

SMITH INTERNATIONAL INC

Form DEF 14A

April 11, 2008

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
SCHEDULE 14A**

Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

**Smith International, Inc.**

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
  - Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
- (1) Title of each class of securities to which transaction applies:

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- o Fee paid previously with preliminary materials.
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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

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**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**May 13, 2008**

To Our Stockholders:

The Annual Meeting of Stockholders (the Annual Meeting ) of Smith International, Inc. (the Company ) will be held on **Tuesday, May 13, 2008**, at 9:00 a.m. local time, at 700 King Street, Wilmington, Delaware, to consider and take action on the following:

1. Election of two directors: Loren K. Carroll and Dod A. Fraser, each for a term of three years;
2. Approval of the Smith International, Inc. Third Amended and Restated 1989 Long-Term Incentive Compensation Plan;
3. Approval of an Amendment to the Restated Certificate of Incorporation to increase the Number of Authorized Shares of Common Stock; and
4. Ratification of Deloitte & Touche LLP as independent registered public accounting firm for 2008.

**Your Board of Directors recommends a vote FOR Proposals 1, 2, 3, and 4.**

**Important Notice Regarding the Availability of Proxy Materials for the Stockholder Meeting to Be Held on May 13, 2008: This proxy statement, along with the 2007 Annual Report to Stockholders, are available on the following website: [www.edocumentview.com/sii](http://www.edocumentview.com/sii).**

The Board of Directors has fixed the close of business on March 14, 2008 as the record date for determining stockholders who are entitled to notice of and to vote at the meeting.

By Order of the Board of Directors

Richard E. Chandler, Jr.  
*Secretary*

Houston, Texas  
April 11, 2008

**YOUR VOTE IS IMPORTANT.**

Please vote your proxy promptly so that your shares will be represented, even if you plan to attend the Annual Meeting. You can vote by Internet, by telephone, or by using the proxy card that is enclosed. Please see your proxy card for specific instructions on how to vote. Brokers cannot vote for Proposal 2 without your instructions.

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**PROXY STATEMENT**

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P. O. Box 60068  
Houston, TX 77205-0068

## **PROXY STATEMENT**

The Board of Directors of Smith International, Inc. is soliciting your proxy to vote your shares of the Company's common stock ( Common Stock ) at the 2008 Annual Meeting. We are distributing this Proxy Statement and the accompanying proxy card beginning on or about April 11, 2008. We solicit proxies to give all stockholders of record an opportunity to vote on matters that will be presented at the Annual Meeting. In this Proxy Statement, you will find information to assist you in voting your shares. **Your vote is very important.**

### **GENERAL INFORMATION ABOUT VOTING**

Except as otherwise specifically noted in this Proxy Statement, we, our, us, and similar words as well as Smith and Company refer to Smith International, Inc.

#### **Who may vote?**

You are entitled to vote your shares of our Common Stock if you are a stockholder of record on March 14, 2008. At the close of business on March 14, 2008, a total of 200,816,561 shares of Common Stock were outstanding and entitled to vote. Each share of Common Stock has one vote. The enclosed proxy card shows the number of shares that you are entitled to vote.

#### **How do I vote?**

Stockholders of record may vote in person or by telephone, internet or mail. If you are voting by mail, please sign, date and mail the enclosed proxy card. If you are voting by telephone or internet, please follow the instructions on the enclosed proxy card.

Whether or not you plan to attend the meeting, we encourage you to vote by proxy as soon as possible.

If you hold your shares in more than one type of account or your shares are registered differently, you may receive more than one proxy card. We encourage you to vote each proxy card that you receive.

If you choose to attend the meeting in person, you will be asked to present valid picture identification and, if you hold your shares through a broker, you will be asked to present a copy of your brokerage statement showing your stock ownership as of March 14, 2008. For directions to the meeting, contact the Doubletree Hotel Downtown Wilmington, Delaware at 302-655-0400.

#### **How will my shares be voted?**

If you vote by proxy, the individuals named on the proxy card (your proxies) will vote your shares in the manner you indicate. You may specify on your proxy card whether your shares should be voted for all of the nominees for director or your vote may be withheld with respect to one or more of the nominees. You may also specify whether you approve, disapprove or abstain from the other proposals.

If you sign and return your proxy card without indicating your voting instructions, your shares will be voted FOR the election of all nominees for director and FOR Proposals 2, 3, and 4.

**What if my shares are held by a broker?**

If your Common Stock is held by a broker, bank or other nominee (in street name ), your broker must vote those shares in accordance with your instructions. However, if you do not give voting instructions to your broker

within ten days of the meeting, your broker may vote your shares for you on any matter that the New York Stock Exchange determines to be routine. If the broker cannot vote on a particular matter because it is not routine, there is a broker non-vote on that matter. Broker non-votes do not count as votes for or against Proposals 2 and 4, but will count as votes against Proposal 3. An abstention counts as a vote against a proposal. Abstentions and broker non-votes have no effect on the outcome of the election of directors.

If you hold your shares in street name and you wish to vote in person at the Annual Meeting, you will need to obtain a proxy from the broker or nominee that holds your shares. If the meeting is adjourned, your Common Stock will be voted as specified on your proxy card on the new meeting date, unless you have revoked your proxy instructions.

### **May I revoke or change my vote?**

You may revoke or change your proxy at any time before it is exercised by submitting written notice of revocation to Smith's Corporate Secretary so that he receives it before the Annual Meeting; voting again by telephone, internet or mail; or voting in person at the Annual Meeting.

Attendance at the Annual Meeting will not by itself revoke a previously granted proxy. If you hold your shares in street name and you wish to change your vote at the Annual Meeting, you will need to obtain a proxy from the broker or nominee that holds your shares.

### **What constitutes a quorum?**

The holders of a majority of the outstanding shares of Common Stock entitled to vote constitutes a quorum for the transaction of business at the Annual Meeting. If you have returned valid proxy instructions or attend the meeting in person, your Common Stock will be counted for the purpose of determining whether there is a quorum, even if you wish to abstain from voting on some or all matters introduced at the meeting. Broker non-votes also count for quorum purposes.

### **How many votes are required to approve a proposal?**

Directors (Proposal 1) must be elected by a plurality of the votes cast at the meeting. This means that the two nominees receiving the greatest number of votes will be elected. The affirmative vote of a majority of the shares represented at the meeting and entitled to vote on a particular matter is required to approve Proposals 2 and 4. The affirmative vote of a majority of the outstanding shares is required to approve Proposal 3. Broker non-votes do not count as votes for or against Proposals 2 and 4, but will count as votes against Proposal 3. An abstention counts as a vote against a proposal. Abstentions and broker non-votes have no effect on the outcome of the election of directors.

### **What other matters will be acted upon at the meeting?**

We do not know of any other matters that will be presented at the Annual Meeting, other than those mentioned in this Proxy Statement.

### **Who pays the cost of this proxy solicitation?**

We will pay the cost of solicitation of proxies including preparing, printing and mailing this Proxy Statement. We have retained Morrow & Co. to help us in soliciting proxies for a fee of \$7,500, plus reasonable out-of-pocket costs and expenses. We will also reimburse brokers, banks and other nominees for their costs in sending proxy materials to beneficial owners of our Common Stock. Other proxy solicitation expenses that we will pay include those for preparation, mailing, returning and tabulating the proxies.



**PROPOSAL 1: ELECTION OF DIRECTORS**

At the Annual Meeting, stockholders will elect two persons as Class I directors to hold office until the 2011 Annual Meeting, or until they are succeeded by other qualified directors who have been appointed or elected. The nominees are Loren K. Carroll and Dod A. Fraser.

Directors must be elected by a plurality of the votes cast at the meeting. This means that the two nominees receiving the greatest number of votes will be elected. Votes withheld for any director will not be counted. We will vote your shares as you specify on your proxy card. If you properly execute and return your proxy card (in paper form, electronically via the internet or by telephone), but do not specify how you want your shares voted, we will vote them *for the election of all of the nominees listed below.*

Each of the nominees is a current member of the Board of Directors and has consented to serve if elected. Although management does not contemplate the possibility, in the event any nominee is not a candidate or is unable to serve as a director at the time of the election, the proxies will vote for any nominee who is designated by the present Board of Directors to fill the vacancy.

A brief biography of all directors is presented below:

### NOMINEES

#### *Directors to be elected to Class I for a term expiring in 2011:*

#### **LOREN K. CARROLL**

Age:	64
Director Since:	1987
Recent Business Experience:	Mr. Carroll joined the Company in December 1984 as Vice President and Chief Financial Officer. He is currently an advisor to the Company. From March 1994 until April 2006, Mr. Carroll served as President and Chief Executive Officer of M-I SWACO, a company in which the Company holds a 60% interest. From 1992 until 1994, he served as Executive Vice President and Chief Financial Officer of the Company. In January 1988, he was appointed Executive Vice President and Chief Financial Officer and served in that capacity until March 1989. He rejoined the Company in 1992.
Committee Membership:	None
Other Directorships:	Fleetwood Enterprises, Inc.; CGG-Veritas; Forest Oil Corporation; KBR, Inc.

#### **DOD A. FRASER**

Age:	57
Director Since:	2004
Recent Business Experience:	Mr. Fraser is the President of Sackett Partners Incorporated, a consulting company, and a member of corporate boards. Mr. Fraser established Sackett

Partners in 2000 upon retiring from a 27-year career in investment banking. From 1995 to 2000, Mr. Fraser was with The Chase Manhattan Bank, now JP Morgan Chase, where he was Managing Director, Group Executive of the global oil and gas group. Prior to that, Mr. Fraser was General Partner of Lazard Freres & Co., which he joined in 1978.

Committee Membership:

Chairman, Audit Committee; Compensation and Benefits Committee.

Other Directorships:

Forest Oil Corporation; Terra Industries, Inc.

**WE RECOMMEND A VOTE FOR THE ELECTION OF THE DIRECTOR NOMINEES.**

**DIRECTORS CONTINUING IN OFFICE**

*Class II directors to continue in office until 2009:*

**ROBERT KELLEY**

Age: 62

Director Since: 2005

Recent Business Experience: Since 2001, Mr. Kelley has served as the President of Kellco Investments, a private investment company. From 1986 to 2001, Mr. Kelley served in several senior management roles including Chairman, President and Chief Executive Officer of Noble Affiliates, Inc. Prior to 1986, he was President and Chief Executive Officer of Samedan Oil Corporation, a subsidiary of Noble Energy Inc.

Committee Membership: Audit Committee; Compensation and Benefits Committee.

Other Directorships: Cabot Oil and Gas Corporation; OGE Energy Corp.

**DOUG ROCK**

Age: 61

Director Since: 1987

Recent Business Experience: Mr. Rock was elected Chairman of the Board of Directors on February 26, 1991. Mr. Rock has been with the Company since 1974 and has been Chief Executive Officer, President and Chief Operating Officer since March 31, 1989.

Committee Membership: None

Other Directorships: Moneygram International, Inc.

*Class III directors to continue in office until 2010:*

**JAMES R. GIBBS**

Age: 63

Director Since: 1990

Recent Business Experience: Mr. Gibbs is the Chairman of the Board, President & Chief Executive Officer of Frontier Oil Corporation. He was President and Chief Operating Officer of Frontier from January 1, 1987 to April 1, 1992, at which time he assumed the additional position of Chief Executive Officer. He was elected Chairman of the Board of Frontier in April 1999. He joined Frontier Oil Corporation in February 1982 as Vice President of Finance and Administration, and was appointed Executive Vice President in September 1985.

Committee Membership: Chairman, Nominating and Corporate Governance Committee.

Other Directorships: Frontier Oil Corporation; advisory director of Frost Bank-Houston; member of the Board of Trustees of Southern Methodist University.

**JOHN YEARWOOD**

Age: 48

Director Since: 2006

Recent Business Experience: Mr. Yearwood, a citizen of Trinidad and Tobago, has served as a Senior Advisor to the Chief Executive Officer of Schlumberger since March 2006. From 1980 to March 2006, he served in a variety of positions at Schlumberger Limited much of which included responsibilities for businesses primarily focused outside of the United States, most recently as President North and South America, Oilfield Services.

Committee Membership: Audit Committee; Nominating and Corporate Governance Committee.

Other Directorships: Logan Oil Tools; Sheridan Production Partners; Remora Energy; NFR Energy.

**DIRECTORS NOT CONTINUING IN OFFICE:****G. CLYDE BUCK**

Age: 70

Director Since: 1992

Recent Business Experience: Mr. Buck has extensive experience in energy-related matters. He received a B.A. in economics from Williams College and a M.B.A. from Harvard. He is currently affiliated with Davis/Chambers & Company, Ltd., a position he has held since January 1, 2008. From April 1998 until December 2007, he was a Senior Vice President and Managing Director of Corporate Finance of the investment banking firm of Sanders Morris Harris Inc. From 1983 to 1998, Mr. Buck was a Managing Director in the Houston corporate finance office of Dain Rauscher Incorporated.

Committee Membership: Chairman, Compensation and Benefits Committee; Nominating and Corporate Governance Committee

Other Directorships: Frontier Oil Corporation.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table shows certain information about stock ownership of all persons known to the Company to own of record or beneficially more than 5% of the outstanding Common Stock of the Company. This information is based upon information furnished to the Company by these persons and statements filed with the SEC:

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
T. Rowe Price Associates, Inc. 100 East Pratt Street Baltimore, Maryland 21202	20,173,160(1)	10.05%
FMR LLC 82 Devonshire Street Boston, Massachusetts 02109	18,978,796(2)	9.45%

- (1) Based upon the statement on Schedule 13G filed with the Securities and Exchange Commission on February 13, 2008. These securities are owned by various individual and institutional investors for which T. Rowe Price Associates, Inc. ( Price Associates ) serves as investment adviser with power to direct investments and/or sole

power to vote the securities. For purposes of the reporting requirements of the Securities Exchange Act of 1934, Price Associates is deemed to be a beneficial owner of such securities; however, Price Associates expressly disclaims that it is, in fact, the beneficial owner of such securities.

- (2) Based upon the statement on Schedule 13G filed with the Securities and Exchange Commission on February 14, 2008. Such filing indicates that FMR LLC has sole voting power over 815,374 shares and sole dispositive power over 18,978,796 shares of Common Stock.

The following table shows the number of shares of Common Stock beneficially owned as of March 15, 2008 by each director or nominee for director, the executive officers named in the Summary Compensation Table included later in this Proxy Statement and all directors and executive officers as a group. Except as otherwise indicated, the persons listed below have sole voting power and investment power relating to the shares shown.

Name of Beneficial Owner	Amount and Nature of Beneficial Ownership(1)(2)	Percent of Class
G. Clyde Buck(3)	68,136	*
Loren K. Carroll	183,411	*
Margaret K. Dorman(4)	167,501	*
Bryan L. Dudman(4)	34,246	*
Dod A. Fraser	11,508	*
James R. Gibbs(3)(5)	30,536	*
Robert Kelley	11,994	*
John Kennedy	59,597	*
Donald McKenzie	38,743	*
Doug Rock	724,433	*
John Yearwood	4,785	*
All directors and executive officers as a group (15 persons)(4)	1,379,539	*

\* Less than 1%

- (1) The amounts reported do not include the shares of Common Stock to be issued to each outside director on or about April 25, 2008 under the Smith International, Inc. Second Amended and Restated 1989 Long-Term Incentive Compensation Plan. The shares to be issued will be based on the closing price of the Company's Common Stock on the date of such issuance and will be a number of shares to give each outside director equity compensation of approximately \$200,000.
- (2) The amounts reported include shares of Common Stock that could be acquired within 60 days of March 15, 2008 through the exercise of stock options as follows: Mr. Rock: 169,500 shares; Mr. Carroll: 59,000 shares; Ms. Dorman: 128,000 shares; Mr. Dudman: 2,400 shares; Mr. Kennedy: 26,500 shares; and all directors and executive officers as a group: 386,300 shares.
- (3) The amounts reported do not include 24,000 restricted stock units held by Messrs. Gibbs and Buck. Each such restricted stock unit represents a contingent right to receive one share of Common Stock and were granted to each of Messrs. Buck and Gibbs in 1999 in connection with the termination of the Directors' Retirement Plan, which will not be issued until the restricted stock units vest upon retirement after ten years of service as a director. Messrs. Buck and Gibbs currently have no voting or investment power with respect to the related shares of Common Stock. Although Mr. Buck retires from his service as a director as of the Annual Meeting, he has deferred receipt of his shares for three years.
- (4) The amounts reported include shares of Common Stock allocated to accounts under a 401(k) plan as follows: Ms. Dorman: 5,344 shares; Mr. Dudman: 23,993 shares; and all directors and executive officers as a group:



29,449 shares. This amount does not include 1,100,056 shares beneficially held by Jerry W. Neely who currently serves as an Advisory Director to the Board.

(5) The amounts reported include 2,000 shares held by Mrs. Gibbs.

## CORPORATE GOVERNANCE

### Corporate Governance Guidelines

Our Corporate Governance Guidelines outline the functions of the Board, director qualifications and responsibilities, and various processes and procedures designed to ensure effective and responsive governance. The full text of the guidelines is published on our website at [www.smith.com](http://www.smith.com) under the Investor Relations caption and link to Governance. Stockholders may also obtain a free copy upon request by contacting the Corporate Secretary, Smith International, Inc., 16740 East Hardy Road, Houston, Texas 77032.

### Board Structure

Our Board of Directors currently consists of seven directors. Board agendas include regularly scheduled sessions for the independent directors to meet without management present. The Board has designated Mr. Gibbs as Lead Director to chair executive sessions of the non-management directors.

G. Clyde Buck has reached retirement age pursuant to our Corporate Governance Guidelines and is, therefore, not standing for re-election as a director. Upon completion of Mr. Buck's service as a director on May 13, 2008, the Board will reduce its size to six members. At that time, it is anticipated that Mr. Buck will become an advisory director to the Board. In this capacity, Mr. Buck will be invited to attend meetings of the Board and its committees and will have access to materials distributed to the Board, but will not be entitled to vote at such meetings.

### Board Meetings

The Board and its committees meet throughout the year on a set schedule, and also hold special meetings and act by written consent from time to time as appropriate. The Board of Directors held five meetings during 2007. All directors attended at least 75% of the meetings of the Board of Directors and of all committees on which they served. The Company does not have a policy regarding directors' attendance at the Annual Meeting of Stockholders. No directors attended the 2007 Annual Meeting.

### Director Independence

The Board annually evaluates the independence of the directors and has affirmatively determined that all directors (including Jerry W. Neely who served as a director during the 2007 year until April 25, 2007) are independent except Doug Rock and Loren Carroll, who are employees of the Company. The Board's determination regarding independence and financial expertise of its members is based on applicable laws and regulations, Smith's Corporate Governance Guidelines, the rules of the New York Stock Exchange and a review of any direct or indirect relationship between each director or his immediate family and Smith. To be considered independent, the Board of Directors must affirmatively determine that a director has no material relationship with Smith. In each case, the Board of Directors broadly considers all relevant facts and circumstances, including the director's commercial, industrial, consulting, legal, accounting, charitable and familial relationships and such other criteria as the Board of Directors may determine from time to time. In evaluating the independence of each non-employee director, the Board considered that in the ordinary course of business our subsidiaries buy from or sell to companies with which our directors have relationships as follows:

(1) Mr. Gibbs is Chairman of the Board, President & Chief Executive Officer of, and Mr. Buck is a director of, Frontier Oil Corporation.

(2) Mr. Fraser is a director of Forest Oil Corporation.

(3) Mr. Kelley is a director of Cabot Oil and Gas Corporation and OGE Energy Corp.

(4) Mr. Yearwood is a director of Logan Oil Tools and Sheridan Production Partners and is a senior advisor to Schlumberger. Schlumberger is also the minority partner in our M-I SWACO business unit, a 60 percent-owned joint venture.

With respect to each of the most recent three completed fiscal years, none of the payments to or payments received from any of the companies for which our directors are employees exceeded the greater of \$1.0 million or

2% of such company's consolidated gross revenues. All of these companies expect to continue their business relationship in 2008.

### Communication with the Board

Stockholders and interested parties who wish to communicate with the non-management directors as a group, the Lead Director, or with any individual director, may do so by contacting Smith's Corporate Secretary at 16740 East Hardy Road, Houston, Texas 77032. Smith's Corporate Secretary will then relay all communications to the appropriate director or group of directors.

### Committees of the Board

The Board has delegated various responsibilities and authority to different Board Committees as described in this section of this Proxy Statement. The Board has determined that all committee members are independent and satisfy the relevant additional independence requirements for the members of such committees imposed by the SEC or the Company. Each committee operates under a formal charter adopted by the Board, the full text of which may be found on our website at [www.smith.com](http://www.smith.com) under the Investor Relations caption and link to Governance. Stockholders may also obtain a free copy upon request by contacting the Corporate Secretary, Smith International, Inc., 16740 East Hardy Road, Houston, Texas 77032.

#### *Members of the Committees of the Board.*

	Audit Committee		Compensation and Benefits Committee		Nominating and Corporate Governance Committee	
G. Clyde Buck			X	*	X	
Loren K. Carroll						
Dod A. Fraser	X	*	X			
James R. Gibbs					X	*
Robert Kelley	X		X			
Doug Rock						
John Yearwood	X				X	

\* Committee Chairman

**Audit Committee.** During 2007, the Audit Committee met ten times, including telephone meetings, to discuss relevant accounting, auditing, internal control and disclosure matters. The Audit Committee's responsibilities, discussed in detail in the charter include, among other duties, the responsibility to:

- assist the Board in its general oversight of Smith's auditing, financial reporting and internal control functions;
- appoint, compensate and oversee the work of Smith's independent registered public accounting firm;
- review the Company's compliance with corporate governance standards; and

review the work and performance of the Company's internal audit function.

The Board of Directors has determined that all members are financially literate and that all members qualify as audit committee financial experts.

***Compensation and Benefits Committee.*** During 2007, the Compensation and Benefits Committee met seven times. The Compensation and Benefits Committee charter permits the Compensation and Benefits

Committee to delegate its authority to sub-committees. The Compensation and Benefits Committee's responsibilities, discussed in detail in the charter include, among other duties, the responsibility to:

review the Company's executive compensation program, including approving corporate goals and objectives relating to CEO compensation and evaluating CEO performance in light of such goals and objectives;

review the Company's employee benefits and incentive compensation plans and programs, including their establishment, modification and administration;

review and make recommendations to the Board with respect to director compensation; and

review and discuss the compensation discussion and analysis with management and recommend its inclusion in this Proxy Statement.

***Nominating and Corporate Governance Committee.*** During 2007, the Nominating and Corporate Governance Committee met five times. The Nominating and Corporate Governance Committee's responsibilities, discussed in detail in the charter include, among other duties, the responsibility to:

monitor developments in corporate governance principles and standards and develop and recommend to the Board a set of corporate governance guidelines;

identify and review the qualifications of director candidates and make recommendations for Board membership and structure;

review and evaluate the effectiveness of the Company's management succession plan; and

administer a process to measure the effectiveness of the Board and its committees.

## **Director Qualifications and Nominations**

The Nominating and Corporate Governance Committee will consider nominees proposed by stockholders. To recommend a prospective nominee for the Nominating and Corporate Governance Committee's consideration, you may submit the candidate's name and qualifications to Smith's Corporate Secretary at 16740 East Hardy Road, Houston, Texas 77032. Recommendations from stockholders for nominees must be received by Smith's Corporate Secretary not later than the date set forth under the section "Stockholders' Proposals."

The process for identifying and evaluating director nominees includes the following steps:

(1) the Nominating and Corporate Governance Committee, Chairman of the Board or other Board members identify a need to fill vacancies or add newly created directorships;

(2) the Chairman of the Nominating and Corporate Governance Committee initiates a search and seeks input from Board members and senior management and, if necessary, hires a search firm or obtains advice from legal or other advisors;

(3) director candidates, including any candidates properly proposed by stockholders in accordance with the Company's Bylaws, are identified and presented to the Nominating and Corporate Governance Committee;

(4) initial interviews of candidates are conducted by the Chairman of the Nominating and Corporate Governance Committee;

(5) the Nominating and Corporate Governance Committee meets to consider and approve final candidate(s) and conduct further interviews as necessary; and

(6) the Nominating and Corporate Governance Committee makes recommendations to the full Board for inclusion in the slate of directors at the Annual Meeting.

The evaluation process will be the same whether the nominee is recommended by a stockholder or by a member of the Board of Directors. The Nominating and Corporate Governance Committee is responsible for establishing the selection criteria for candidates from time to time and reviewing with the Board such criteria and the appropriate skills and characteristics required of Board members in the context of the then current make-up of the Board. At a minimum, the Nominating and Corporate Governance Committee must be satisfied that each

nominee for director has the necessary business and/or professional knowledge and experience relevant to the Company, its business and the goals and perspectives of its stockholders; is well regarded in the community, with a long term, good reputation for high ethical standards; has good common sense and judgment; has a positive record of accomplishment in present and prior positions; has an excellent reputation for preparation, attendance, participation, interest and initiative on other boards on which he or she may serve; and has the time, energy, interest and willingness to become involved in the Company and its future.

### **Compensation Committee Interlocks and Insider Participation**

During 2007, Messrs. Gibbs (until April 25, 2007), Buck, Fraser and Kelley served as members of the Company's Compensation and Benefits Committee. None of the Compensation and Benefits Committee members has served as an employee or officer of the Company, and none of the Company's executive officers has served as a director or member of the compensation committee of another entity, which has an executive officer serving as a member of the Company's Board.

### **Code of Business Conduct and Ethics**

All of our officers, employees and directors are required to comply with our Code of Business Conduct and Ethics to help ensure that our business is conducted in accordance with the highest standards of ethical behavior. Our Code of Business Conduct and Ethics covers all areas of professional conduct, including customer relationships, conflicts of interest, insider trading, financial disclosure, intellectual property and confidential information, as well as requiring strict adherence to all laws and regulations applicable to our business. Employees may report any violations or suspected violations of the Code by using Smith's ethics hotline. The Code includes an anti-retaliation statement. The full text of the Code of Business Conduct and Ethics, as well as any waiver of a provision of the Code granted to any senior officer or director or material amendment to the Code, if any, is published on our website at [www.smith.com](http://www.smith.com) under the Investor Relations caption and link to Governance. Stockholders may also obtain a free copy upon request by contacting the Corporate Secretary, Smith International, Inc., 16740 East Hardy Road, Houston, Texas 77032.

## **COMPENSATION DISCUSSION AND ANALYSIS**

### **Overview**

**Compensation Objectives.** We have designed our executive compensation program to reward our executives based on Company, business unit and individual performance. The general objectives of our executive compensation program are to:

attract and retain the best available individuals to serve on our executive team;