SMITH INTERNATIONAL INC
Form DEF 14A
March 22, 2007

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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 (Amendment No.)

Filed by the Registrant þ
Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement
o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
þ Definitive Proxy Statement
o Definitive Additional Materials
o 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):

þ No fee required.
o 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:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

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o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

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NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

April 24, 2007

To Our Stockholders:

The Annual Meeting of Stockholders (the Annual Meeting) of Smith International, Inc. (the Company) will be held on **Tuesday, April 24, 2007**, 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: James R. Gibbs and John Yearwood, each for a term of three years;

2. Approval of the Smith International, Inc. Second Amended and Restated 1989 Long-Term Incentive Compensation Plan; and

3. Ratification of Deloitte & Touche LLP as independent registered public accounting firm for 2007.

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

The Board of Directors has fixed the close of business on February 28, 2007 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
March 22, 2007

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.

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 common stock at the 2007 Annual Meeting. We are distributing this Proxy Statement and the accompanying proxy card beginning on or about March 22, 2007. 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

Who may vote?

You are entitled to vote your shares of our Common Stock if you are a stockholder of record on February 28, 2007. At the close of business on February 28, 2007, a total of 200,025,778 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.

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 and 3.

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 any proposal; however, 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.

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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 in time for him to receive 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 3. Broker non-votes do not count as votes for or against any proposal; however, 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 2007 Annual Meeting, stockholders will elect two persons as Class III directors to hold office until the 2010 Annual Meeting, or until they are succeeded by other qualified directors who have been appointed or elected. The nominees are James R. Gibbs and John Yearwood.

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.*

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Each of the nominees are current members of the Board of Directors and have consented to serve if elected. Mr. Yearwood was recommended as a director to the Nominating and Corporate Governance Committee in 2006 by our Chief Executive Officer and other members of senior management. 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 III for a term expiring in 2010:

JAMES R. GIBBS

Age:	62
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, Compensation and Benefits Committee; 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:	47
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:	None
Other Directorships:	Logan Oil Tools

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

DIRECTORS CONTINUING IN OFFICE

Class I directors to continue in office until 2008:

G. CLYDE BUCK

Age:	69
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 Senior Vice President and Managing Director Corporate Finance of the investment banking firm of Sanders Morris Harris Inc., a position he has held since April 1998. From 1983 to 1998, Mr. Buck was a Managing Director in the Houston corporate finance office of Dain Rauscher Incorporated.
Committee Membership:	Compensation and Benefits Committee; Nominating and Corporate Governance Committee.
Other Directorships:	Frontier Oil Corporation

LOREN K. CARROLL

Age:	63
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

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DOD A. FRASER

Age:	56
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.

Class II directors to continue in office until 2009:

ROBERT KELLEY

Age:	61
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; Lone Star Technologies Inc.; OGE Energy Corp.

DOUG ROCK

Age:	60
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.; CE Franklin Ltd.

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DIRECTORS NOT CONTINUING IN OFFICE:

JERRY W. NEELY

Age:	70
Director Since:	1977
Recent Business Experience:	Mr. Neely held a number of positions with the Company from 1965 to 1987. He was President from February 1976 to December 1977, at which time he assumed the additional positions of Chairman of the Board and Chief Executive Officer and served in those capacities until December 1987. Since that time, Mr. Neely has been a private investor.
Committee Membership:	Audit Committee; Nominating and Corporate Governance Committee.
Other Directorships:	Member of the Board of Trustees of the University of Southern California

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 as of March 5, 2007. 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
FMR Corp. 82 Devonshire Street Boston, Massachusetts 02109	22,051,965(1)	11.0
Capital Research and Management Company 333 South Hope Street Los Angeles, CA 90071	15,549,000(2)	7.8
T. Rowe Price Associates, Inc. 100 East Pratt Street Baltimore, Maryland 21202	18,259,377(3)	9.1

(1) Based upon the statement on Schedule 13G filed with the Securities and Exchange Commission on February 14, 2007, Fidelity Management & Research Company (Fidelity), a wholly owned subsidiary of FMR Corp. (FMR) and an investment adviser, is the beneficial owner of 20,796,154 shares as a result of acting as investment adviser to various investment companies (the Funds).

(2) Based upon the statement on Schedule 13G filed with the Securities and Exchange Commission on February 7, 2007, these securities are owned by various investment companies for which Capital Research and Management Company (Capital Research) serves as an investment advisor. For purposes of the reporting requirements of the Exchange Act, Capital Research is deemed to be a beneficial owner of such securities; however, Capital Research expressly disclaims that it is, in fact, the beneficial owner of such securities.

(3) Based upon the statement on Schedule 13G filed with the Securities and Exchange Commission on February 14, 2007, 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.

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The following table shows the number of shares of Common Stock beneficially owned as of March 5, 2007 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)	65,136	*
Loren K. Carroll	607,427	*
Margaret K. Dorman(4)	263,429	*
Bryan L. Dudman(4)	65,454	*
Dod A. Fraser	8,508	*
James R. Gibbs(3)(5)	29,136	*
Robert Kelley	8,994	*
John Kennedy	153,064	*
Donald McKenzie	43,621	*
Jerry W. Neely(3)(6)	1,096,956	*
Doug Rock	678,311	*
John Yearwood	1,785	*
All directors and executive officers as a group (16 persons)(4)	3,089,302	1.5

* 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, 2007 under the Smith International, Inc. Stock Plan for Outside Directors (the Stock 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 $150,000.

(2) The amounts reported include shares of Common Stock that could be acquired on or before March 5, 2007 through the exercise of stock options as follows: Mr. Rock: 43,000 shares; Mr. Carroll: 498,000 shares; Ms. Dorman: 241,500 shares; Mr. Dudman: 30,800 shares; Mr. Kennedy: 136,000 shares; Mr. McKenzie: 29,200; and all directors and executive officers as a group: 1,010,634 shares.

(3) The amounts reported do not include 24,000 restricted stock units held by each of Messrs. Buck and Gibbs. The amounts include 24,000 restricted stock units held by Mr. Neely. Each such restricted stock unit represents a contingent right to receive one share of Common Stock and were granted to each of Messrs. Buck, Gibbs and Neely in 1999 in connection with the termination of the Directors Retirement Plan. Messrs. Buck, Gibbs and Neely currently have no voting or investment power with respect to the related shares of Common Stock, which will not be issued until the restricted stock units vest upon retirement after ten years of service as a director.

(4) The amounts reported include shares of Common Stock allocated to accounts under a 401(k) plan as follows: Ms. Dorman: 4,855 shares; Mr. Dudman: 23,673 shares; and all directors and executive officers as a group: 33,613 shares.

(5) The amounts reported include 2,000 shares held by Mrs. Gibbs and 1,600 shares held in a trust for the benefit of their child where Mrs. Gibbs is a co-trustee.

(6) The amounts reported include 980,778 shares held by the Neely Family Trust and 50,340 by a Family Trust for the benefit of the Neely children.

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* 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 Hardy Street, Houston, Texas 77032.

Board Structure

Our Board of Directors currently consists of eight 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.

Jerry W. Neely 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. Neely s service as a director on the Board, the Board will reduce its size to seven members. At that time, it is anticipated that Mr. Neely will become an advisory director to the Board. In this capacity, Mr. Neely will attend meetings of 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 six meetings during 2006. 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 2006 Annual Meeting.

Director Independence

The Board annually evaluates the independence of the directors and has affirmatively determined that all directors (including Mr. Bailar who served during the 2006 year) are independent except Doug Rock and Loren Carroll. 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, banking, 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-management director, the Board evaluated the following:

(1) Mr. Gibbs is Chairman of the Board, President & Chief Executive Officer of Frontier Oil Corporation and Mr. Buck is a director of Frontier Oil. Smith s Wilson business unit distributes maintenance, repair and operating supplies and equipment to Frontier Refining and Smith s Services and Technologies business units sell products and services to Frontier Well, both of which are subsidiaries of Frontier Oil.

(2) Mr. Fraser is a director of Forest Oil Corporation to which all of the Company s business units sell equipment, products or services.

(3) Mr. Kelley is a director of Cabot Oil and Gas Corporation and OGE Energy Corp. All of the Company s business units sell equipment, products or services to one or both of these companies. Mr. Kelley is also a director of Lone Star, from which Wilson purchases products.

(4) Mr. Yearwood is a director of Logan Oil Tools, from which Smith Services purchases products, and an employee of Schlumberger, with which all of the Company s business units sell or buy equipment, products

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or services. 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 2007.

Communication with the Board

Stockholders and employees who wish to communicate with the directors, the Lead Director, or with any individual director, may do so by contacting Smith s Corporate Secretary at 16740 Hardy Street, Houston, Texas 77032. Smith s Corporate Secretary will then relay all communications to the appropriate director.

Committees of the Board

The Board has delegated various responsibilities and authority to different Board Committees as described in this section of the 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* under the Investor Relations caption and link to Governance.

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 *	X *
Robert Kelley	X	X	
Jerry W. Neely	X		X
Doug Rock			
John Yearwood			

* Committee Chairman

Audit Committee. During 2006, the Audit Committee met nine 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 all members qualify as audit committee financial experts. In addition, the Board has determined that Mr. Kelley s simultaneous service on three other public company audit committees does not impair his ability to effectively serve on Smith s Audit Committee.

Compensation and Benefits Committee. During 2006, the Compensation and Benefits Committee met five 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; and
- review and make recommendations to the Board with respect to director compensation.

Nominating and Corporate Governance Committee. During 2006, the Nominating and Corporate Governance Committee met four 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 Hardy Street, 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 that follows.

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 2006, Messrs. Bailar (until April 24, 2006), Buck, Fraser, Gibbs and Kelley (since April 24, 2006) 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

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* 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 Hardy Street, Houston, Texas 77032.

COMPENSATION DISCUSSION AND ANALYSIS

Overview

Compensation Objectives. The general objectives of our executive compensation program are to attract and retain the best available individuals to serve on our executive team, to motivate our executives to achieve our short-term and long-term financial and operational goals, and to align our executives interests with those of our other stockholders.

Pay for Performance. Our executive compensation program is designed to reward our executives based on Company, business unit and individual performance. We maintain a pay-for-performance compensation philosophy that provides executives with direct financial incentives in the form of cash awards and long-term equity awards that are earned by achieving financial performance objectives established by the Board of Directors for each fiscal year based upon either consolidated or business unit financial results. In addition, we reward individual performance through adjustments in annual base salary.

Decision Process. Executive compensation decisions are made solely by our Compensation and Benefits Committee (which we refer to in this section as the Compensation Committee). The Compensation Committee has retained Frederic W. Cook & Co., Inc. (which we refer to in this section as Cook), an independent compensation consultant that reports solely to the Compensation Committee, to assist it in making executive compensation decisions. Cook presents current and comparative compensation data, including benchmarking results as discussed below, and preliminary compensation recommendations to the Compensation Committee in October of each year. For all executive officers other than the CEO, the Compensation Committee discusses Cook s recommendations with and receives additional recommendations from our CEO and our Senior Vice President of Human Resources. For CEO compensation, Company management has no input. In December of each year, Cook, with the support of our CEO and Senior VP of Human Resources, presents its final compensation data and recommendations to the Compensation Committee. These final recommendations are timed to correspond to the Board of Directors approval of the upcoming fiscal year s business plan and with the Compensation Committee s evaluation of executive performance for the current year. The Compensation Committee reviews not only the final compensation data and recommendations but also Company performance, individual executive performance, the Company s overall compensation objectives and other relevant matters and the value of equity held by each of the executive officers. The Compensation Committee then makes its final executive compensation decisions to become effective January 1 of the upcoming fiscal year. With the exception of equity incentive awards for new hires or promotions, which are granted at the next regularly scheduled Compensation Committee meeting following the hire or promotion date, equity incentive awards are granted only in December.

Benchmarking Group. The Compensation Committee seeks to design the compensation of the Company s executives to be competitive within the worldwide energy industry in order to maintain a high level of expertise within the Company. In setting the current year s total executive compensation, the Compensation Committee reviewed compensation data from the following companies whose executives have similar duties and responsibilities: Baker Hughes Incorporated, BJ Services Company, Cameron International Corporation, FMC Technologies, Inc., Grant Prideco, Inc., Halliburton Company, Maverick Tube Corporation, McDermott International, Inc., Nabors Industries Ltd., National Oilwell Varco, Inc., Schlumberger Ltd., and Weatherford International Ltd. In addition to public information available for this benchmarking group, Cook reviewed data from the Oilfield and Manufacturing Services survey, a Towers Perrin survey covering oil and gas companies and a Towers Perrin survey covering the Company s general industry.

Fixed v. Variable Pay. Our compensation program is divided into two general categories, fixed and variable pay. The fixed pay component, or base salary, represents only about 20% of each named executive officer s total target compensation, whereas 80% of target compensation is based upon consolidated or business unit financial performance, relative to established annual financial targets approved by the Compensation Committee. Because a substantial portion of total compensation is tied to the Company s financial performance and is not earned unless these goals are met, we view it at-risk to the executive.

The financial performance targets for executive officers are determined at the beginning of each fiscal year based on the financial results and returns established in the Company s annual business plan, as approved by the Board of Directors. On an annual basis and within 90 days after the start of the year, the Compensation Committee approves the consolidated and business unit matrices established for the variable pay component of executive compensation. We expect that each member of our senior management team will produce outstanding results and have established performance targets that are generally achievable under the annual business plan.

Alignment of Interests with Stockholders. Equity-based compensation constitutes approximately 62% of our total target executive officer compensation, with performance measures tied in large part to overall stockholder wealth. Our emphasis on equity- and performance-based compensation provides our executives with incentive to create long-term stockholder value while keeping fixed base salary costs as one of the smallest components of total compensation potential. Further, it is consistent with our compensation philosophy that our executive management should be rewarded when financial targets are met or exceeded, thereby creating value for our stockholders.

Executive Compensation Components

Below is a summary of the various components of executive compensation. Although Mr. Carroll is a named executive officer, he is no longer an executive officer of the Company and, unless otherwise noted, is not included in any executive officer compensation discussion.

Annual Base Salary. The Compensation Committee targets base salaries between the 60th and 75th percentile of the range of executive salary paid by comparable companies or business operations. The Compensation Committee does not use a specific formula for evaluating individual performance. Instead, executives are assessed primarily by the

CEO based upon how they contributed to the Company s business success in their respective areas of responsibility. The criteria used in evaluating individual performance vary depending on the executive s function, but generally include leadership inside and outside the Company; advancing the Company s interests with customers, vendors and in other business relationships; product quality and development; advancement in skills and responsibility; and financial results. The Compensation Committee, therefore, sets each executive s base salary in light of their individual performance and the salary range paid by the benchmarking

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group. Effective January 1, 2007, all named executive officers received merit increases to base salary in a range of 6% to 8%.

Annual Cash Bonus. Our executive officers participate in the Executive Officer Annual Incentive Plan (AIP) which provides for annual cash bonuses. The Compensation Committee ties approximately 18% of each named executive officer s total target compensation to the achievement of financial performance goals under the AIP.

Participants in the AIP can earn a cash bonus based upon the achievement of established financial performance goals for each fiscal year. The target percentages for the named executive officers, which ranged from 60% to 100% of annual base salary for the 2006 performance year and range from 65% to 120% of annual base salary for the 2007 performance year, are determined based upon the grade level of the executive position. The actual payout relative to the target amount for any fiscal year is variable and tied to consolidated or business unit performance. The financial performance goals are measured using two metrics, generally (i) earnings per share and (ii) return on equity; however, for certain business unit management, the metrics are defined as operating earnings for that business unit and return on operating assets of that business unit. When consolidated, the business unit operating income targets and return on operating assets targets equal the consolidated corporate earnings per share and return on equity targets. For the 2006 fiscal year, the corporate earnings per share target was $1.80 and the return on stockholder equity target was 21.3%. Upon the achievement of the target performance goals, participants earn 100% of the target amount. Depending upon performance, the payout can range from zero to 200% of the target amount. Generally, the actual financial performance achieved must be 80% or more of both target metrics in order to earn any payout under the AIP and must be 120% or more of both target metrics in order to earn a payout under the AIP of 200% of the target amount. For the fiscal year ended December 31, 2006, the actual performance levels achieved by the Company and business units were above the target goals, resulting in each named executive officer earning between 175% and 200% of their target percentage.

The Compensation Committee has chosen return on stockholder equity and earnings per share (and the related operating income and return on operating assets for the business units) as the performance measures for the AIP because these metrics are tied to overall stockholder wealth, are readily understood by the executives and provide a balanced incentive to increase income while managing the Company s investment in its net assets.

The payout award, if any, earned by each executive officer is determined by multiplying the actual bonus percentage earned by the executive s base salary in effect as of the beginning of the AIP s fiscal year. The Compensation Committee has no discretion to increase any award once the performance targets have been established, but may decrease or eliminate any annual bonus award due to unacceptable individual performance even if the financial performance targets are met. The AIP is intended to comply with Section 162(m) of the Internal Revenue Code of 1986 and, as such, amounts paid under the AIP are fully deductible by the Company for federal income tax purposes.

Annual Performance-Based Restricted Stock Unit Award. The annual performance-based restricted stock unit (Unit) award is the largest potential component of total annual compensation. The executive officers are awarded Units in December of each year under the Amended and Restated Smith International, Inc., 1989 Long-Term Incentive Compensation Plan (LTICP). Units represent the right to receive shares of common stock in the future subject to the attainment of an established consolidated return on equity performance goal in the coming year. The monetary value of the award is determined by the Compensation Committee utilizing competitive data provided by Cook. The number of target Units granted is determined based on the closing price of the common stock on the date of grant. Shares subject to Unit awards are not owned until the performance goal is obtained and the awards have vested, accordingly participants have no voting rights on the shares and do not receive dividends until the shares are earned and vested. If the Units are earned at year end, they vest in equal installments over a three-year period, based on continued employment requirements.

For the 2006 fiscal year, the return on equity goal was 21.3%. Upon the achievement of the return on equity target goal, participants earn 100% of the Units awarded. Participants can earn up to 115% of the target number of Units awarded to them. In order for the participant to earn any Units, at least 80% of the financial goal must be met and in order for the participant to earn 115% of the target award, 110% of the financial goal must be met. After performance goals have been set, the Compensation Committee does not exercise any discretion in the amount of

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Units awarded. For fiscal year ended December 31, 2006, the actual performance level achieved by the Company was above the maximum target goal, resulting in each individual earning 115% of their target award.

In 2005, the Company made the decision to award Units rather than Non-Qualified Stock Options, which had been issued under the LTICP since 1989. In reaching the decision to award Units, the Compensation Committee evaluated, among other considerations, changes to the required accounting treatment of stock option awards and other tax and accounting implications of various types of equity awards. Awarding Units instead of Non-Qualified Stock Options reduces stockholder dilution because the Company can offer equal long term value while issuing fewer shares. In addition, because Unit awards are only granted when the performance goal is met, contain a retention element and align executive management with stockholder interests, the Compensation Committee has determined that they are the most appropriate long-term equity based incentive for our Company and are the only type of equity incentive that the Company currently awards to its executive officers.

Perquisites. The Company has an interest in ensuring the physical and mental wellness of its employees and, therefore, provides for a reimbursement of up to $3,000 for an annual physical for each executive officer. In addition, in lieu of providing specific perquisites, the Company provides a set cash dollar amount based upon the value of specifically identified perquisites. This dollar amount is paid in 26 equal bi-weekly payments annually, as identified in the footnotes to the Summary Compensation Table. The executive officers do not need to spend their allowance on the specified items, but are free to use the allowance at their discretion. We believe that providing a set dollar amount allows our executive officers more flexibility and is more efficient to administer than reimbursing for each individual expense. The amount provided is reviewed periodically and is consistent with perquisites provided by the benchmarking group. In addition, our executive officers may receive personal administrative assistant services at no incremental cost to the Company. Perquisite amounts are not considered annual salary for bonus purposes or 401(k) contributions.

401(k) Plan. The Company believes that financial security during retirement is an important benefit to provide to our executive management. For this reason, the Company offers a 401(k) plan to its employees, including its executive officers. Participants may contribute up to 12% of eligible compensation to the 401(k) plan, subject to federal limits. The Company makes various contributions to the plan, including age-weighted contributions ranging from 0.5% to 4% and performance-based matching contributions ranging from zero to 100% of employee salary deferrals, up to 12%. Although the majority of the Company s peers have both defined benefit and defined contribution plans, the Compensation Committee elected to implement a defined contribution plan to control Company costs. The Company s defined contribution plan is consistent with similar plans available generally in the energy industry. Executive officers participate in the 401(k) plan on the same basis as other employees.

Supplemental Executive Retirement Plan. In addition to the 401(k) plan described above, Company officers, including all of the executive officers, are eligible to participate in the Company s Post-2004 Supplemental Executive Retirement Plan (Post-2004 SERP). In connection with the adoption of the Post-2004 SERP, the Company suspended contributions to its previous SERP (SERP), except for guaranteed interest contributions discussed below. The SERP and Post-2004 SERP were implemented to allow Company officers to defer additional pre-tax compensation for retirement without regard to the limits placed on 401(k) plans under the Internal Revenue Code. We believe that the Post-2004 SERP is an important tool for the retirement planning efforts of our officers. Moreover, after reviewing data from the benchmarking group, our Compensation Committee determined that the Post-2004 SERP is important to remain competitive in the compensation arena.

The Company provides an age-based contribution to the Post-2004 SERP for all executive officers in the amount of 6% of each executive s cash compensation (as defined in the Post-2004 SERP), regardless of the individual s age and less any age-based contributions made in the individual s 401(k) account. The Company will also match deferrals up to 6% of each executive s cash compensation (as defined in the Post-2004 SERP), less any matching contributions made in the individual s 401(k) account. Deferred funds are placed with the fund trustee and are invested at the direction of the participant in a variety of funds managed by the trustee, which includes a money market fund. To the extent deferrals remain in the money market fund of the SERP or Post-2004 SERP, the Company guarantees that the funds will yield interest at 120% of the Applicable Federal Long Term Rate as published by the U.S. Treasury. This percentage was selected as a reasonable rate of return when the original SERP was implemented. The Company does not guarantee return for any other SERP or Post-2004 SERP investment

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option. Additional information regarding the SERP and Post-2004 SERP may be found in the footnotes and narrative disclosure following the Nonqualified Deferred Compensation Table.

Change of Control and Employment Agreements

Change of Control Employment Agreements. The Company has entered into Change of Control Employment Agreements with nine executive officers, including all of the named executive officers. After benchmarking studies performed by outside legal counsel at the request of the Compensation Committee in 1999, the Compensation Committee adopted a form of Change of Control Agreement. In 2005, the Compensation Committee again retained outside legal counsel to perform an update of the benchmarking study to determine whether the Change of Control Agreements remained competitive in the Company s industry. As a result of this analysis, the Compensation Committee revised the form of Change of Control Agreement to reduce the termination multiple for future agreements, as discussed in the section titled Executive Compensation Change of Control and Employment Agreements. Benchmarking in 2006 shows that the Change of Control Agreements remain generally consistent with those of the benchmarking group.

The Compensation Committee has determined that the Change of Control Agreements are a necessary component of our compensation package in order for us to provide competitive compensation arrangements, particularly as such agreements are standard in our industry. Moreover, we believe that the Change of Control Agreements help us to attract and retain our named executive officers by reducing the personal uncertainty and anxiety that arises from the possibility of a future business combination. We selected objective criteria to determine whether a change of control has occurred for purposes of the Change of Control Agreements in order to reduce the likelihood of a dispute in the event of a change of control and to help ensure that the agreements are triggered only under circumstances when a true transfer of control or ownership has occurred. Additional information regarding the Change of Control Agreements may be found in the section titled Executive Compensation Change of Control and Employment Agreements.

Employment Agreements. When the Company emerged from bankruptcy in 1987, it offered employment agreements to certain key officers. The only remaining executive officers with the 1987 employment agreements are Messrs. Rock and Dudman. These agreements were entered into primarily as a retention tool but also because the Board of Directors felt that Messrs. Rock and Dudman could provide extraordinary and unique management and strategy skills to maintain and grow the Company. The Compensation Committee has reviewed these contracts and has concluded that they should remain in place but no longer offers new employment agreements to executive officers. Both agreements contain severance provisions that would entitle each individual to receive a lump sum payment in cash equal to his current annual base salary and bonus through the end of the employment period in the event that such individual were to be terminated by the Company (other than for cause, death or disability) or if for any reason his position is eliminated or otherwise becomes redundant. The Company also has an employment agreement with Mr. Carroll. Additional information regarding these agreements may be found in the section titled Executive Compensation Change of Control and Employment Agreements.

Pension Plan. The Company has a defined benefit pension plan, which is currently frozen. The benefit accruals were frozen effective March 1, 1987, and the amount of the pension benefit was fixed for all eligible employees based only upon benefit accruals from September 1, 1985 to March 1, 1987. Any benefits under the pension plan are offset by benefits paid under a previous pension plan of the Company. The only named executive officers who have any benefit accruals under the plan are Messrs. Rock and Carroll. Additional information regarding the plan may be found in the narrative discussion following the Pension Benefits Table.

Stock Ownership Guidelines. Our Compensation Committee encourages stock ownership by executive management and periodically reviews the ownership levels and considers the appropriateness of implementing stock ownership guidelines. Our Compensation Committee has chosen not to require stock ownership guidelines for the executive management. However, the value of common stock owned by our CEO and CFO are approximately 25 times and 16 times their current individual annual salaries. This level of stock ownership evidences the alignment of the interests of our CEO and CFO with our investor s interests. Our Insider Trading Policy prohibits our executive officers from engaging in any hedging or monetization transactions involving Company securities.

COMPENSATION AND BENEFITS COMMITTEE REPORT ON EXECUTIVE COMPENSATION

The Compensation and Benefits Committee has reviewed and discussed the Compensation Discussion and Analysis with management. Based on such review and discussion, the Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement.

Compensation and Benefits Committee:

James R. Gibbs, *Chairman*
G. Clyde Buck
Dod A. Fraser
Robert Kelley

EXECUTIVE COMPENSATION

The following tables show compensation for services to the Company of the persons who during 2006 were the Principal Executive Officer, Principal Financial Officer, the next three most highly compensated executive officers and one other person who was an executive officer during 2006 but who was not serving as an executive officer as of December 31, 2006 (the Named Executive Officers).

Summary Compensation Table

ame and Principal osition)	Year (b)	Salary ($) (c)	Bonus ($)(2) (d)	Stock Awards ($)(3) (e)	Option Awards ($) (f)	Non-Equity Incentive Plan Compensation ($)(4) (g)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($) (h)	All Other Compensation ($)(5) (i)	Total ($) (j)
oug Rock hairman of the oard, Chief xecutive Officer, resident and Chief perating Officer	2006	$ 1,100,000	$ 0	$ 4,810,583	$ 0	$ 2,200,000	$ 1,446	$ 580,903	$ 8,692,932
largaret K. Dorman enior Vice President, hief Financial fficer and Treasurer	2006	$ 430,000	$ 0	$ 874,315	$ 0	$ 516,000	$ 0	$ 150,110	$ 1,970,425

onald McKenzie resident and Chief xecutive Officer, I-I SWACO	2006	$ 525,000	$ 0	$ 997,476	$ 0	$ 840,000	$ 0	$ 117,168	$ 2,479,644
ryan L. Dudman resident, Smith ervices	2006	$ 450,000	$ 0	$ 659,447	$ 0	$ 540,000	$ 0	$ 127,576	$ 1,777,023
ohn J. Kennedy resident and Chief xecutive Officer, Vilson	2006	$ 375,000	$ 0	$ 874,315	$ 0	$ 396,450	$ 0	$ 113,960	$ 1,759,725
oren K. Carroll(1) ormer President and hief Executive fficer, M-I SWACO	2006	$ 379,310	$ 0	$ 1,919,686	$ 0	$ 383,962(6)	$ 1,257	$ 403,738	$ 3,087,953

(1) Mr. Carroll was an executive officer through April 2006.

(2) Performance-based cash bonuses paid pursuant to the AIP are included in column (g).

(3) The amounts in column (e) reflect the dollar value recognized in the Company s financial statements for the fiscal year ended December 31, 2006 per FAS 123R for equity awards made pursuant to the Company s 1989 Long-Term Incentive Compensation Plan, ignoring the FAS 123R assumption for non-vested forfeitures. See note 15 to the consolidated financial statements included in the Company s Annual Report for the year ended

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December 31, 2006 for a complete description of the FAS 123R valuation. The target, threshold and maximum value of equity awards granted during 2006 are shown below in the Grants of Plan-Based Awards table.

(4) The amounts in column (g) reflect the cash awards paid to the named individuals in 2007 for the 2006 performance year under the AIP, which is discussed in more detail under the heading Compensation Discussion and Analysis Annual Cash Bonus.

(5) The amounts in column (i), which include Company contributions to the SERP and the 401(k) Plan and perquisites, are itemized below.

	SERP	401(k)	Perquisite Allowance(a)	Spouse Airfare(b)	M-I SWACO Profit Sharing Contributions	Life Insurance Premiums
D. Rock	$ 497,034	$ 26,000	$ 32,800	$ 10,873	$ 0	$ 14,196
M. Dorman	$ 107,612	$ 20,500	$ 21,700	$ 0	$ 0	$ 298
D. McKenzie	$ 54,845	$ 29,155	$ 26,500	$ 5,653	$ 3,155	$ 1,014
B. Dudman	$ 66,453	$ 21,600	$ 21,700	$ 16,496	$ 0	$ 1,328
J. Kennedy	$ 66,887	$ 23,800	$ 21,700	$ 0	$ 0	$ 1,573
L. Carroll	$ 302,838	$ 28,200	$ 59,192(c)	$ 11,387	$ 0	$ 2,120

(a) These amounts include a specified dollar amount for an annual physical, automobile allowance, financial planning and tax preparation, mobile phone, medical reimbursement, club memberships and legal counseling that may be used at the discretion of each individual. Perquisites are described in more detail under the heading Compensation Discussion and Analysis Perquisites.

(b) These amounts were for spousal travel to accompany the executive on company business.

(c) This amount includes an annual perquisite allowance of $8,135 for the portion of the year that Mr. Carroll was an executive officer, $3,000 for a company-paid annual physical and a perquisite allowance of $48,057 to be spent at Mr. Carroll s discretion pursuant to his current employment agreement.

(6) This amount reflects the pro-rata portion of the AIP bonus attributed to the portion of the year during which Mr. Carroll served as an executive officer of the Company.

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GRANTS OF PLAN-BASED AWARDS FOR FISCAL 2006

The following table provides information regarding incentive awards made to the Named Executive Officers during the 2006 fiscal year.

me)	Grant Date (b)	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards(1) Threshold ($) (c)	Target ($) (d)	Maximum ($) (e)	Estimated Future Payouts Under Equity Incentive Plan Awards(2) Threshold (#) (f)	Target (#) (g)	Maximum (#) (h)	All Other Stock Awards: Number of Shares of Stock or Units (#) (i)	All Other Option Awards: Number of Securities Underlying Options (#) (j)	Exercise or Base Price of Option Awards ($/Sh) (k)	Grant Date Fair Value o Stock ar Option Award (l)
Rock	12/5/2006				58,103	116,206	133,637				$5,002,6
	N/A	$ 550,000	$ 1,100,000	$ 2,200,000							N/A
Dorman	12/5/2006				10,156	20,312	23,359				$874,43
	N/A	$ 129,000	$ 258,000	$ 516,000							N/A
McKenzie	12/5/2006				23,144	46,287	53,230				$1,992,6
	N/A	$ 210,000	$ 420,000	$ 840,000							N/A
Dudman	12/5/2006				10,156	20,312	23,359				$874,43
	N/A	$ 135,000	$ 270,000	$ 540,000							N/A
Kennedy	12/5/2006				10,156	20,312	23,359				$874,43
	N/A	$ 112,500	$ 225,000	$ 450,000							N/A
Carroll(3)	N/A	$ 288,000	$ 576,000	$ 1,152,000							N/A

(1) Amounts represent possible payouts for the 2006 performance year under the AIP, which is discussed in more detail under the heading Compensation Discussion and Analysis Annual Cash Bonus. The actual payout amount is included in column (g) of the Summary Compensation Table.

(2) Amounts represent performance-based restricted stock unit awards made in December 2006 for the 2007 performance year under the LTICP, which is discussed in more detail under the heading Compensation Discussion and Analysis Annual Performance-Based Restricted Stock Unit Award. If threshold levels of performance are not met, then no shares would be issued.

(3) Amounts represent the approved target, threshold and maximum levels at the time that Mr. Carroll was an executive officer. The actual award to Mr. Carroll was pro-rated for the portion of the year during which he so

served.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR END FOR FISCAL 2006

The following table shows the number of shares covered by exercisable and unexercisable options and unvested restricted stock units held by the Company s Named Executive Officers on December 31, 2006.

		Option Awards					Stock Awards			
	Grant Date (b)	Number of Securities Underlying Unexercised Options (#) Exercisable (c)	Number of Securities Underlying Unexercised Options (#) Unexercisable (d)	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Unearned Options (#) (e)	Option Exercise Price ($) (f)	Option Expiration Date(1) (g)	Number of Shares or Units of Stock That Have Not Vested (#) (h)	Market Value of Shares or Units of Stock That Have Not Vested ($) (i)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That have Not Vested (#) (j)	E In A Ma P V Un S U C F Th No
	12/5/2006								116,206	$ 4
	12/6/2005						105,416	$ 4,329,435(3)		
	4/26/2005						29,801	$ 1,194,126(4)		
	12/7/2004	43,000	43,000		$ 28.13	12/7/2014				
	12/2/2003		105,000		$ 19.41	12/2/2013				
	12/5/2006								20,312	$
	12/6/2005						16,560	$ 680,119(3)		
	4/26/2005						5,524	$ 221,347(4)		
	12/7/2004	8,000	8,000		$ 28.13	12/7/2014				
	12/2/2003	67,500	22,500		$ 19.41	12/2/2013				
	12/3/2002	104,000			$ 17.36	12/3/2012				
	12/4/2001	62,000			$ 11.75	12/4/2011				
e	12/5/2006								46,287	$ 1
	12/6/2005						37,950	$ 1,558,607(3)		
	4/26/2005						217	$ 8,695(4)		
	12/7/2004						300	$ 12,021(5)		
	12/7/2004	700	700		$ 28.13	12/7/2014				
	12/2/2003	13,000	13,000		$ 19.41	12/2/2013				

12/3/2002	15,500		$ 17.36	12/3/2012				
12/14/2001	4,252(6)		$ 26.00	12/14/2011				
12/12/2002	2,800(7)	2,800	$ 22.565	12/12/2012				
12/3/2003	3,500(8)	3,500	$ 23.62	12/3/2013				
12/9/2004	850(9)	1,700	$ 31.65	12/9/2014				
12/5/2006							20,312	$
12/6/2005					16,560	$ 680,119(3)		
4/26/2005					3,343	$ 133,954(4)		
12/7/2004	4,800	4,800	$ 28.13	12/7/2014				
12/2/2003	26,000	13,000	$ 19.41	12/2/2013				
12/3/2002	31,000		$ 17.36	12/3/2012				
12/12/2002		2,800(7)	$ 22.565	12/12/2012				
12/3/2003		3,500(8)	$ 23.62	12/3/2013				
12/9/2004		11,100(9)	$ 31.65	12/9/2014				
12/5/2006							20,312	$
12/6/2005					16,560	$ 680,119(3)		
4/26/2005					5,524	$ 221,347(4)		
12/7/2004	8,000	8,000	$ 28.13	12/7/2014				
12/2/2003	45,000	22,500	$ 19.41	12/2/2013				
12/3/2002	52,000		$ 17.36	12/3/2012				
12/4/2001	31,000		$ 11.75	12/4/2011				
12/6/2005					37,950	$ 1,558,607(3)		
4/26/2005					12,356	$ 495,105(4)		
12/7/2004	18,000	18,000	$ 28.13	12/7/2014				
12/2/2003	150,000	50,000	$ 19.41	12/2/2013				
12/3/2002	234,000		$ 17.36	12/3/2012				
12/4/2001	69,000		$ 11.75	12/4/2011				
12/3/1997	27,000		$ 17.26	12/3/2007				

(1) Unless otherwise noted, all options listed above vest at the rate of 25% a year, over the first four years of the ten-year option term.

(2) Performance-based restricted stock units vest at the rate of 331/3% a year, subject to satisfaction of performance criteria for the applicable year, with vesting dates of 12/31/2007, 12/6/2008 and 12/6/2009.

(3) Performance-based restricted stock units vest at the rate of 331/3% a year, subject to satisfaction of performance criteria for the applicable year, with vesting dates of 12/31/2006, 12/6/2007 and 12/6/2008.

(4) Performance-based restricted stock units vest at the rate of 331/3% a year, subject to satisfaction of performance criteria for the applicable year, with vesting dates of 12/31/2005, 12/1/2006 and 12/1/2007.

(5) Time-based restricted stock units vest at the rate of 25% a year with vesting dates of 12/7/05, 12/7/06, 12/7/07 and 12/7/08.

(6) These awards are Schlumberger Stock Appreciation Rights based on Schlumberger stock price appreciation. They are awarded as part of the compensation structure at M-I SWACO prior to the time the individuals became executive officers of the Company and vest at a rate of 20% per year, conditioned on continuous employment through the vest date, with vesting dates of 12/14/2002, 12/14/2003, 12/14/2004, 12/14/2005 and 12/14/2006.

(7) These awards are Schlumberger Stock Appreciation Rights based on Schlumberger stock price appreciation. They are awarded as part of the compensation structure at M-I SWACO prior to the time the individuals became executive officers of the Company and vest at a rate of 20% per year, conditioned on continuous employment through the vest date, with vesting dates of 12/12/2003, 12/12/2004, 12/12/2005, 12/12/2006 and 12/12/2007.

(8) These awards are Schlumberger Stock Appreciation Rights based on Schlumberger stock price appreciation. They are awarded as part of the compensation structure at M-I SWACO prior to the time the individuals became executive officers of the Company and vest at a rate of 20% per year, conditioned on continuous employment through the vest date, with vesting dates of 12/3/2004, 12/3/2005, 12/3/2006 and 12/3/2007. Maximum payout is limited to 125% of the initial value of the units subject to the award.

(9) These awards are Schlumberger Stock Appreciation Rights based on Schlumberger stock price appreciation. They are awarded as part of the compensation structure at M-I SWACO prior to the time the individuals became executive officers of the Company and vest at a rate of 20% per year, conditioned on continuous employment through the vest date, with vesting dates of 12/9/2005, 12/9/2006, 12/9/2007 and 12/9/2008. Maximum payout is limited to 125% of the initial value of the units subject to the award.

**OPTION EXERCISES AND STOCK VESTED
FOR FISCAL 2006**

The following table shows all stock options exercised and value received upon exercise, and all stock awards vested and value received upon vesting by the Named Executive Officers during the fiscal year ended December 31, 2006.

	Option Awards		Stock Awards	
Name (a)	**Number of Shares Acquired on Exercise (#) (b)**	**Value Realized on Exercise ($) (c)**	**Number of Shares Acquired on Vesting (#) (d)**	**Value Realized on Vesting ($) (e)**

D. Rock	560,400	$	14,305,889	82,510	$	3,413,421
M. Dorman				13,804	$	571,515
D. McKenzie		$	389,314(1)	19,343	$	794,704
B. Dudman		$	829,787(1)	11,623	$	480,131
J. Kennedy				13,804	$	571,515
L. Carroll				31,331	$	1,297,020

(1) This amount reflects the exercise of Schlumberger Stock Appreciation Rights described in more detail in the footnotes to the Outstanding Equity Awards at Fiscal Year End table.

PENSION BENEFITS FOR FISCAL 2006

The following table shows the number of years of credited service of and present value of accumulated benefits payable to each of the named Executive Officers under the Company s Restated Pension Plan.

Name (a)	Plan Name (b)	Number of Years Credited Service (#) (c)	Present Value of Accumulated Benefit ($) (d)	Payments During Last Fiscal Year ($) (e)
D. Rock	Smith International, Inc. Restated Pension Plan	1.5	$67,303	0
M. Dorman	N/A	N/A	N/A	N/A
D. McKenzie	N/A	N/A	N/A	N/A
B. Dudman	N/A	N/A	N/A	N/A
J. Kennedy	N/A	N/A	N/A	N/A
L. Carroll	Smith International, Inc. Restated Pension Plan	1.5	$42,804	0

The Company has a defined benefit pension plan (the Restated Pension Plan), which is currently frozen. The benefit accruals were frozen effective March 1, 1987, and the amount of the pension benefit was fixed for all eligible employees based only upon benefit accruals from September 1, 1985 to March 1, 1987. Since benefit accruals under the Restated Pension Plan have been frozen since March 1, 1987, the years of service for the Named Executive Officers include only the period from September 1, 1985 to March 1, 1987. The accumulated benefit presented above assumes a retirement age of 65, no pre-retirement decrements, a post-retirement mortality assumption based on the RP2000 Combined Healthy Mortality Table Projected by Scale AA to 2015, and payment in the form of a single life annuity.

NONQUALIFIED DEFERRED COMPENSATION FOR FISCAL 2006

The following table and narrative disclosure provides information regarding nonqualified deferred compensation with respect to each Named Executive Officer.

Name (a)	Executive Contributions in Last FY ($) (b)	Registrant Contributions in Last FY ($)(1) (c)	Aggregate Earnings in Last FY ($) (d)	Aggregate Withdrawals/ Distributions ($) (e)	Aggregate Balance at Last FYE ($) (f)
D. Rock	$ 546,000	$ 497,034	$ 579,747	$ 0	$ 13,360,488

M. Dorman	$ 77,750	$ 107,612	$ 54,504	$ 0	$ 1,338,559
D. McKenzie	$ 0	$ 54,845	$ 142,415	$ 0	$ 3,110,299
B. Dudman	$ 145,856	$ 66,453	$ 366,763	$ 0	$ 2,475,322
J. Kennedy	$ 0	$ 66,887	$ 114,677	$ 0	$ 2,514,356
L. Carroll	$ 1,194,018	$ 302,838	$ 523,687	$ 0	$ 12,118,654

(1) Includes age-weighted and matching contributions made by the Company and additional Company contributions, if any, as explained below. These amounts are reported as All Other Compensation for each named executive officer in the Summary Compensation Table.

Smith International, Inc. Post-2004 Supplemental Executive Retirement Plan. The Smith International, Inc. Post-2004 Supplemental Executive Retirement Plan (the Post-2004 SERP) is a non-qualified, deferred compensation plan, for the benefit of officers and certain other eligible employees of the Company as selected by the Compensation Committee. Participants may contribute, on a pre-tax basis, up to 100% of their cash compensation, as defined in the Post-2004 SERP. Distributions may generally be made either as a lump sum or installment payments following the participant s termination of employment due to death, disability, retirement or other separation from service. Distributions may also be made on a limited basis and to the extent necessary as a lump sum upon the occurrence of the participant s unforeseeable financial emergency as approved by the Compensation Committee. The Post-2004 SERP also provides for Company contributions, as follows:

Age-Weighted Contributions. The Company provides an age-weighted contribution percentage (AWCP) ranging from 2% to 6% of qualified compensation, less any age-weighted contributions made to the participant s 401(k) account. The Post-2004 SERP provides that the AWCP for executive officers is 6% of qualified compensation regardless of age. The difference between a participant s (i) Total 401(k) Compensation and (ii) Net 401(k) Compensation is multiplied by the AWCP to compute the age-weighted contribution. Total 401(k) Compensation generally means the total of all cash amounts paid by the Company to a participant, including deferred amounts. Net 401(k) Compensation generally means Total 401(k) Compensation less participant contributions to the Post-2004 SERP, but not to exceed the limit set under the Internal Revenue Code.

Matching Contributions. The Company provides a performance-based matching contribution ranging from zero to 100% of salary deferrals that mirrors the matching formulas in effect for the Company s 401(k) Plan, but without regard to certain Code limits applicable to the 401(k) Plan. Matching contributions for all plan participants are limited to 6% of Total 401(k) Compensation, less any performance-based matching contributions made in their individual 401(k) account. Executive officers receive 100% matching contributions subject to the same limitation.

Additional Company Contributions. Deferred funds are placed with the fund trustee and invested a the discretion of the participant in a variety of funds, including a money market fund. The Company guarantees that the deferrals invested in the money market fund will yield interest at 120% of the long-term applicable federal rate (AFR). Therefore, in addition to the contributions described above, for the portion of each participant s account invested in the money market fund that is earning less than 120% of AFR, the Company makes a contribution equal to the difference in interest between the money market fund rate actually earned by the money market fund and 120% of the AFR, which contribution is credited to the participant s account.

Discretionary Profit Sharing Contributions. The Compensation and Benefits Committee may, in its discretion, determine the amount of any profit sharing contribution for a plan year and how that amount is to be allocated among the accounts of the Post-2004 SERP participants.

In the event of insolvency or bankruptcy, all assets allocable to the Post-2004 SERP are available to satisfy the claims of all general unsecured creditors of the Company. The Company will establish a trust to serve as a source of funds from which it can satisfy its obligations under the Post-2004 SERP. Participants in the Post-2004 SERP will have no rights to any assets held in the trust, except as general creditors of the Company. A participant s rights to any amounts credited to an account under the Post-2004 SERP cannot be anticipated, alienated, sold, assigned, pledged, encumbered or charged by the participant and may only pass upon the participant s death pursuant to a beneficiary designation made by the participant under the Post-2004 SERP. The Company may, by action of the Compensation and Benefits Committee, terminate the Post-2004 SERP with respect to future contributions; provided, however, such termination shall not affect any participant s right to receive any distribution due under the Post-2004 SERP.

The Post-2004 SERP will be interpreted by the Compensation and Benefits Committee in such manner as necessary to comply with the requirements of Code Section 409A and the authority issued thereunder.

Smith International, Inc. Supplemental Executive Retirement Plan. In connection with the adoption of the Post-2004 SERP and Code Section 409A, the Company suspended contributions to the SERP effective December 31, 2004, other than such contributions that were earned and vested as of December 31, 2004. However, the Company may be required to make contributions to participants accounts to guarantee an investment return equal to 120% of the AFR on deferrals invested in the money market fund, in the same manner as explained above.

With respect to Company insolvency or bankruptcy, participant s rights, beneficiary designations and plan termination, the SERP is in all material respects the same as the Post-2004 SERP.

Change of Control and Employment Agreements

Employment Agreements. As discussed in Compensation Discussion and Analysis above, the Company has employment agreements from 1987 with Messrs. Rock and Dudman. These agreements have an initial term of three years and are automatically extended for an additional year at each anniversary date. Automatic renewals may not be suspended by the Company without triggering severance. The agreements automatically terminate when the respective executive reaches age 65. Each employment agreement contains salary and other conditions of employment and entitles the employee to participate in the Company s bonus program and other benefit programs. If the employment of Mr. Rock or Mr. Dudman is terminated by the Company (other than for cause, death or disability) or if for any reason his position is eliminated or otherwise becomes redundant, Mr. Rock or Mr. Dudman, as applicable, would be entitled to receive a lump sum payment in cash equal to his current annual base salary and bonus through the end of the employment period; provided, however, that in the event of a change of control, the Change of Control agreements discussed elsewhere in this proxy statement would control, except with respect to any accrued obligations under the employment agreements that were not fully accrued under the applicable Change of Control Agreement.

In addition, the Company has an employment agreement with Mr. Carroll. This agreement has a term of two years and contains salary and other conditions of employment and entitles Mr. Carroll to participate in the Company s benefit programs. It may be terminated by either party with 30 days written notice.

Change of Control Employment Agreements. The Company has entered into Change of Control Employment Agreements (Agreements) with nine executive officers, including all of the Named Executive Officers. In the event of a change of control of the Company (as defined in the Agreements), the Agreements provide for the continued employment of the executive officers for a period of three years and provide for the continuation of salary and benefits.

If, after a change of control event, the executive is terminated by the Company (other than for cause, death or disability), or if the executive elects to terminate his or her employment for Good Reason (as defined in the Agreements), the executive, except Mr. Carroll (as explained below), is entitled to receive the following:

A lump sum cash payment equal to:

The current annual base salary through the date of termination to the extent not paid and highest annual bonus (as explained below) prorated for the number of days worked in the year (referred to as Accrued Obligations).

Any compensation previously deferred by the executive and any accrued vacation pay to the extent not paid.

The sum of the executive s annual base salary and highest annual bonus (as explained below) multiplied by the termination multiple applicable to the executive (as explained below), with annual base salary to be calculated as 12 times the highest monthly base salary paid or payable to the executive during the preceding 12 months.

Any actuarial difference in the SERP benefit the executive would have received had the executive s employment continued for the number of years after the date of the executive s termination multiplied by the termination multiples applicable to the executive.

For these calculations, the annual bonus is calculated as the highest annual bonus paid or payable to the executive for the last three full fiscal years prior to the effective date of the change of control event.

Continued coverage under applicable welfare and benefit plans for a number of years equal to the termination multiple applicable to the executive.

Outplacement services for the executive.

Any other amounts or benefits required to be paid or provided under any other Company plan (referred to as Other Benefits).

A tax gross-up of any excise tax due under the Internal Revenue Code.

If the executive s employment is terminated by reason of the executive s death or disability, the executive or the estate of the executive shall be entitled to payment of Accrued Obligations and Other Benefits as explained above.

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Pursuant to Mr. Carroll s current employment agreement (referred to in this paragraph as his employment agreement), in the event of a change of control, Mr. Carroll is entitled to receive all benefits under his Change of Control Employment Agreement as stated above except that (i) the length of Mr. Carroll s employment shall not be extended beyond the term of employment set forth in his employment agreement, (ii) the amount payable by the Company to Mr. Carroll shall not exceed the total amount that he would have received under his employment agreement had he remained an employee during the term of his employment agreement, and (iii) the period for the continuation of benefits shall not exceed the term of employment under his employment agreement.

Termination Multiple. The agreements for Messrs. Rock, Carroll and Kennedy and Ms. Dorman include a termination multiple of three times for termination at any time within three years after the change of control event occurs. The agreements for Messrs. McKenzie and Dudman include a termination multiple of three times for termination of employment in year one after the change of control event; two times in year two and one time in year three.

Stock Incentive Plan. The Company s 1989 Long-Term Incentive Compensation Plan provides for the vesting of all outstanding stock options and the satisfaction of all restrictions and conditions on restricted stock and other stock-based awards and the full vesting at 100% target levels of all performance-based awards, as of the day immediately preceding the change of control date.

Potential Payments upon a Change of Control. The table below shows potential payments if an executive is terminated other than for cause or voluntary termination after a change of control event. The amounts assume that the change of control event and termination of employment were both effective on December 31, 2006, and are estimates that reflect the amounts that would be paid and the incremental value of benefits that would be enhanced through accelerated vesting of options and stock awards. The value of equity awards is based on Smith s closing market price of $41.07 on December 29, 2006, the last trading day before year end. As discussed above, the accelerated vesting of outstanding equity awards occurs on the day immediately preceding the change of control date, regardless of whether the executive is terminated or terminates his or her employment following the change of control event. The table also assumes that the executive has been paid in full for salary due for the fiscal year and has no deferred compensation, pro-rated perquisites payments or accrued vacation due for the year. Because the termination is assumed to be on the same day as the change of control, amounts shown in this column use a 3x termination multiple for all executives, except Mr. Carroll. For Messrs. McKenzie and Dudman, if the termination of employment occurred in year two after the change of control event, the termination multiple would be 2x and if the termination of employment occurred in year three after the change of control event, the termination multiple would be 1x.

ame (a)	Pro Rata Bonus for Current Fiscal Year(1) (b)	Salary and Bonus Severance(2) (c)	Option Awards(3) (d)	Stock Awards(4) (e)	SERP Benefits(5) (f)	Welfare and Benefit Plan Coverage and Outplacement Services(6) (g)	Tax Gross-Up (h)	Total (i)
. Rock	$ 2,200,000	$ 9,900,000	$ 2,830,720	$ 10,296,142	$ 594,000	$ 88,988	$ 0	$ 25,909,850
. Dorman	$ 516,000	$ 2,838,000	$ 590,870	$ 1,735,680	$ 170,280	$ 88,988	$ 0	$ 5,939,818
. McKenzie	$ 840,000	$ 4,095,000	$ 290,638	$ 3,480,330	$ 245,700	$ 88,988	$ 1,849,388	$ 10,890,044

Kennedy	$ 396,450	$ 2,410,200	$ 590,870	$ 1,735,680	$ 144,612	$ 88,988	$ 0	$ 5,366,80
Dudman	$ 540,000	$ 2,970,000	$ 343,692	$ 1,648,287	$ 178,200	$ 88,988	$ 0	$ 5,769,16
Carroll(7)	$ 383,962	$ 266,667	$ 1,315,920	$ 2,053,711	$ 16,000	$ 17,134	$ 0	$ 4,053,39

(1) Because the termination is assumed to be effective on December 31, 2006, the amount shown represents bonus for the full year.

(2) Amounts shown in column (c) assume a 3x termination multiple for all executives except Mr. Carroll.

(3) Amounts shown in column (d) represent the value of unvested options that would accelerate upon a change of control based on the difference between the closing price of Smith s common stock at the end of fiscal 2006 and the exercise price of the respective options. The number of vested and exercisable options outstanding for each individual on December 31, 2006 is included in the Outstanding Equity Awards at Fiscal Year End table.

(4) Amounts shown in column (e) represent the value of unvested performance share awards at the target performance level and unvested restricted stock units, the vesting of which would accelerate upon a change of control based on the closing price of Smith s common stock at the end of fiscal 2006.

(5) Amounts shown in column (f) represent the excess of (i) the actuarial equivalent of the benefit under the Company s current SERP and previous SERP and (ii) the actuarial equivalent of the executive s actual benefit, if any, as of the date of termination, assuming that the executive s base salary and contribution amounts remain at the same level as the highest monthly salary paid during fiscal year 2006. Amounts assume a 3x termination multiple for all executives except Mr. Carroll.

(6) Amounts shown in column (g) represent the continuation of benefits to the executive and the executive s family equal to those that would have been provided to them in accordance with the plans if (i) the executive s employment had not terminated and (ii) the executive had remained employed and retired on the last day of such period, assuming full family coverage at the lowest deductible amounts under all benefit plans for each individual. Amounts assume benefits for three years for all executives, except Mr. Carroll. This amount also includes $50,000 in outplacement services for each executive, except Mr. Carroll.

(7) As of December 31, 2006, Mr. Carroll s employment agreement extended through April 30, 2008. All amounts stated for Mr. Carroll take into account the term remaining under his employment agreement as of December 31, 2006.

In the event of the executive s termination of employment due to death or disability on December 31, 2006, payments would include the amounts indicated in column (b), (d) and (e) above.

DIRECTOR COMPENSATION
FOR FISCAL 2006

Set forth below is a summary of the dollar values of the total annual compensation attributable to each non-employee director s service to Smith during 2006.

Name (a)	Fees Earned or Paid in Cash ($) (b)	Stock Awards ($) (c)	Option Awards ($) (d)	Non-Equity Incentive Plan Compensation ($) (e)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (f)	All Other Compensation ($)(3) (g)	Total ($) (h)
Benjamin F. Bailar(1)	$ 33,000	$ 220,670(2)	$ 0	$ 0	$ 0	$ 9,117	$ 262,787
G. Clyde Buck	$ 93,000	$ 74,990	$ 0	$ 0	$ 0	$ 12,992	$ 180,982
Dod A. Fraser	$ 104,250	$ 74,990	$ 0	$ 0	$ 0	$ 14,921	$ 194,161

James R. Gibbs	$ 107,000	$ 74,990	$ 0	$ 0	$ 0	$ 0	$ 181,990
Robert Kelley	$ 93,000	$ 74,990	$ 0	$ 0	$ 0	$ 13,181	$ 181,171
Jerry W. Neely	$ 89,000	$ 74,990	$ 0	$ 0	$ 0	$ 8,898	$ 172,888
John Yearwood	$ 5,179	$ 76,612	$ 0	$ 0	$ 0	$ 0	$ 81,791

(1) Mr. Bailar served as a director until April 24, 2006.

(2) This amount includes the FAS 123R value of common stock issued to Mr. Bailar as a result of 24,000 restricted stock units vesting upon his retirement from the Board.

(3) This amount includes spousal airfare to a board meeting. It also includes matching educational gifts on behalf of Mr. Fraser ($5,000) and Mr. Kelley ($1,000).

Directors Compensation

Employee directors receive no additional compensation other than their normal salary for serving on the Board or its committees. Non-employee directors receive $50,000 annually and $2,000 for each Board meeting attended. In addition, they are paid $10,000 per year for chairing a committee (other than the chairman of the Audit Committee who is paid $15,000 per year) and $2,000 for each committee meeting attended even if they are not members of such committee. Expenses for Company related business travel are either paid or reimbursed by the Company. Non-employee directors also receive an initial grant of shares, upon first election or appointment, along with an annual grant of shares of Common Stock, each with a value of approximately $150,000.

Non-Employee Director Programs

The Company terminated its Directors Retirement Plan in 1998. The Company issued restricted stock unit grants to each of the non-employee directors in 1999 to fund the actuarial value of their accrued benefits under the retirement plan. These grants of 24,000 shares (adjusted for the two-for-one stock splits on June 20, 2002 and August 24, 2005) will vest upon retirement after ten years of service as a director. Cash dividends are not paid and do not accrue on the unvested units. The three directors with outstanding restricted stock units are Messrs. Buck, Gibbs and Neely.

Director Stock Ownership Guidelines

The Board has established non-employee director stock ownership guidelines to align the interests of the directors with those of our stockholders and further promote Smith s commitment to sound corporate governance. The guidelines are premised upon every non-employee director holding, within three years of the date the guidelines become effective with respect to each individual, a number of shares of common stock equaling five times the director s annual cash retainer.

ADDITIONAL INFORMATION ABOUT OUR DIRECTORS AND EXECUTIVE OFFICERS

Certain Relationships and Related Transactions

The Audit Committee has adopted a written policy which provides guidelines for monitoring and approving transactions with related parties. Pursuant to the policy, related parties include all executive officers, members of the Board of Directors and stockholders who own more than 5% of our common stock. Transactions with related parties that are entered into at prevailing prices and which comply with standard terms and conditions require no prior approval, except that all transactions with the Chief Executive Officer or Chief Financial Officer require pre-approval from the Nominating and Corporate Governance Committee. Transactions with related parties that do not reflect prevailing prices and do not comply with standard terms and conditions require pre-approval from the Chief Executive Officer or Chief Financial Officer and the Nominating and Corporate Governance Committee.

We have not engaged in any transaction, or series of similar transactions, since the beginning of 2006, nor is there any currently proposed transaction, or series of similar transactions, to which Smith or any of its subsidiaries was or is to be a participant, in which the amount involved exceeds $120,000 and in which any of Smith s directors or executive officers, members of their immediate family or any stockholder who owns more than 5% of our common stock had, or will have, a direct or indirect material interest.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires the Company s officers and directors, and persons who own more than 10% of the Company s outstanding shares of Common Stock (collectively, Section 16 Persons), to file with the SEC initial reports of ownership and reports of changes in ownership of Common Stock and other equity securities. Section 16 Persons are required by Commission regulations to furnish the Company with copies of all Section 16(a) reports they file.

Based solely on its review of the copies of such reports received by it, or written representations from certain Section 16 Persons that all Section 16(a) reports required to be filed for such persons had been filed, the Company believes that during 2006 the Section 16 Persons complied with all Section 16(a) filing requirements applicable to them, except that Mr. Chandler filed one late report disclosing shares held directly by him that were inadvertently omitted from his Form 3; Mr. Dudman filed one late report disclosing shares held directly by him that were inadvertently omitted from his Form 3 and one late report disclosing one 401(k) account transaction in Company stock; and Geraldine Wilde filed one late report disclosing transactions by her husband, who is employed by M-I SWACO.

PROPOSAL 2: APPROVAL OF THE SMITH INTERNATIONAL, INC. SECOND AMENDED AND RESTATED 1989 LONG-TERM INCENTIVE COMPENSATION PLAN

The Board has adopted, subject to stockholder approval, the Second Amended and Restated 1989 Long-Term Incentive Compensation Plan (the Plan). The Plan is intended to merge the Smith International, Inc. Stock Plan for Outside Directors (the Directors Plan) into the Smith International, Inc. 1989 Long-Term Incentive Compensation Plan (the LTIC Plan), with the Plan as the sole surviving source of shares for the Directors Plan and the LTIC Plan (the Prior Plans). At the Annual Meeting, you will be asked to approve the Plan in accordance with the rules of the New York Stock Exchange and the provisions of the Plan. If the Plan is approved, the share reserves under the Prior Plans will be combined. No additional shares will be reserved for issuance under the Plan. Your vote on this Proposal 2 will not affect the aggregate number of shares of the Company s Common Stock previously reserved for issuance under the Prior Plans, and the Company intends to continue to make awards at similar levels and on the same criteria as it had done under the Prior Plans.

Description of the Plan

The following summary describes briefly the principal features of the Plan, and is qualified in its entirety by reference to the full text of the Plan, which is provided as Appendix A to this proxy statement.

Purpose. The purpose of the Plan is to foster and promote the long-term financial success of the Company and to increase stockholder value by: (a) encouraging the commitment of selected key Employees, (b) motivating superior performance of key Employees by means of long-term performance related incentives, (c) encouraging and providing key Employees with a program for obtaining ownership interests in the Company which link and align their personal interests to those of the Company s stockholders, (d) attracting and retaining key Employees by providing competitive compensation opportunities, (e) enabling key Employees to share in the long-term growth and success of the Company, (f) providing additional incentives for securing and retaining qualified individuals who are not employees of the Company to serve on the Board of Directors of the Company (Outside Directors), and (g) to enhance the future growth of the Company by furthering Outside Directors alignment with the interests of the Company and its stockholders.

Key Changes. You are being asked to approve the merger of the Directors Plan into the LTIC Plan. The key changes to the Prior Plans are outlined below:

Advisory directors are added as a class of participants, limited to the provisions in which outside directors may participate.

Outside directors are permitted to receive awards of Stock Options and Stock Appreciation Rights.

At the discretion of the Compensation and Benefits Committee of the Board (referred to in this section as the Compensation Committee), participants may defer the receipt of their Restricted Stock Unit awards, as specified in the Plan.

Restricted Stock Unit awards are more clearly defined in the new Plan.

Common stock awards, which were permitted under the Director Plan, are included in the Plan, but remain available only to outside directors.

The minimum vesting period for a Restricted Stock Award or Restricted Stock Unit Award is three years (or one year if vesting is based on a performance measure).

Awards Under the Plan. The Plan provides for the following types of awards: (a) nonqualified stock option; (b) stock appreciation right; (c) common stock; (d) restricted stock (including performance-based); (e) restricted stock unit (including performance-based) (f) stock-based award; (g) any combination of the foregoing. The Plan permits the grant of awards subject to performance objectives in order to qualify for the performance-based exception within Section 162(m) of the Internal Revenue Code. As of March 5, 2007, nonqualified stock options, common stock and restricted stock units (including performance-based) have been awarded under the Prior Plans.

Plan Administration. The Plan is administered by the Compensation Committee. The Compensation Committee determines awards based on criteria specified in more detail elsewhere in this proxy statement, as indicated below. Future awards are based on future performance or future stock price and, therefore, are not currently determinable. Please see the section entitled Compensation Discussion and Analysis for more information regarding future grants to the named executive officers; the Outstanding Equity Awards at Fiscal Year End Table for more information regarding past grants to the named executive officers; and the Director Compensation Table and related narrative discussion for more information regarding grants to outside directors.

Participation and Eligibility. All full-time salaried employees of the Company whom the Compensation Committee determines are in a position to contribute to the growth, development or financial success of the Company and Outside Directors are eligible to receive awards under the Plan. Common stock awards are only available to Outside Directors.

Shares Subject to Awards Under the Plan. Since 1989, as adjusted to reflect stock splits, a total of 29,040,000 shares of Common Stock have been reserved for issuance under the Prior Plans. This amount will remain the same under the Plan. Upon expiration, cancellation or termination of unexercised awards granted under the Plan or forfeiture of shares of restricted stock, the shares of Common Stock subject to such awards will again be available for the grant of awards under the Plan. If any change occurs in the capitalization of the Company, such as a stock dividend or stock split, or if a merger takes place in which the Company is the surviving corporation, the Board or the Compensation Committee may take such action as it deems appropriate so that the value of each outstanding award shall not be adversely affected by such corporate event.

General Terms of the Awards. The specific terms and conditions of each award, including the vesting and termination of such awards, shall be fixed by the Compensation Committee pursuant to the Plan at the time the award is granted. Subject to exceptions, determined by the Compensation Committee pursuant to the Plan, the maximum stock based award that may be granted to a Plan participant in a given year is 1,000,000 shares. The maximum cash payout on an award payable in cash that may be paid to a Plan participant in a given year is $10,000,000. The grant price of an option or stock appreciation right (SAR) may not be less than 100% of the fair market value of our Common Stock on the date of grant of the option. Pursuant to the provisions of the Plan and New York Stock Exchange rules, awards under the Plan may not be re-priced without stockholder approval.

Federal Income Tax Consequences Associated with Awards Granted Under the Plan. The following is a general summary as of the date of this proxy statement of the United States federal income tax consequences associated with the grant of awards under the Plan. The federal tax laws may change and the federal, state and local tax consequences for any participant will depend upon his or her individual circumstances, thus the tax consequences for any particular individual may be different. Also, this information may not be applicable to any employees of foreign subsidiaries or to participants who are not residents of the United States.

As discussed above, several different types of incentive awards may be issued under the Plan. The tax consequences related to the issuance of each type of award is discussed separately below.

Nonqualified Stock Options and Stock Appreciation Rights (SARs). Nonqualified stock options granted under the Plan are not intended to qualify as incentive stock options and will not qualify for any special tax benefits to the optionee. A participant receiving a nonqualified stock option or SAR that has been issued with an exercise price not less than the fair market value of the Company s common stock on the grant date will not recognize income and the Company will not be allowed a deduction at the time such an option is granted. When a participant exercises a nonqualified stock option or SAR, the difference between the exercise price and any higher market value of the stock on the date of exercise will be ordinary income to the participant. When a participant disposes of shares acquired by the exercise of the option or SAR, any additional gain or loss will be a capital gain or loss.

In general, there will be no federal income tax deduction allowed to the Company upon the grant or termination of a nonqualified stock option or SAR or a sale or disposition of the shares acquired upon exercise of the stock option or SAR. However, upon the exercise of a nonqualified stock option or SAR, the Company will be entitled to a deduction for federal income tax purposes equal to the amount of ordinary income that the participant is required to

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recognize as a result of the exercise, provided that the deduction is not otherwise disallowed under the Internal Revenue Code.

Restricted Stock Awards, Restricted Stock Unit Awards and Stock-Based Awards. Generally, the recipient of a restricted stock award or restricted stock unit award has no federal income tax consequences at the time of grant. Rather, at the time the shares are vested and no longer subject to a substantial risk of forfeiture, the participant will recognize ordinary income to the extent of the excess of the fair market value of the stock on the date the risk of forfeiture ceases over the amount paid, if any, by the participant for such stock. For a restricted stock award only, the participant may instead elect to be taxed at the time of grant by making an election under Section 83(b) of the Internal Revenue Code.

In the year that the recipient of a restricted stock award, restricted stock unit award or stock-based award recognizes ordinary taxable income in respect of such award, the Company will be entitled to a deduction for federal income tax purposes equal to the amount of ordinary income that the participant is required to recognize, provided that the deduction is not otherwise disallowed under the Internal Revenue Code. Upon disposition of the shares received, the gain or loss recognized by the participant will be treated as capital gain or loss.

Performance-Based Awards. With certain exceptions, Section 162(m) of the Internal Revenue Code denies a deduction to the Company for compensation paid to certain executive officers in excess of $1 million per executive per taxable year. One such exception applies to certain performance-based compensation as described in Section 162(m), and certain awards granted under the Plan will be intended to qualify as performance-based compensation. The Plan contains provisions consistent with the requirements for performance-based compensation under Section 162(m). However, the Compensation Committee may award non-deductible compensation when such grants are in the best interest of the Company, balancing tax efficiency with long-term strategic objectives.

Section 409A. Section 409A of the Internal Revenue Code provides certain new requirements for non-qualified deferred compensation arrangements. These include requirements with respect to an individual s election to defer compensation and the individual s selection of the timing and form of distribution of deferred compensation. Section 409A also generally provides that distributions must be made on or after the occurrence of certain events (e.g., the individual s separation from service, a predetermined date, or the individual s death). Section 409A imposes restrictions on an individual s ability to change his or her distribution timing or form of distribution, after the compensation has been deferred.

Awards granted under the Plan with a deferral feature will be subject to the requirements of Section 409A. If an award is subject to and fails to satisfy the requirements of Section 409A, the recipient of that award may recognize ordinary income on the amounts deferred under the award, to the extent vested, which may be prior to when the compensation is actually or constructively received. Also, if an award that is subject to Section 409A fails to comply with Section 409A, an additional 20% federal income tax is imposed on compensation recognized as ordinary income, as well as interest on such deferred compensation.

ERISA. The Company believes that the Plan is not subject to any provisions of the Employee Retirement Income Security Act of 1974 (ERISA). The Plan is not a qualified plan under Section 401(a) of the Internal Revenue Code.

Amendment of the Plan. The Board of Directors may terminate, modify or amend the Plan at any time without stockholder approval, except for amendments that (a) change the class of persons eligible to receive awards; (b) materially increase benefits; (c) transfer the administration of the Plan to anyone who is not a disinterested person under the federal securities law; (d) increase the number of shares subject to the Plan or (e) require stockholder approval under New York Stock Exchange listing standards or the Internal Revenue Code in order to maintain listing requirements or favorable tax advantages or qualifications.

Required Approval. The affirmative vote of a majority of the shares represented at the annual meeting and entitled to vote will be sufficient to approve the Plan. In the event that stockholder approval of the Plan is not obtained, the original Smith International, Inc. 1989 Long-Term Incentive Compensation Plan and Smith International, Inc. Directors Stock Plan, as previously amended, would remain in effect.

WE RECOMMEND THAT YOU VOTE FOR APPROVAL OF THE SECOND AMENDED AND RESTATED LONG-TERM INCENTIVE COMPENSATION PLAN.

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EQUITY COMPENSATION PLAN INFORMATION

The following table shows information as of December 31, 2006, with respect to the LTIC Plan and the Smith International, Inc. Stock Plan for Outside Directors under which equity securities of the Company are authorized for issuance, aggregated as follows:

Plan Category	(a) Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future issuance under Equity Compensation Plans (Excluding Securities Reflected in Column(a))
Equity compensation plans approved by security holders	5,441,582(1)	$18.78(2)	1,873,277(3)
Equity compensation plans not approved by security holders	Not applicable	Not applicable	Not applicable
Total	5,441,582	$18.78	1,873,277

(1) Includes an aggregate of 2,090,201 restricted stock units and performance-based restricted stock units awarded to employees and 72,000 restricted stock units to be awarded to directors upon their retirement from the board.

(2) Weighted average exercise price of outstanding options; excludes restricted stock units and performance-based restricted stock units.

(3) Includes 15,969 shares available for issuance pursuant to the Stock Plan for Outside Directors.

PROPOSAL 3: RATIFICATION OF DELOITTE & TOUCHE LLP AS INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee has selected Deloitte & Touche LLP as its independent registered public accounting firm to audit the books and records of the Company for its fiscal year ending December 31, 2007. The services of Deloitte & Touche LLP will include the audit of the effectiveness of internal controls over financial reporting. The Company has been advised by Deloitte & Touche LLP that the firm has no relationship with the Company or its subsidiaries other than that arising from the firm s engagement as independent registered public accountants and, in limited circumstances, tax advisors. Deloitte & Touche LLP has audited the Company s financial statements since April 15, 2002.

Deloitte & Touche LLP has offices in or convenient to most of the locations in the world where the Company and its subsidiaries operate. Representatives of Deloitte & Touche LLP are not expected to be present at the Annual Meeting, will not have the opportunity to make a statement and will not be available to respond to questions.

Fees Paid to Deloitte & Touche LLP

During fiscal years 2006 and 2005, the Company incurred the following fees for services performed by Deloitte & Touche LLP:

	2006	**2005**
Audit Fees	$ 4,890,000	$ 4,404,000
Audit-Related Fees	104,000	78,000
Tax Fees	35,000	35,000
All Other Fees	0	0
Total	$ 5,029,000	$ 4,517,000

Audit Fees. This category includes the audit of Smith s annual financial statements and Management s Report on Internal Control over Financial Reporting as required by Section 404 of the Sarbanes-Oxley Act, audits of

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statutory accounts in certain non-U.S. jurisdictions, review of financial statements included in Smith s quarterly reports on Form 10-Q and services that are normally provided by the independent registered public accountants in connection with statutory and regulatory filings or engagements for those fiscal years. This category also includes the audit of the combined financial statements of M-I SWACO, the Company s majority-owned joint venture.

Audit-Related Fees. This category consists of assurance and related services by Deloitte & Touche LLP that are reasonably related to the performance of the audit or review of Smith s financial statements and are not reported above under Audit Fees. The services for the fees disclosed under this category primarily relate to the audit of various U.S. employee benefit plans, which were not directly related to the audit of the consolidated financial statements. The Audit Committee approved 100% of these Audit-Related Fees pursuant to its pre-approval policy.

Tax Fees. This category includes fees for professional services performed by Deloitte & Touche LLP with respect to tax compliance, tax advice and tax planning. The Audit Committee approved 100% of these Tax Fees pursuant to its pre-approval policy.

Services Provided by Deloitte & Touche LLP

All services rendered by Deloitte & Touche LLP are permissible under applicable laws and regulations, and are pre-approved by the Audit Committee. Pursuant to SEC rules, the fees paid to Deloitte & Touche LLP for services are disclosed in the table above under the categories listed.

Although ratification by stockholders is not required by law, the Audit Committee has determined that it is desirable to seek stockholder ratification of this appointment in light of the critical role played by independent registered public accountants in maintaining the integrity of Company financial controls and reporting. Notwithstanding its selection, the Audit Committee, in its discretion, may appoint new independent registered public accountants at any time during the year if the Audit Committee believes that such a change would be in the best interest of the Company and its stockholders. If the stockholders do not ratify the appointment of Deloitte & Touche LLP, the Audit Committee may reconsider its selection.

WE RECOMMEND THAT YOU VOTE FOR THE CONTINUED ENGAGEMENT OF DELOITTE & TOUCHE LLP AS INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM TO AUDIT THE BOOKS AND RECORDS OF THE COMPANY FOR THE FISCAL YEAR ENDING DECEMBER 31, 2007.

AUDIT COMMITTEE REPORT

Smith s Audit Committee reviews the Company s financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements and the reporting process, including the system of internal controls. Smith s independent registered public accounting firm (independent auditors), Deloitte & Touche LLP, is responsible for performing an independent audit of the Company s consolidated financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States) and to issue a report thereon. The Committee monitors these processes.

The Audit Committee members are not professional accountants or auditors, and their functions are not intended to duplicate or to certify the activities of management and the independent auditors, nor can the Audit Committee certify that the independent auditors are independent under applicable rules. The Audit Committee serves a board-level oversight role, in which it provides advice, counsel and direction to management and the auditors on the basis of the information it receives, discussions with management and the auditors, and the experience of the Audit Committee s members in business, financial and accounting matters. The Audit Committee has the authority to engage its own outside advisers, including experts in particular areas of accounting, as it determines appropriate, apart from counsel or advisers hired by management.

In this context, the Audit Committee has reviewed and discussed the audited consolidated financial statements with management and representatives of the Company s independent auditors. During the year, the Audit Committee also discussed with the Company s independent auditors the matters required to be discussed by SAS No. 61 (Codification of Statements on Auditing Standards, AU 380).

The Audit Committee has received the written disclosures and letter from Deloitte & Touche LLP required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and has discussed with Deloitte & Touche LLP any relationships that may have an impact on their objectivity and independence.

Based on the above-mentioned review and discussions, the Audit Committee recommended to the Board of Directors that the Company s audited consolidated financial statements be included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2006 for filing with the SEC.

Audit Committee

Dod A. Fraser, *Chairman*
Robert Kelley
Jerry W. Neely

OTHER BUSINESS

The Board of Directors does not intend to present any other business for action at the meeting, and the Company has not been advised of any other business intended to be presented by others.

STOCKHOLDERS PROPOSALS

To be considered for inclusion in the proxy statement for next year s annual meeting, stockholder proposals must be submitted to the Company in writing by no later than November 22, 2007. In addition, in order for a stockholder to bring any business before next year s annual meeting, notice must be received by the Company in writing by no later than November 22, 2007, in accordance with the Company s Restated Bylaws. If we do not receive notice of your proposal within this time frame, our management will use its discretion to vote all the shares for which we have received proxies as the Board may recommend.

ANNUAL REPORT AND FINANCIAL INFORMATION

A copy of our 2006 Annual Report to Stockholders is being mailed with this Proxy Statement. We will provide without charge the Company s annual report on Form 10-K for the fiscal year ended December 31, 2006, to any person requesting a copy in writing and stating that he or she was a beneficial holder of the Company s Common Stock on February 28, 2007. The annual report on Form 10-K is also available on our website at *www.smith.com* using the Investor Relations caption and following the SEC Filings links. The Company will also furnish copies of any exhibits to the Form 10-K at $0.50 per page, paid in advance. Requests and inquiries should be addressed to:

Investor Relations
Smith International, Inc.
P. O. Box 60068
Houston TX 77205-0068

The Company s 2006 Annual Report to Stockholders should not be regarded as proxy soliciting material or as a communication for which a solicitation of proxies is to be made.

By Order of the Board of Directors

Richard E. Chandler, Jr.
Secretary

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APPENDIX A

SMITH INTERNATIONAL, INC.
1989 LONG-TERM INCENTIVE
COMPENSATION PLAN

(Second Amendment and Restatement Effective January 1, 2005)

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