales	\$ 74,054	\$ 44,132	\$ -	\$ -	\$ 118,186
Inter-segment sales	(322)	(176)	-	-	(498)
Net sales	<u>\$ 73,732</u>	<u>\$ 43,956</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 117,688</u>
Operating income	\$ 628	\$ 6,553	\$ -	\$ -	\$ 7,181
Other income (expense), net	442	46	(17)	-	471
Earnings (loss) from continuing operations before income tax provision	<u>\$ 1,070</u>	<u>\$ 6,599</u>	<u>\$ (17)</u>	<u>\$ -</u>	<u>\$ 7,652</u>

Three Months Ended September 30, 2008

	<u>Oil Field</u>	<u>Power Transmission</u>	<u>Corporate & Other*</u>	<u>Adjustment</u>	<u>Total</u>
Gross sales	\$ 149,714	\$ 49,612	\$ -	\$ -	\$ 199,326
Inter-segment sales	(2,641)	(1,595)	-	-	(4,236)
Net sales	<u>\$ 147,073</u>	<u>\$ 48,017</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 195,090</u>
Operating income	\$ 32,598	\$ 6,241	\$ -	\$ -	\$ 38,839
Other income (expense), net	(347)	61	345	-	59
Earnings from continuing operations before income tax provision	<u>\$ 32,251</u>	<u>\$ 6,302</u>	<u>\$ 345</u>	<u>\$ -</u>	<u>\$ 38,898</u>

Nine Months Ended September 30, 2009

	<u>Oil Field</u>	<u>Power Transmission</u>	<u>Corporate & Other*</u>	<u>Adjustment</u>	<u>Total</u>
Gross sales	\$ 262,542	\$ 137,158	\$ -	\$ -	\$ 399,700
Inter-segment sales	(2,134)	(3,001)	-	-	(5,135)
Net sales	<u>\$ 260,408</u>	<u>\$ 134,157</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 394,565</u>
Operating income (loss)	\$ 14,366	\$ 16,971	\$ (5,000)	\$ -	\$ 26,337
Other income, net	888	136	662	-	1,686
Earnings (loss) from continuing operations before income tax provision	<u>\$ 15,254</u>	<u>\$ 17,107</u>	<u>\$ (4,338)</u>	<u>\$ -</u>	<u>\$ 28,023</u>

* Corporate & Other includes the litigation reserve.

Nine Months Ended September 30, 2008

	<u>Oil Field</u>	<u>Power Transmission</u>	<u>Corporate & Other</u>	<u>Adjustment*</u>	<u>Total</u>
Gross sales	\$ 378,433	\$ 138,549	\$ -	\$ -	\$ 516,982
Inter-segment sales	(3,944)	(2,390)	-	-	(6,334)
Net sales	<u>\$ 374,489</u>	<u>\$ 136,159</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 510,648</u>

Operating income (loss)	\$ 77,600	\$ 17,384	\$ -	\$ (1,571)	\$ 93,413
Other income (expense), net	(563)	64	1,491	-	992
Earnings (loss) from continuing operations					
before income tax provision	<u>\$ 77,037</u>	<u>\$ 17,448</u>	<u>\$ 1,491</u>	<u>\$ (1,571)</u>	<u>\$ 94,405</u>

* Due to the discontinuation of the Trailer segment, certain items previously allocated to that segment have been reclassified to continuing operations. One adjustment is related to pension and postretirement charges associated with Trailer personnel that will continue to be a liability in future years. The other adjustment is for corporate allocations previously charged to Trailer as these expenses will continue in the future.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Overview

General

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

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

In support of the above strategy, the Company has been making capital investments in Oil Field to increase manufacturing capacity and capabilities in its three main manufacturing facilities in Lufkin, Texas, Canada and Argentina. These investments should reduce production lead times, improve quality and reduce manufacturing costs. Investments also continue to be made to expand the Company's presence in automation products and international service. During the first quarter of 2009, the Company purchased International Lift Systems ("ILS"), which manufactures and services gas lift, plunger lift and completion equipment for the oil and gas industry. In Power Transmission, the Company continues to expand its gear repair network by opening and expanding facilities in various locations in the U.S. and Canada. The Company is making targeted capital investments in the U.S. and France to expand capacity, develop new product lines and reduce manufacturing lead times, in addition to certain capital investments targeting cost reductions. On July 1, 2009, the Company purchased Rotating Machinery Technology, Inc. (RMT), which specializes in the analysis, design and manufacture of precision, custom-engineered tilting-pad bearings and related components for high-speed turbo equipment operating in critical duty applications. RMT also services, repairs and upgrades turbo-expander process units for air and gas separation, both on-site with its skilled field service team and at its repair facility in Wellsville, New York.

Trends/Outlook

Oil Field

Demand for artificial lift equipment is primarily dependent on the level of new onshore oil wells, workover drilling activity, the depth and fluid conditions of such drilling activity and general field maintenance budgets. Drilling activity is driven by the available cash flow of the Company's customers as well as their long-term perceptions of the level and stability of the price of oil. Increasing energy prices from 2004 to late 2008 increased the demand for pumping units and related service and products from higher drilling activity, activation of idle wells and the upgrading of existing wells. During the first nine months of 2008, demand levels in North America increased over the levels experienced in 2007 as higher energy prices drove increased drilling and workover activity. Additionally, the demand for pumping units, oilfield services and automation equipment continued to increase in international markets as well as a partial recapture of market share from imported equipment domestically.

In the fourth quarter of 2008, energy prices dramatically declined due to reductions in global demand. Planned new drilling and workover activity has also reduced significantly as capital and operating budgets have been reduced. Exploration and production (E&P) companies have reduced drilling in higher-cost fields that are not economically viable at lower energy prices and have reduced overall capital budgets in order to remain cash-flow positive and avoid the more-expensive credit markets. These declines were more pronounced in the U.S., but are starting to be reflected in international markets. New pumping unit booking levels declined in the fourth quarter of 2008 from lower demand, order cancellations for units scheduled to ship in 2009 and price reductions for units scheduled to ship in 2009. These price reductions were primarily in response to the decline in raw material costs in the fourth quarter of 2008 for steel and iron castings.

These negative trends continued into the first quarter of 2009 and worsened during the second quarter of 2009 as E&P companies deferred or cancelled drilling programs and reduced field spending in response to lower energy prices. This trend has been more pronounced in North America than in international markets. E&P companies have indicated that drilling activity will not be reactivated until energy prices stabilize at economically viable levels and drilling and service costs decrease. While oil prices continued to increase during the third quarter of 2009, demand levels did not change significantly over the second quarter of 2009 and will not increase until customers are confident these higher prices will be maintained. Demand for new equipment in North America during the fourth quarter of 2009 will continue to be negatively impacted by customer inventory of new pumping unit equipment ordered in late in 2008 or early 2009 unless oil drilling activity increases over the current levels. Gross margin levels will be negatively impacted from customer pricing pressure and from reduced plant utilizations. While net bookings were up 62% in Oil Field during the third quarter of 2009 compared to the second quarter of 2009, second quarter bookings were negatively impacted by cancellation of orders originally placed in late 2008.

While the market is suffering a cyclical decline, the Company continues to believe that there are long-term positive growth trends for artificial lift equipment, and as existing fields mature, the market will require an increased use of artificial lift, especially in the South American, Russian and Middle Eastern markets. The acquisition of ILS is consistent with the company's long-term growth strategy of integrating strategic assets to leverage Lufkin's position of industry leadership. ILS has a solid reputation for high-quality products, customer responsiveness and long-standing relationships with major independent and super-major integrated companies. This provides an entry for Lufkin into the offshore market for artificial lift wells, including deepwater plays, and expanded reach into the artificial lift market.

Power Transmission

Power Transmission services many diverse markets, with high-speed gearing for markets such as petrochemicals, refineries, offshore production and transmission of oil and slow-speed gearing for the gas, rubber, sugar, paper, steel, plastics, mining, cement and marine propulsion, each of which has its own unique set of drivers. Generally, if global industrial capacity utilizations are not high, spending on new equipment lags. Also impacting demand are government regulations involving safety and environmental issues that can require capital spending. Recent market demand increases have come from energy-related markets such as refining, petrochemical, drilling, coal, marine and power generation in response to higher global energy prices. Recent declines in energy prices and restricted credit markets have started to impact demand as plans for large energy infrastructure projects are being deferred or cancelled. This was reflected in lower bookings in the third quarter of 2009 as compared to the second quarter of 2009. However, governments are increasing funding for infrastructure and alternative energy projects for economic stimulus purposes, which may create opportunities for power transmission products.

Discontinued Operations

During the second quarter of 2008, the Trailer segment was classified as a discontinued operation. In January 2008, the Company announced the decision to suspend its participation in the commercial trailer markets and to develop a plan to run-out existing inventories, fulfill contractual obligations and close all trailer facilities in 2008. During the second quarter of 2008, this plan was completed, with the majority of the remaining inventory and manufacturing equipment sold and all facilities closed.

Other

During the first half of 2009, the Company recorded an additional contingent liability provision of \$5.0 million (pre-tax) related to our ongoing class-action lawsuit. No provisions were recorded during the third quarter of 2009. See Part II, Item 1. "Legal Proceedings" for additional information.

Summary of Results

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

Overall, sales for the three months ended September 30, 2009, decreased to \$117.7 million from \$195.1 million for the three months ended September 30, 2008, or 39.7%, and sales for the nine months ended September 30, 2009, decreased to \$394.6 million from \$510.6 million for the nine months ended September 30, 2008, or 22.7%. This decrease was primarily driven by lower sales of oil field products and services in the North American market.

Gross margin for the three months ended September 30, 2009, decreased to 21.2% from 28.6% for the three months ended September 30, 2008, and gross margin for the nine months ended September 30, 2009, decreased to 21.8% from 28.2% for the nine months ended September 30, 2008. This gross margin decrease was primarily related to price decreases in response to material price decreases and lower demand and the negative impact of lower plant utilization on fixed cost coverage in the Oil Field segment. Additional segment data on gross margin is provided later in this section.

Higher selling, general and administrative expenses also negatively impacted net earnings, with these expenses increasing to \$17.8 million during the third quarter of 2009 from \$17.0 million during the third quarter of 2008, and increasing to \$54.8 million during the first nine months of 2009 from \$50.7 million during the first nine months of 2008. This increase was primarily related to resources added from the ILS and RMT acquisitions. As a percentage of sales, selling, general and administrative expenses also increased to 15.1% for the three months ended September 30, 2009, from 8.7% in the three months ended September 30, 2008, and increased to 13.9% for the nine months ended September 30, 2009, from 9.9% for the nine months ended September 30, 2008. The Company has made the strategic decision to maintain employment levels in this area to focus on new product and geographic expansion opportunities. Operating income was also impacted by a litigation reserve of \$5.0 million during the nine months ended September 30, 2009, related to its ongoing class-action lawsuit.

The Company reported net earnings from continuing operations of \$5.1 million or \$0.34 per share (diluted) for the three months ended September 30, 2009, compared to net earnings from continuing operations of \$25.0 million or \$1.66 per share (diluted) for the three months ended September 30, 2008. Net earnings from continuing operations were \$18.9 million or \$1.27 per share (diluted) for the nine months ended September 30, 2009, compared to net earnings from continuing operations of \$61.7 million or \$4.14 per share (diluted) for the nine months ended September 30, 2008.

Debt/equity (long-term debt net of current portion as a percentage of total equity) levels were 0.5% as of September 30, 2009, and 0.0% at December 31, 2008. Cash balances at September 30, 2009, were \$102.2 million, down from \$107.8 million at December 31, 2008.

Three Months Ended September 30, 2009, Compared to Three Months Ended September 30, 2008

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

	Three Months Ended		Increase/ (Decrease)	% Increase/ (Decrease)
	September 30,			
	2009	2008		
Sales				
Oil Field	\$ 73,732	\$ 147,073	\$ (73,341)	(49.9)
Power Transmission	43,956	48,017	(4,061)	(8.5)

Total	\$ 117,688	\$ 195,090	\$ (77,402)	(39.7)
Gross Profit				
Oil Field	\$ 11,054	\$ 41,232	\$ (30,178)	(73.2)
Power Transmission	13,878	14,590	(712)	(4.9)
Total	\$ 24,932	\$ 55,822	\$ (30,890)	(55.3)

Oil Field

Oil Field sales decreased to \$73.7 million, or 49.9%, for the three months ended September 30, 2009, from \$147.1 million for the three months ended September 30, 2008. New unit sales of \$37.3 million during the third quarter of 2009 were down \$55.6 million, or 59.9%, compared to \$92.9 million during the third quarter of 2008, primarily from lower U.S. demand and pricing pressure. Pumping unit service sales of \$19.9 million during the third quarter of 2009 were down \$7.6 million, or 27.6%, compared to \$27.4 million during the third quarter of 2008, from declines in the U.S. market due to demand and pricing pressure. Automation sales of \$9.8 million during the third quarter of 2009 were down \$9.3 million, or 48.6%, compared to \$19.2 million during the third quarter of 2008, from lower sales in the U.S. and pricing pressure. Commercial casting sales of \$2.0 million during the third quarter of 2009 were down \$5.5 million, or 72.8%, compared to \$7.5 million during the third quarter 2008, from lower sales to the machine tool market. Sales from Lufkin ILS contributed \$4.7 million during the third quarter of 2009. Oil Field's backlog decreased to \$35.9 million as of September 30, 2009, from \$279.8 million at September 30, 2008, and \$188.1 million at December 31, 2008. This decrease was caused primarily by lower orders for new pumping units as U.S. and international customers deferred or cancelled drilling programs in response to lower energy prices.

Gross margin (gross profit as a percentage of sales) for the Oil Field segment decreased to 15.0% for three months ended September 30, 2009, compared to 28.0% for the three months ended September 30, 2008, or 13.0 percentage points. This gross margin decrease was related to price reductions in response to material price decreases and lower customer demand and the negative impact of lower plant utilization on fixed cost coverage.

Direct selling, general and administrative expenses for Oil Field increased to \$6.2 million, or 26.3%, for the three months ended September 30, 2009, from \$4.9 million for the three months ended September 30, 2008. The majority of this increase is related to the resources added with the ILS acquisition. Direct selling, general and administrative expenses as a percentage of sales increased to 8.5% for the three months ended September 30, 2009, from 3.4% for the three months ended September 30, 2008.

Power Transmission

Sales for the Company's Power Transmission segment decreased to \$44.0 million, or 8.5%, for the three months ended September 30, 2009, compared to \$48.0 million for the three months ended September 30, 2008. New unit sales of \$34.0 million during the third quarter of 2009 were down \$2.0 million, or 5.5%, compared to \$36.0 million during the third quarter of 2008 from decreased sales of low-speed units to the industrial and marine markets. Repair and service sales of \$9.1 million during the third quarter of 2009 were down \$3.0 million, or 24.5%, compared to \$12.1 million during the third quarter 2008 as customers deferred spending on maintenance projects due to poor economic conditions. Sales from Lufkin RMT contributed \$0.9 million during the third quarter of 2009. Power Transmission backlog at September 30, 2009, decreased to \$97.9 million from \$134.1 million at September 30, 2008, and \$129.3 million at December 31, 2008, primarily from decreased bookings of new units for the energy-related and marine markets.

Gross margin for the Power Transmission segment increased to 31.6% for the three months ended September 30, 2009, compared to 30.4% for the three months ended September 30, 2008, or 1.2 percentage points. This gross margin increase was primarily from the favorable mix effect of increased sales of high-speed units from marine units and repair work.

Direct selling, general and administrative expenses for Power Transmission increased to \$5.9 million, or 7.7%, for the three months ended September 30, 2009, from \$5.5 million for the three months ended September 30, 2008. The majority of this increase is related to the resources added with the RMT acquisition. Direct selling, general and administrative expenses as a percentage of sales also increased to 13.5% for the three months ended September 30, 2009, from 11.5% for the three months ended September 30, 2008.

Corporate/Other

Corporate administrative expenses, which are allocated to the segments primarily based on budgeted sales levels, were \$5.6 million for the three months ended September 30, 2009, a decrease of \$1.0 million or 14.6%, from \$6.5 million for the three months ended September 30, 2008, primarily from decreased personnel-related expenses.

Interest income, interest expense and other income and expense for the three months ended September 30, 2009, increased to \$0.5 million of income compared to \$0.1 million of income for the three months ended September 30, 2008, from currency gains offsetting reduced interest income.

Pension expense, which is reported as an increase in cost of sales, increased to \$2.5 million for the three months ended September 30, 2009, compared to pension income of \$0.5 million for the three months ended September 30, 2008. This increase in expense was primarily due to lower expected returns on asset balances and the amortization of 2008 market losses.

The net tax rate for the three months ended September 30, 2009, was 33.9% compared to 35.8% for the three months ended September 30, 2008. The net tax rate in the third quarter of 2009 benefitted from adjustments to prior period tax filings in the U.S. The tax rate for the balance

of 2009 is expected to be approximately 36.0%.

Nine Months Ended September 30, 2009, Compared to Nine Months Ended September 30, 2008

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

	Nine Months Ended September 30,		Increase/ (Decrease)	% Increase/ (Decrease)
	2009	2008		
Sales				
Oil Field	\$ 260,408	\$ 374,489	\$ (114,081)	(30.5)
Power Transmission	134,157	136,159	(2,002)	(1.5)
Total	<u>\$ 394,565</u>	<u>\$ 510,648</u>	<u>\$ (116,083)</u>	(22.7)
Gross Profit				
Oil Field	\$ 47,255	\$ 102,488	\$ (55,233)	(53.9)
Power Transmission	38,856	41,534	(2,678)	(6.4)
Adjustment*	-	115	(115)	(100.0)
Total	<u>\$ 86,111</u>	<u>\$ 144,137</u>	<u>\$ (58,026)</u>	(40.3)

* Due to the discontinuation of the Trailer segment, certain items previously allocated to that segment in cost of sales have been reclassified to continuing operations. The adjustment is related to pension and postretirement charges associated with Trailer personnel that will continue to be a liability in future years.

Oil Field

Oil Field sales decreased to \$260.4 million, or 30.5%, for the nine months ended September 30, 2009, from \$374.5 million for the nine months ended September 30, 2008. New unit sales of \$144.6 million during the first nine months of 2009 were down \$83.2 million, or 36.5%, compared to \$227.8 million during the first nine months 2008, primarily from lower U.S. demand and pricing pressure. Pumping unit service sales of \$61.2 million during the first nine months of 2009 were down \$11.2 million, or 15.4%, compared to \$72.4 million during the first nine months of 2008, from declines in the U.S. market. Automation sales of \$36.4 million during the first nine months of 2009 were down \$18.7 million, or 33.9%, compared to \$55.1 million during the first nine months 2008, from lower sales in the U.S. and pricing pressure. Commercial casting sales of \$7.2 million during the first nine months of 2009 were down \$11.9 million, or 62.3%, compared to \$19.1 million during the first nine months 2008, from lower sales to the machine tool market. Sales from Lufkin ILS contributed \$10.9 million during the first nine months of 2009. Oil Field's backlog decreased to \$35.9 million as of September 30, 2009, from \$188.1 million at December 31, 2008. This decrease was caused primarily by lower orders for new pumping units as U.S. and international customers deferred or cancelled drilling programs in response to lower energy prices.

Gross margin (gross profit as a percentage of sales) for the Oil Field segment decreased to 18.1% for nine months ended September 30, 2009, compared to 27.4% for the nine months ended September 30, 2008, or 9.3 percentage points. This gross margin decrease was related to price reductions in response to material price decreases and lower customer demand and the negative impact of lower plant utilization on fixed cost coverage.

Direct selling, general and administrative expenses for Oil Field increased to \$19.1 million, or 25.9%, for the nine months ended September 30, 2009, from \$15.2 million for the nine months ended September 30, 2008. The majority of this increase is related to higher international sales commissions as well as the resources added with the ILS acquisition. Direct selling, general and administrative expenses as a percentage of sales increased to 7.3% for the nine months ended September 30, 2009, from 4.1% for the nine months ended September 30, 2008.

Power Transmission

Sales for the Company's Power Transmission segment decreased to \$134.2 million, or 1.5%, for the nine months ended September 30, 2009, compared to \$136.2 million for the nine months ended September 30, 2008. New unit sales of \$104.9 million during the first nine months of 2009 were up \$0.3 million, or 0.3%, compared to \$104.6 million during the first nine months of 2008. Repair and service sales of \$28.3 million during the first nine months of 2009 were down \$3.2 million, or 10.0%, compared to \$31.5 million during the first nine months 2008 as customers deferred spending on maintenance projects due to poor economic conditions. Sales from Lufkin RMT contributed \$0.9 million during the first nine months of 2009. Power Transmission backlog at September 30, 2009, decreased to \$97.9 million from \$129.3 million at December 31, 2008, primarily from decreased bookings of new units for the energy-related and marine markets.

Gross margin for the Power Transmission segment decreased to 29.0% for the nine months ended September 30, 2009, compared to 30.5% for the nine months ended September 30, 2008, or 1.5 percentage points. This gross margin decrease was primarily from the unfavorable impact of lower production levels in manufacturing and repair on fixed cost coverage.

Direct selling, general and administrative expenses for Power Transmission increased to \$17.3 million, or 3.5%, for the nine months ended September 30, 2009, from \$16.7 million for the nine months ended September 30, 2008. Direct selling, general and administrative expenses as a percentage of sales increased to 12.9% for the nine months ended September 30, 2009, from 12.3% for the nine months ended September 30, 2008.

Corporate/Other

Corporate administrative expenses, which are allocated to the segments primarily based on budgeted sales levels, were \$18.3 million for the nine months ended September 30, 2009, a decrease of \$0.5 million or 2.5%, from \$18.8 million for the nine months ended September 30, 2008.

Interest income, interest expense and other income and expense for the nine months ended September 30, 2009, increased to \$1.7 million of income compared to \$1.0 million of income for the nine months ended September 30, 2008, from currency gains offsetting reduced interest income.

Pension expense, which is reported as an increase in cost of sales, increased to \$7.6 million for the nine months ended September 30, 2009, compared to pension income of \$1.6 million for the nine months ended September 30, 2008. This expense increase was primarily due to lower expected returns on asset balances and the amortization of 2008 market losses.

The net tax rate for the nine months ended September 30, 2009, was 32.6% compared to 34.6% for the nine months ended September 30, 2008. The net tax rate in the first nine months of 2009 benefitted from adjustments to prior period tax filings in the U.S., the settlement of the 2006 IRS tax audit and R&E tax credit estimate adjustments. The tax rate for the balance of 2009 is expected to be approximately 36.0%.

Due to the discontinuation of the Trailer segment, certain items previously allocated to that segment have been reclassified to continuing operations. One adjustment is related to pension and postretirement charges associated with Trailer personnel that will continue to be a liability in future years. The other adjustment is for corporate allocations previously charged to Trailer as these expenses will continue in the future.

Liquidity and Capital Resources

The Company has historically relied on cash flows from operations and third-party borrowing to finance its operations, including acquisitions, dividend payments and stock repurchases. The Company believes that its cash flows from operations and its available borrowing capacity under its credit agreements will be sufficient to fund its operations, including planned capital expenditures, dividend payments and stock repurchases, through December 31, 2009, and the foreseeable future.

The Company's cash balance totaled \$102.2 million at September 30, 2009, compared to \$107.8 million at December 31, 2008. For the nine months ended September 30, 2009, net cash provided by operating activities was \$87.8 million, net cash used in investing activities totaled \$79.7 million and net cash used in financing activities amounted to \$14.1 million. Significant components of cash provided by operating activities included net earnings from continuing operations, adjusted for non-cash expenses, of \$37.6 million and a decrease in working capital of \$49.8 million. This working capital decrease was primarily due to a reduction in trade receivables balances of \$65.1 million and inventory balances of \$20.3 million due to sales volumes declines since the fourth quarter of 2008, partially offset by reductions in accounts payable and accrued liabilities of \$33.5 million. Net cash used in investing activities included net capital expenditures totaling \$26.9 million and the ILS and RMT acquisitions totaling \$51.7 million. Capital expenditures in the first nine months of 2009 were primarily for new facilities to support geographical and product line expansions in the Oil Field and Power Transmission segments. Capital expenditures for 2009 are projected to be approximately \$40.0 to \$45.0 million, primarily for the new facilities to support geographical and product line expansions and equipment replacement for efficiency improvements in the Oil Field and Power Transmission segments and will be funded by operating cash flows. Significant components of net cash used by financing activities included dividend payments of \$11.1 million, or \$0.75, per share and debt repayments of \$3.0 million.

The Company has a three-year credit facility with a domestic bank (the "Bank Facility") consisting of an unsecured revolving line of credit that provides up to \$40.0 million of aggregate borrowing. This Bank Facility expires on December 31, 2010. 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 September 30, 2009, no debt was outstanding under the Bank Facility and the Company was in compliance with all financial covenants under the terms of the Bank Facility. Deducting outstanding letters of credit of \$17.0 million, \$23.0 million of borrowing capacity was available at September 30, 2009. The fair market value of the outstanding debt as of September 30, 2009 is not materially different than its carrying value.

The Company assumed various notes payable and entered into purchase price hold back agreements in conjunction with the ILS and RMT acquisitions in 2009. These obligations will require principal payments of \$0.3 million during the fourth quarter of 2009.

Recently Issued Accounting Pronouncements

In December 2008, the Financial Accounting Standards Board amended "Employer's Disclosures about Postretirement Benefit Plan Assets" (ASC 715-20-65-2). This amendment expands the disclosure requirements about postretirement plan assets to include how investment allocations are made, including the factors that are pertinent to an understanding of investment policies and strategies, the major categories of plan assets, the input and valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the periods and significant concentration of risk with plan assets. Such required disclosures will be provided in our annual financial statements for the year ending December 31, 2009. Upon initial application, the disclosures of ASC 715-20-65-2 are not required for earlier periods that are presented for comparative purposes.

In May 2009, the Financial Accounting Standards Board issued "Subsequent Events" (ASC 855-10), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855-10 requires disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. The

Company adopted this Statement in these interim financial statements. The Company has evaluated subsequent events through November 9, 2009, which represents the date that the financial statements were issued.

In October 2009, the FASB issued an update to existing guidance on revenue recognition for arrangements with multiple deliverables. This update will allow companies to allocate consideration received for qualified separate deliverables using estimated selling price for both delivered and undelivered items when vendor-specific objective evidence or third-party evidence is unavailable. Additional disclosures discussing the nature of multiple element arrangements, the types of deliverables under the arrangements, the general timing of their delivery, and significant factors and estimates used to determine estimated selling prices are required. The Company has not determined the impact on its condensed consolidated financial statements.

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

Critical Accounting Policies and Estimates

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

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

Revenue is not recognized until it is realized or realizable and earned. The criteria to meet this guideline are: persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price to the buyer is fixed or determinable and 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; and
- The product must be completed and ready for shipment.

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

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

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

The Company adopted ASC 740-10, "Accounting for Uncertainty in Income Taxes", on January 1, 2007. ASC 740-10 clarifies the accounting for uncertainty in income taxes by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The application of income tax law is inherently complex. The

Company is required to determine if an income tax position meets the criteria of more-likely-than-not to be realized based on the merits of the position under tax laws, in order to recognize an income tax benefit. This requires the Company to make many assumptions and judgments regarding merits of income tax positions and the application of income tax law. Additionally, if a tax position meets the recognition criteria of more-likely-than-not the Company is required to make judgments and assumptions to measure the amount of the tax benefits to recognize based on the probability of the amount of tax benefits that would be realized if the tax position was challenged by the taxing authorities. Interpretations and guidance surrounding income tax laws and regulations change over time. As a consequence, changes in assumptions and judgments can materially affect amounts recognized in the consolidated financial statements.

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

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

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

The Company offers defined benefit plans and other benefits upon the retirement of its employees. Assets and liabilities associated with these benefits are calculated by third-party actuaries under the rules provided by various accounting standards, with certain estimates provided by management. These estimates include the discount rate, expected rate of return of assets and the rate of increase of compensation and health claims. On a regular basis, management reviews these estimates by comparing them to actual experience and those used by other companies. If a change in an estimate is made, the carrying value of these assets and liabilities may have to be adjusted. The impact of changes in these estimates could cause significant fluctuations in these balances.

Forward-Looking Statements and Assumptions

This quarterly report on Form 10-Q 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," "plan," "schedule," "could," "may," "might," "should," "project" or similar expressions are intended to identify forward-looking statements. Similarly, statements that describe the Company's future plans, objectives or goals are also forward-looking statements. 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. Undue reliance should not be placed on forward-looking statements. These risks and uncertainties include, but are not limited to:

- oil price volatility;
- declines in domestic and worldwide oil and gas drilling;
- capital spending levels of oil producers;
- availability and prices for raw materials;
- the inherent dangers and complexities of our operations;
- uninsured judgments or a rise in insurance premiums;
- the inability to effectively integrate acquisitions;
- labor disruptions and increasing labor costs;
- the availability of qualified and skilled labor;
- disruption of our operating facilities or management information systems;
- the impact on foreign operations of war, political disruption, civil disturbance, economic and legal sanctions and changes in global trade policies;
- currency exchange rate fluctuations in the markets in which the Company operates;
- changes in the laws, regulations, policies or other activities of governments, agencies and similar organizations where such actions may affect the production, licensing, distribution or sale of the Company's products, the cost thereof or applicable tax rates;
- costs related to legal and administrative proceedings, including adverse judgments against the Company if the Company fails to prevail in reversing such judgments; and
- general industry, political and economic conditions in the markets where the Company 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.

Additional information about risks and uncertainties that could cause actual results to differ materially from forward-looking statements is contained in Part I, Item 1A. "Risk Factors" of the Company's Annual Report on Form 10-K for the year ended December 31, 2008. All forward-looking statements attributable to the Company or persons acting on the Company's behalf are expressly qualified in their entirety by these factors. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, believed, estimated or expected. The forward-looking statements included in this report are only made as of the date of this report and, except as required by securities laws, the Company disclaims any obligation to publicly update forward-

looking statements to reflect subsequent events or circumstances.

Item 3. 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's accounts receivable are not concentrated in one customer 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 lack of current debt, the Company does not have any significant exposure to interest rate fluctuations. However, if the Company drew on its line of credit under its Bank Facility, the Company would have exposure since the interest rate is variable. In addition, the Company primarily invoices and purchases in the same currency as the functional currency of its operations, which minimizes exposure to currency rate fluctuations.

The Company uses large amounts of steel, iron and electricity in the manufacture of its products. The price of these raw materials has a significant impact on the cost of producing products. Steel prices increased significantly between 2004 and 2008 caused primarily by higher energy prices and increased global demand. In 2009 the Company has seen a reduction in steel prices but currently estimates that prices will increase in 2010. Since most of the Company's suppliers are not currently parties to long-term contracts with us, the Company is vulnerable to fluctuations in prices of such raw materials. Factors such as supply and demand, freight costs and transportation availability, inventory levels of brokers and dealers, the level of imports and general economic conditions may affect the price of cast iron and steel. Raw material prices may increase significantly in the future. Certain items such as steel round, bearings and aluminum have continued to experience price increases, price volatility and longer lead times. If the Company is unable to pass future raw material price increases on to its customers, margins, results of operations, cash flow and financial condition could be adversely affected.

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 September 30, 2009, this inter-company debt was comprised of 0.1 million euros and \$9.0 million Canadian dollars. As of September 30, 2009, if the U.S. dollar strengthened by 10% over these currencies, the net income impact would be \$0.6 million of expense and if the U.S. dollar weakened by 10% over these currencies, the net income impact would be \$0.6 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. As of September 30, 2009, if the U.S. dollar strengthened by 10% over these currencies, the net income impact would be \$0.1 million of income.

Item 4. Controls and Procedures.

Based on their evaluation of the Company's disclosure controls and procedures as of September 30, 2009, the Chief Executive Officer of the Company, John F. Glick, and the Chief Financial Officer of the Company, Christopher L. Boone, have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934) are effective to ensure that information required to be disclosed in reports that the Company files or submits under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and effective to ensure that information required to be disclosed in such reports is accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, to allow timely decisions regarding disclosure.

There were no changes in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2009, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II- OTHER INFORMATION

Item 1. Legal Proceedings .

On March 7, 1997, a class action complaint was filed against Lufkin Industries, Inc. (the "Company") in the U.S. District Court for the Eastern District of Texas by an employee and a former employee of the Company who alleged race discrimination in employment. Certification hearings were conducted in Beaumont, Texas in February 1998 and in Lufkin, Texas in August 1998. In April 1999, the District Court issued a decision that certified a class for this case, which included all black employees employed by the Company from March 6, 1994, to the present. The case was administratively closed from 2001 to 2003 while the parties unsuccessfully attempted mediation. Trial for this case began in December 2003, and after the close of plaintiff's evidence, the court adjourned and did not complete the trial until October 2004. Although plaintiff's class certification encompassed a wide variety of employment practices, plaintiffs presented only disparate impact claims relating to discrimination in initial assignments and promotions at trial.

On January 13, 2005, the District Court entered its decision finding that the Company discriminated against African-American employees in initial assignments and promotions. The District Court also concluded that the discrimination resulted in a shortfall in income for those employees and ordered that the Company pay those employees back pay to remedy such shortfall, together with pre-judgment interest in the amount of 5%. On August 29, 2005, the District Court determined that the back pay award for the class of affected employees was \$3.4 million (including interest to January 1, 2005) and provided a formula for attorney fees that the Company estimates will result in a total not to exceed \$2.5 million. In addition to back pay with interest, the District Court (i) enjoined and ordered the Company to cease and desist all racially biased assignment and promotion practices and (ii) ordered the Company to pay court costs and expenses.

The Company reviewed this decision with its outside counsel and on September 19, 2005, appealed the decision to the U.S. Court of Appeals for the Fifth Circuit. On April 3, 2007, the Company appeared before the appellate court in New Orleans for oral argument in this case. The appellate court subsequently issued a decision on Friday, February 29, 2008 that reversed and vacated the plaintiff's claim regarding the initial assignment of black employees into the Foundry Division. The court also denied plaintiff's appeal for class certification of a class disparate treatment claim. Plaintiff's claim on the issue of the Company's promotional practices was affirmed but the back pay award was vacated and remanded for recomputation in accordance with the opinion. The District Court's injunction was vacated and remanded with instructions to enter appropriate and specific injunctive relief. Finally, the issue of plaintiff's attorney's fees was remanded to the District Court for further consideration in accordance with prevailing authority.

On December 5, 2008, the U.S. District Court Judge Clark held a hearing in Beaumont, Texas during which he reviewed the 5th U.S. Circuit Court of Appeals class action decision and informed the parties that he intended to implement the decision in order to conclude this litigation. At the conclusion of the hearing Judge Clark ordered the parties to submit positions regarding the issues of attorney fees, a damage award and injunctive relief. Subsequently, the Company reviewed the plaintiff's submissions which described the formula and underlying assumptions that supported their positions on attorney fees and damages. After careful review of the plaintiff's submission to the court the Company continued to have significant differences regarding legal issues that materially impacted the plaintiff's requests. As a result of these different results, the court requested further evidence from the parties regarding their positions in order to render a final decision. The judge reviewed both parties arguments regarding legal fees, and awarded the plaintiffs an interim fee, but at a reduced level from the plaintiffs original request. The Company and the plaintiffs reconciled the majority of the differences and the damage calculations which also lowered the originally requested amounts of the plaintiffs on those matters. Due to the resolution of certain legal proceedings on damages during first half of 2009 and the District Court awarding the plaintiffs an interim award of attorney fees and cost totaling \$5.8 million, the Company recorded an additional provision of \$5.0 million in the first half of 2009 above the \$6.0 million recorded in fourth quarter of 2008. The plaintiffs have filed an appeal of the District Court's interim award of attorney fees with the U.S. Fifth Circuit Court of Appeals. The Company has filed a cross-appeal on the attorney fee issue. The Fifth Circuit subsequently dismissed these appeals on August 28, 2009 on the basis that an appealable final judgment in this case had not been issued. The court commented that this issue can be reviewed with an appeal of final judgment. On June 19, 2009, the District Court issued a damage award in favor of the plaintiffs totaling \$3.1 million for the period 2004 through 2007 plus annual interest 5%. The Company estimates that the total damage award will be \$5.0 million and, as a result, in the second quarter of 2009, the Company increased its damage provision in this case by an additional \$2.0 million which represents the Company's best estimate of its ultimate exposure.

Additionally, during the first quarter of 2009, the court appointed an industrial expert to review the Company's promotional policies and practices and prepare a report for the court which would contain recommendations for injunctive relief in this case. The Company anticipates the District Court's injunctive relief award by the end of the fourth quarter of 2009.

There are various other claims and legal proceedings arising in the ordinary course of business pending against or involving the Company wherein monetary damages are sought. For certain of these claims, the Company maintains insurance coverage while retaining a portion of the losses that occur through the use of deductibles and retention limits. Amounts in excess of the self-insured retention levels are fully insured to limits believed appropriate for the Company's operations. Self-insurance accruals are based on claims filed and an estimate for claims incurred but not reported. While the Company does maintain insurance above its self-insured levels, a decline in the financial condition of its insurer, while not currently anticipated, could result in the Company recording additional liabilities. It is management's opinion that the Company's liability under such circumstances or involving any other non-insured claims or legal proceedings would not materially affect its consolidated financial position, results of operations, or cash flow.

Item 1A. Risks Factors.

In addition to other information set forth in this quarterly report, the factors discussed in Part I, Item 1A. "Risk Factors" in the Company's

Annual Report on Form 10-K for the year ended December 31, 2008, which could materially affect the Company's business, financial condition and/or operating results, should be carefully considered. The risks described in the Company's Annual Report on Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to the Company or that it currently deems to be immaterial also may materially adversely affect the Company's business, financial condition and/or operating results.

Item 6. Exhibits.

- ***3.1 Fourth Restated Articles of Incorporation, as amended (incorporated by reference to Exhibit 4.1 to the Company's registration statement on Form S-8 filed on February 17, 2004 (SEC File No. 333-112890)).
- ***3.2 Articles of Amendment to Fourth Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K filed on December 10, 1999 (File No. 0-02612)).
- ***3.3 Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K filed on October 9, 2007 (File No. 0-02612)).
- *31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
- *31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.
- **32.1 Section 1350 Certification of Chief Executive Officer.
- **32.2 Section 1350 Certification of Chief Financial Officer.

* Filed herewith

** Furnished herewith

*** Incorporated by reference

SIGNATURES

Pursuant to the requirements 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.

Date: November 9, 2009

LUFKIN INDUSTRIES, INC.

By: /s/ Christopher L. Boone

Christopher L. Boone
Signing on behalf of the registrant and as
Vice President/Treasurer/Chief Financial Officer
(Principal Financial and Accounting Officer)

INDEX TO EXHIBITS

- ***3.1 Fourth Restated Articles of Incorporation, as amended (incorporated by reference to Exhibit 4.1 to the Company's registration statement on Form S-8 filed on February 17, 2004 (SEC File No. 333-112890)).
- ***3.2 Articles of Amendment to Fourth Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K filed on December 10, 1999 (File No. 0-02612)).
- ***3.3 Amended and Restated Bylaws (incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K filed on October 9, 2007 (File No. 0-02612)).
- *31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.
- *31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.
- **32.1 Section 1350 Certification of Chief Executive Officer.
- **32.2 Section 1350 Certification of Chief Financial Officer.

* Filed herewith

** Furnished herewith

*** Incorporated by reference

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, John F. Glick, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q 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 control 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.

November 9, 2009

/s/ John F. Glick

John F. Glick

Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Christopher L. Boone, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q 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.

November 9, 2009

/s/ Christopher L. Boone
Christopher L. Boone
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 Quarterly Report of Lufkin Industries, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, John F. Glick, 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/ John F. Glick

John F. Glick
Chief Executive Officer
November 9, 2009

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 Quarterly Report of Lufkin Industries, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Christopher L. Boone, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

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

/s/ Christopher L. Boone
Christopher L. Boone
Chief Financial Officer
November 9, 2009

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