

SMITH INTERNATIONAL INC

Form 10-K

March 01, 2010

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

Form 10-K

(Mark One)

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2009**
- or**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 1-8514**

SMITH INTERNATIONAL, INC.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

95-3822631

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

1310 Rankin Road

Houston, Texas

(Address of principal executive offices)

77073

(Zip Code)

**Registrant's telephone number, including area code (281) 443-3370
Securities Registered Pursuant to Section 12(b) of the Act:**

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$1.00 par value	New York Stock Exchange, Inc.
Preferred Share Purchase Rights	New York Stock Exchange, Inc.

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the voting stock held by non-affiliates on June 30, 2009 was \$5,614,831,358 (218,051,703) shares at the closing price on the New York Stock Exchange of \$25.75. On June 30, 2009, 236,995,440 shares of common stock were outstanding, including shares held in Treasury. For this purpose all shares held by officers and directors and their respective affiliates are considered to be held by affiliates, but neither the Registrant nor such persons concede that they are affiliates of the Registrant.

There were 248,412,065 shares of common stock outstanding, net of shares held in Treasury, on February 25, 2010.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement related to the Registrant's 2010 Annual Meeting of Stockholders will be incorporated by reference into Part III of this Form.

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PART I

Item 1. *Business*

General

Smith International, Inc. is a leading global provider of premium products and services used during the drilling, completion and production phases of oil and natural gas exploration and development activities. As used herein, Smith, the Company, we, our and us may refer to Smith International, Inc. and/or its subsidiaries.

The Company was incorporated in the state of California in January 1937 and reincorporated under Delaware law in May 1983. The Company's executive offices are headquartered at 1310 Rankin Road, Houston, Texas 77073 and its telephone number is (281) 443-3370. The Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are made available free of charge on the Company's website at www.smith.com as soon as reasonably practicable after the Company has electronically filed such material with, or furnished it to, the Securities and Exchange Commission. The Company's Corporate Governance Guidelines, Code of Business Conduct and Ethics and the charters of the Audit Committee, Compensation and Benefits Committee and Nominating and Corporate Governance Committee are also available on the Investor Relations section of the Company's website. The Company intends to disclose on its website any amendments or waivers to its Code of Business Conduct and Ethics that are required to be disclosed pursuant to Item 5.05 of Form 8-K. Printed copies of these documents are available without charge to stockholders upon request.

Our business is segregated into three operating segments, M-I SWACO, Smith Oilfield and Distribution, which is the basis upon which we report our results. We provide a comprehensive line of technologically-advanced products and engineering services, including drilling and completion fluid systems, solids-control and separation equipment, waste-management services, three-cone and diamond drill bits, borehole enlargement services, tubulars, directional systems, measurement-while-drilling and logging-while-drilling services, coiled tubing, cased-hole wireline and other complementary downhole tools and services. The Company also offers supply-chain management solutions through an extensive North American branch network providing pipe, valves and fittings as well as mill, safety and other maintenance products.

Financial information regarding reportable segments and international operations appears in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 16 of the Notes to Consolidated Financial Statements included elsewhere in this Form 10-K. Additional information related to business combinations appears in Note 3 of the Notes to Consolidated Financial Statements included elsewhere in this Form 10-K.

Recent Developments

Schlumberger Limited Merger Agreement

On February 21, 2010, the Company, Schlumberger Limited (Schlumberger) and Turnberry Merger Sub, Inc., a wholly-owned subsidiary of Schlumberger, entered into an Agreement and Plan of Merger (the Merger Agreement), pursuant to which Turnberry Merger Sub, Inc. will merge with and into the Company, with the Company surviving as a wholly-owned subsidiary of Schlumberger, and each share of Company common stock will be converted into the right to receive 0.6966 shares of Schlumberger common stock (the Merger). Completion of the Merger is subject to (i) approval of the Merger by the stockholders of the Company, (ii) applicable regulatory approvals, including the

termination or expiration of the applicable waiting period (and any extensions thereof) under the U.S. Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and European Community merger regulations, and (iii) other customary closing conditions.

Under the Merger Agreement, the Company agreed to conduct its business in the ordinary course while the Merger is pending, and, except as permitted under the Merger Agreement, to generally refrain from, among other things, acquiring new or selling existing businesses, incurring new indebtedness, repurchasing Company shares, issuing new capital stock or equity awards, or entering into new material contracts or commitments outside the ordinary course of business, without the consent of Schlumberger.

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Stockholder Litigation

Subsequent to the announcement of the proposed combination of the Company and Schlumberger and through February 25, 2010, four putative class action lawsuits were commenced on behalf of stockholders of the Company against the Company and its directors in the District Court of Harris County, Texas, challenging the proposed transaction. One of the lawsuits also names Schlumberger and one of its affiliates as defendants. The lawsuits variously allege that the Company's directors breached their fiduciary duties by, among other things, causing Smith to enter into the proposed transaction at an allegedly inadequate and unfair price and agreeing to transaction terms that improperly inhibit alternative transactions. One of the lawsuits separately alleges that the Company aided and abetted the directors' breaches of fiduciary duties, and another of the lawsuits alleges that Schlumberger aided and abetted the directors' breaches of fiduciary duties. The various complaints seek, among other things, an injunction barring defendants from consummating the proposed transaction, declaratory relief and attorneys' fees. The Company believes that the lawsuits are without merit and intends to defend these lawsuits vigorously.

Where to Find Additional Information

Additional information about Schlumberger is included in documents that it has filed with the Securities and Exchange Commission. Additional information concerning the Merger is contained in Item 1A, Risk Factors, and in the proxy statement/prospectus and registration statement to be filed with the Securities and Exchange Commission. **STOCKHOLDERS ARE URGED TO READ THE PROXY STATEMENT/PROSPECTUS AND REGISTRATION STATEMENT REGARDING THE PROPOSED TRANSACTION WHEN IT BECOMES AVAILABLE BECAUSE IT WILL CONTAIN IMPORTANT INFORMATION ABOUT THE PROPOSED TRANSACTION.** These materials will be made available to the stockholders of Smith at no expense to them. Investors and security holders will be able to obtain the documents (when available) free of charge at the Securities and Exchange Commission's website, www.sec.gov. In addition, such materials (and all other documents filed with the Securities and Exchange Commission) will be available free of charge at www.smith.com or www.slb.com. Such documents are not currently available. You may also read and copy any reports, statements and other information filed by Smith or Schlumberger with the Securities and Exchange Commission at the Securities and Exchange Commission public reference room at 100 F Street N.E., Room 1580, Washington, D.C. 20549. Please call the Securities and Exchange Commission at (800) 732-0330 or visit the Securities and Exchange Commission's website for further information on its public reference room.

Each company's directors and executive officers and other persons may be deemed, under Securities and Exchange Commission rules, to be participants in the solicitation of proxies in connection with the proposed transaction. Information regarding Schlumberger's directors and officers can be found in its preliminary proxy statement filed with the Securities and Exchange Commission on February 9, 2010 and information regarding Smith's directors and officers can be found in its proxy statement filed with the Securities and Exchange Commission on April 13, 2009. Additional information regarding the participants in the proxy solicitation and a description of their direct and indirect interests in the transaction, by security holdings or otherwise, will be contained in the proxy statement/prospectus and other relevant materials to be filed with the Securities and Exchange Commission when they become available.

Business Operations

M-I SWACO Segment

M-I SWACO, a majority-owned joint venture operation, is a leading supplier of drilling fluid systems engineered to improve wellbore quality and increase drilling performance. We also offer a broad range of waste management equipment and services, provide completion fluids and related tools and supply oilfield production chemicals.

M-I SWACO accounted for just over half of our total revenues in 2009, with more than three-quarters of the business concentrated in markets outside North America. Approximately 65 percent of M-I SWACO's revenues relate to drilling fluid systems and related services, 20 percent to environmental and process solutions and the remainder is comprised of completion fluids, completion tools and production chemical offerings.

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Drilling fluid systems are used to cool and lubricate the drill bit, contain formation pressures, suspend and remove rock cuttings from the hole and maintain the stability of the wellbore. Fluids are pumped downhole during drilling operations and are later returned to the surface where drill cuttings are removed, the fluid is reconditioned and then circulated back through the drill string. Fluid systems are engineered for specific drilling applications and reservoir environments to optimize drilling operations, typically combining a blend of weighting materials with a broad range of chemical additives to yield required performance characteristics.

Environmental and process solutions involve a wide array of equipment and services used to remove drill cuttings from the fluid system and collect, treat and dispose of drilling waste. Engineered screens, shakers and centrifuges are typically used to perform these services, resulting in extended fluid life, increased rates of penetration and reduced wear on sensitive directional drilling and other downhole equipment. Waste treatment services encompass a range of activities, including water treatment, site assessment, pit closure and remediation, drill cuttings injection and thermal processing.

Completion fluids, or clear brines, are solids-free, clear-salt solutions that are non-damaging to the producing formation. Operators use these specially designed fluid systems in combination with a range of specialty chemicals to control bottom-hole pressures, while meeting the specific corrosion inhibition, viscosity and fluid loss requirements necessary during the completion and workover phases of a well.

M-I SWACO's primary competitors are Halliburton Company (Halliburton), Baker Hughes, Inc. (Baker Hughes) and Newpark Resources, Inc. Competition for drilling and completion fluids is based on a number of factors, including product quality and availability, wellsite engineering services, technical support, service response and price. Competition for our environmental and process solutions is based on product availability, equipment performance, technical support and price.

Smith Oilfield Segment

The Smith Oilfield operations provide a comprehensive suite of premium products and services used in oil and natural gas development activities.

The segment accounted for 27 percent of our total revenues in 2009, with 57 percent of the business base focused in the North American region. We are a global leader in the design, manufacture and marketing of drill bits and borehole enlargement tools, which on a combined basis, represents the segment's largest product revenue component. The segment is also a leading supplier of drilling tools and services, tubulars, completion services and other related downhole solutions. The following provides a discussion of drill bits and borehole enlargement tools, directional drilling services and other key product offerings of the segment.

Drill bits are consumable products used during the drilling operation to cut the rock formation. The Company's three-cone and diamond (or fixed cutter) drill bits are designed for premium market segments where faster penetration rates and increased footage provide significant economic benefits in lowering overall well costs. Borehole enlargement tools (or hole openers) and underreamers are placed above the bit in the drill string to create larger hole diameters in certain sections of the wellbore.

Drilling tools and services include directional drilling, measurement-while-drilling and logging-while-drilling services which reduce the operational and economic risks in both exploration and development drilling. Directional drilling services involve the use of skilled personnel to direct the drilling assembly along a predetermined path to enable the optimal recovery of oil and natural gas from a reservoir. Measurement-while-drilling products and services use downhole tools to help locate and direct the drill bit on a real-time basis to the intended target. Logging-while-drilling tools provide operators with real-time data about the physical properties of downhole formations and assist in

improving drilling performance.

Premium tubular drill string components, such as drill collars and Hevi-Wate[™] drill pipe, are manufactured by Smith Oilfield in accordance with customer specifications while certain conventional drill pipe products are purchased for resale. In addition to the tubular product offerings, we offer proprietary downhole impact tools such as drilling jars and accelerators which can be added to the drill string to address potential drilling problems which may be encountered, including stuck pipe.

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A variety of products and services are employed by operators after drilling is complete to bring the well online and to workover mature fields in a state of declining production. We provide a suite of completion and production related operations, including coiled tubing and cased-hole wireline services, packers and liner hangers. Coiled tubing and cased-hole wireline equipment, together with experienced personnel, are used in a variety of applications over the life of the well, such as perforating, wellbore cleanout and stimulation, cased-hole logging, and other intervention services. Engineered and manufactured products include production and service packers, which provide zonal isolation within the wellbore to direct oil and gas flow to the surface, and liner hangers for suspension of casing liners in deeper wells.

Fishing tools and services assist in locating, freeing and retrieving damaged or stuck tubulars, drilling tools or other non-drillable items in the wellbore, alleviating the need to drill around or abandon the well. Casing exit and multi-lateral systems allow the operator to divert around obstructions in the main wellbore or to reach multiple production zones from the main wellbore.

Smith Oilfield also leverages its proprietary suite of modeling and design software and application data together with its comprehensive product and service offerings to optimize the creation of the wellbore. Predictive knowledge gained through offset wells, product design and highly-trained engineers allows us to simulate the downhole environment to optimize bottom hole assembly components, drilling parameters and fluid hydraulics. Through collaborative exchanges with the clients' engineers and rig-based drilling teams, we can test drill the well in a virtual environment to fully understand the application-specific challenges and effectively apply appropriate products and technologies to deliver enhanced performance improvement prior to beginning the drilling process.

Smith Oilfield's major competitors in the drill bit business include Baker Hughes, Halliburton and National Oilwell Varco, Inc. (National Oilwell). With respect to drilling and completion services and tools, the segment's primary competitors include Halliburton, Schlumberger, Baker Hughes and Weatherford International Ltd. (Weatherford). Competition for Smith Oilfield's operations is based on a number of factors, including performance, price, reliability, experience and capabilities of service personnel, breadth of products and service offerings, and response time.

Distribution Segment

The Company's Distribution operations provide products and services to the energy, refining, petrochemical, power generation and mining industries. The Distribution segment consists of the operations of our wholly-owned subsidiary, Wilson International, Inc. (Wilson) and a majority-owned interest in C.E. Franklin Ltd., a publicly-traded Canadian distribution company. We operate an extensive network of supply branches, service centers and sales offices through which we market pipe, valves and fittings as well as mill, safety and other maintenance products, predominately in the United States and Canada. In addition, we provide warehouse management, vendor integration and various surplus and inventory management services. The majority of our operations are focused on the distribution of maintenance, repair and operating supplies and equipment with the remainder associated with line pipe and automated valve products (including valve, actuator and control packages).

This segment accounted for 22 percent of our total revenues in 2009, with 95 percent of the business base concentrated in North America. Approximately three-quarters of the Distribution segment's revenues were generated in the energy sector, which includes companies with operations in the petroleum industry's pipeline sector and exploration and production companies. The remainder related to sales in the downstream and industrial market, including refineries, petrochemical and power generation plants and other energy-focused operations.

Our competitors in the energy sector operations include National Oilwell, McJunkin Red Man Corporation (McJunkin) and a significant number of smaller, locally-based operations. Our competitors in the downstream and industrial market include Hagemeyer NV, Ferguson Enterprises, Inc., McJunkin and W.W. Grainger, Inc. The

distribution market is highly competitive involving numerous factors, including price, experience, customer service and equipment availability.

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Non-U.S. Operations

Sales to oil and gas exploration and production markets outside the United States are a key strategic focus of Smith's management. The Company markets its products and services through subsidiaries, joint ventures and sales agents located in virtually all petroleum-producing areas of the world, including Canada, Latin America, Europe/Africa and Middle East/Asia. Approximately 60 percent, 53 percent and 55 percent of the Company's revenues in 2009, 2008 and 2007, respectively, were derived from equipment or services sold or provided outside the United States. The Company's Distribution operations constitute 22 percent of the consolidated revenue base and are concentrated in North America which masks the geographic revenue mix of the Company's oilfield operations. Excluding the impact of the Distribution operations, approximately 69 percent, 63 percent and 64 percent of the Company's revenues were generated in non-U.S. markets in 2009, 2008 and 2007, respectively.

Smith has limited operations in countries which are subject to trade or economic sanctions or other restrictions imposed by the U.S. government. These countries include Iran, Syria and Sudan. Smith's operations in these countries are conducted through non-U.S. wholly and partially owned affiliates. The Company is actively pursuing the termination of all business activities in Iran and Sudan. Approximately one percent of Smith's annual revenue in each of the last three years was derived from these countries. Smith does not believe such to be strategically significant to its worldwide operations as a whole.

Historically, drilling activity outside the United States has been less volatile than U.S.-based activity as the high cost exploration and production programs outside the United States are generally undertaken by major oil companies, consortiums and national oil companies. These entities operate under longer-term strategic development plans than do the independent drilling operators that are more common in the U.S. market.

Sales and Distribution

Sales and service efforts are directed to end users in the exploration and production industry, including major and independent oil companies, national oil companies and independent drilling contractors. The Company's products and services are primarily marketed through the direct sales force of each operating segment. In certain markets where direct sales efforts are not practicable, the Company utilizes independent sales agents, distributors or joint ventures.

The Company maintains field service centers, which function as a base for its global sales force and support the distribution and processing of our products and technologies, as well as the repair and maintenance of our rental equipment, in all major oil and gas producing regions of the world. The location of these service centers near the Company's customers is an important factor in maintaining favorable customer relations.

Manufacturing

The Company's manufacturing operations, along with quality control and engineering support, are designed to ensure that all products and services marketed by the Company will meet standards of performance and reliability consistent with the Company's reputation in the industry.

Management believes that it generally has sufficient internal manufacturing capacity to meet anticipated demand for its products and services. During periods of peak demand, certain product lines utilize outside resources to provide additional manufacturing capacity.

Raw Materials

Through its company-owned mines in and outside the United States, M-I SWACO has the capability to produce a large portion of its requirements for barite and bentonite, which are typically added to engineered drilling fluid systems. Barite reserves are mined in the United States, the United Kingdom and Morocco. Bentonite is produced from ore deposits in the United States. Mining exploration activities continue worldwide to locate and evaluate ore bodies to ensure deposits are readily available for production when market conditions dictate. In addition to its own production, M-I SWACO purchases the majority of its worldwide barite requirement from suppliers outside the United States, mainly the People's Republic of China, India and Morocco.

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The Company purchases a variety of raw materials for the Smith Oilfield segment, including alloy and stainless steel bars, tungsten carbide inserts and forgings. Generally, the Company is not dependent on any single source of supply for any of its raw materials or purchased components, and believes that numerous alternative supply sources are available for all such materials. The Company does not currently expect any material interruption in supply, but there can be no assurance that there will be no price or supply issues over the long term.

Product Development, Engineering and Patents

The Company's M-I SWACO and Smith Oilfield segments maintain product development and engineering departments whose activities are focused on improving existing products and services and developing new technologies to meet customer demands for improved drilling performance and environmental-based solutions for drilling and completion operations. The Company's primary research facilities are located in Houston, Texas; Stavanger, Norway; Aberdeen, Scotland; and Florence, Kentucky.

The Company has historically invested significant resources in research and engineering in order to provide customers with broader product offerings and technologically-advanced products and services. The Company's expenditures for research and engineering activities are attributable to the Company's M-I SWACO and Smith Oilfield segments and totaled \$141.0 million in 2009, \$129.4 million in 2008 and \$110.7 million in 2007. Research and engineering expenditures approximated 2.2 percent, 1.6 percent and 1.7 percent of the Company's oilfield-related operations revenues in 2009, 2008 and 2007, respectively.

Although the Company has over 6,300 issued and pending patents and regards its patents and patent applications as important in the operation of its business, it does not believe that any significant portion of its business is materially dependent upon any single patent.

Employees

At December 31, 2009, the Company had 21,931 full-time employees throughout the world. Most of the Company's employees in the United States are not covered by collective bargaining agreements except in certain U.S. mining operations of M-I SWACO and several distribution locations of Wilson. The Company considers its labor relations to be satisfactory.

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The table below sets forth, as of February 25, 2010, the names and ages of the executive officers of the Company, including all positions and offices held by each in the past five years. Positions, unless otherwise specified, are with the Company.

Name and Age	Principal Current Occupation and Other Significant Positions Held
Doug Rock(63)	Chairman of the Board, since February 1991; Special Executive Advisor to the Chief Executive Officer, since January 2009; Chief Executive Officer, President and Chief Operating Officer, March 1989 to December 2008; Joined the Company in June 1974.
John Yearwood(50)	Chief Executive Officer, President and Chief Operating Officer, since January 2009; Executive Vice President and President of Smith Completion and Production, August 2008 to December 2008; Member of the Board, since December 2006; Senior Advisor to the Chief Executive Officer of Schlumberger, March 2006 to May 2008; Various positions at Schlumberger (most recently, President North and South America, Oilfield Services), September 1980 to March 2006; Joined the Company as an employee in August 2008.
William Restrepo(50)	Senior Vice President, Chief Financial Officer and Treasurer, since October 2009; Executive Vice President, Chief Financial Officer and Secretary of Seitel, Inc., July 2005 to September 2009; Various financial and operational positions at Schlumberger (most recently, Vice President of Finance North and South America, Oilfield Services), August 1985 to June 2005. Joined the Company in October 2009.
Malcolm W. Anderson(62)	Senior Vice President, Human Resources, since December 2006; Vice President, Human Resources, May 2004 to November 2006. Joined the Company in May 2004.
Richard E. Chandler, Jr.(53)	Senior Vice President and Secretary, since January 2006; General Counsel, since August 2005; Senior Vice President Administration, General Counsel and Secretary of M-I SWACO, January 2004 to July 2005. Joined predecessor to M-I SWACO in December 1986.
Bryan L. Dudman(53)	Executive Vice President and President, Smith Drilling and Evaluation, since August 2008; President, Smith Services, January 2006 to July 2008; Senior Vice President Western Hemisphere Operations of M-I SWACO, May 1994 to December 2005; Joined the Company in January 1979.
John J. Kennedy(57)	President and Chief Executive Officer of Wilson, since June 1999; Joined the Company in November 1986.
Christopher I.S. Rivers(55)	President and Chief Executive Officer of M-I SWACO, since January 2009; Chief Operating Officer of M-I SWACO, October 2008 to December 2008; Executive Vice President Product Segments of M-I SWACO, April 2006 to September 2008; Vice President Eastern Hemisphere of M-I SWACO, January 2005 to March 2006; Joined the Company in July 1977.
Norman A. Mckay(50)	Executive Vice President and President of Smith Technologies, since November 2009; President Eastern Hemisphere of Exterran Holdings, Inc., April 2005 to October 2009; Various operational and management positions at Schlumberger (most recently Global Account Director, Oilfield Services), September 1981 to April 2005; Joined the Company in November 2009.
Peter J. Pintar(51)	Vice President Corporate Strategy and Development, since September 2005; Various positions at DTE Energy Company, including Director, Corporate Development, Managing Director, Venture Capital Investments; and Director, Investor Relations, October 1997 to August 2005; Joined the Company in September 2005.

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Lee A. Turner(62)	Vice President QHSE, since January 2009; Vice President QHSE of M-I SWACO, January 2005 to December 2008; Joined M-I SWACO in January 2005.
Brian E. Taylor(47)	Vice President and Controller since September 2009; Various financial positions within the Company (most recently Vice President Finance), June 2002 to August 2009; Vice President and Controller, September 1999 to May 2002; Joined the Company in September 1999.
Geraldine D. Wilde(59)	Vice President, Taxes and Assistant Treasurer, since February 1998; Joined predecessor to M-I SWACO in December 1986.

All officers of the Company are elected annually by the Board of Directors. They hold office until their successors are elected and qualified. There are no family relationships between the officers of the Company.

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Item 1A. Risk Factors

This document contains forward-looking statements within the meaning of the Section 21E of the Securities Exchange Act of 1934, as amended, concerning, among other things, our outlook, financial projections and business strategies, all of which are subject to risks, uncertainties and assumptions. These forward-looking statements are identified by their use of terms such as anticipate, believe, could, estimate, expect, project, should and similar terms. These statements are based on certain assumptions and analyses that we believe are appropriate under the circumstances. Such statements are subject to, among other things, overall demand for and pricing of the Company's products and services, general economic and business conditions, the level of oil and natural gas exploration and development activities, global economic growth and activity, political stability of oil-producing countries, finding and development costs of operations, decline and depletion rates for oil and natural gas wells, seasonal weather conditions, industry conditions, changes in laws or regulations, and other risk factors that are discussed below, many of which are beyond the control of the Company. Should one or more of these risks or uncertainties materialize, or should the assumptions prove incorrect, actual results may differ materially from those expected, estimated or projected. Management believes these forward-looking statements are reasonable. However, you should not place undue reliance on these forward-looking statements, which are based only on our current expectations. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to publicly update or revise any of them in light of new information, future events or otherwise.

You should consider the following important factors that could cause our actual results to differ materially from those expressed in any forward-looking statement made by us or on our behalf.

Risks Related To Our Business

The significant deterioration in the global business environment and related factors could adversely impact our financial condition and results of operations.

The deterioration in the global business environment has led to a significant reduction in commodity prices from average levels reported in 2008, which has contributed to lower cash flow generation for oil and natural gas exploration and production companies. In addition, the reduction in the availability and increased cost of financing which began in the second half of 2008 had a significant impact on a number of our customers. These factors, if continued or worsened, could contribute to a sustained or further decline in our customers' spending levels. As a result, we must manage our costs, including our workforce levels, to match the decline. A continued reduction in the level of future investment or our inability to reduce our costs sufficiently to match the material slowdown in drilling activity could have a material adverse effect on our results of operations, financial condition and cash flows.

Moreover, if the business environment experiences a significant deterioration from current levels, we may be required to record goodwill and/or other intangible asset impairment losses, which could have a material adverse effect on our results of operations and financial condition and our compliance with applicable debt covenants.

The financial and credit market environment may limit our ability to expand our business through acquisitions and to fund necessary expenditures.

The global financial and credit market environment has, at times, limited the availability of financing and increased costs when available. Any inability to access the credit and capital markets could limit our ability to make significant business acquisitions and pursue business opportunities. On February 21, 2010, we and Schlumberger entered into an Agreement and Plan of Merger pursuant to which a wholly-owned subsidiary of Schlumberger will merge with and into us and we will become a wholly-owned subsidiary of Schlumberger. If the Merger is not consummated, either we or our M-I SWACO joint venture partner, Schlumberger, can offer to sell to the other party its entire ownership

interest in the joint venture in exchange for a cash purchase price specified by the offering partner. If the initiating partner's offer to sell is not accepted, such party is obligated to purchase the other party's interest at the same valuation per interest. If we agree to purchase Schlumberger's joint venture interest, whether pursuant to these provisions or otherwise, we would need to fund the transaction. Our funding could include issuing equity, resulting in dilution to our existing stockholders, obtaining additional debt, which may require waivers of applicable debt covenants, or obtaining other financing, as well as using available cash to fund the purchase. This financing and/or use of cash could impact our ability to fund working capital requirements, make capital

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expenditures and investments or fund other general corporate requirements, and could limit our ability to make future acquisitions. Should we instead not purchase Schlumberger's interest, we would no longer have an interest in the joint venture. The failure to pursue significant acquisition opportunities, or the consequences of seeking waivers, issuing equity or obtaining other financing, could have a material adverse effect on our future results of operations, financial condition and cash flows.

We are dependent on the level of oil and natural gas exploration and development activities.

Demand for our products and services is dependent upon the level of oil and natural gas exploration and development activities. The level of worldwide oil and natural gas development activities is primarily influenced by the price of oil and natural gas, as well as price expectations. The current state of world economies could lead to further weakness in exploration and production spending levels, further reducing demand for our products and services and adversely impacting future results. In addition to oil and natural gas prices, the following factors impact exploration and development activity and may lead to significant changes in worldwide activity levels:

overall level of global economic growth and activity;

actual and perceived changes in the supply of and demand for oil and natural gas;

political stability and policies of oil-producing countries;

finding and development costs of operators;

decline and depletion rates for oil and natural gas wells;

seasonal weather conditions that temporarily curtail drilling operations; and

laws and regulations related to environmental or energy security matters, including those addressing alternative energy sources and the risks of global climate change.

Changes in any of these factors could adversely impact our financial condition, results of operations or cash flows.

A significant portion of our revenue is derived in markets outside of North America.

We are a multinational oilfield service company and generate the majority of our oilfield-related revenues in markets outside of North America. Changes in conditions within certain countries that have historically experienced a high degree of political and/or economic instability could adversely impact our operations in such countries and as a result our financial condition, results of operations or cash flows. Additional risks inherent in our non-North American business activities include:

changes in political and economic conditions in the countries in which we operate, including civil uprisings, riots and terrorist acts;

unexpected changes in regulatory requirements affecting oil and natural gas exploration and development activities;

fluctuations in currency exchange rates and the value of the U.S. dollar;

restrictions on repatriation of earnings or expropriation of property without fair compensation;

governmental actions that result in the deprivation of contract or proprietary rights in the countries in which we operate; and

governmental sanctions.

We operate in a highly technical and competitive environment.

We operate in a highly competitive business environment. Accordingly, demand for our products and services is largely dependent on our ability to provide leading-edge, technology-based solutions that reduce the operator's overall cost of developing energy assets and to commercialize performance-driven new technology. If competitive

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or other market conditions impact our ability to continue providing superior-performing product offerings, our financial condition, results of operations or cash flows could be adversely impacted.

Regulatory compliance costs and liabilities could adversely impact our earnings and cash available for operations.

We are exposed to a variety of federal, state, local and international laws and regulations relating to matters such as the use of hazardous materials, health and safety, labor and employment, import/export control, currency exchange, bribery, corruption and taxation, and the environment, including laws and regulations governing air emissions, wastewater discharges and waste management. These laws and regulations are complex, change frequently and have tended to become more stringent over time. In the event the scope of these laws and regulations expand in the future, the incremental cost of compliance could adversely impact our financial condition, results of operations or cash flows. For example, the adoption of more stringent laws and regulations that curtailed either directly or indirectly the level of oil and natural gas exploration and development activities could adversely affect our operations by limiting demand for our products and services.

Our industry is experiencing more litigation involving claims of infringement of intellectual property rights.

Over the past years, the industry in which we operate has experienced increased litigation related to the infringement of intellectual property rights. Although no material matters are pending or threatened at this time, we, as well as certain of our competitors, have been named as defendants in various intellectual property matters in the past. These types of claims are typically costly to defend, involve the risk of monetary judgments that, in certain circumstances, are subject to being enhanced and are often brought in venues that have proved to be favorable to plaintiffs. If we are served with any intellectual property claims that we are unsuccessful in defending, it could adversely impact our results of operations, financial condition and cash flows.

Our business operations in countries outside the United States are subject to a number of U.S. federal laws and regulations, including restrictions imposed by the Foreign Corrupt Practices Act as well as trade sanctions administered by the Office of Foreign Assets Control and the Commerce Department.

Our business operations in countries outside the United States are subject to a number of U.S. federal laws and regulations, including restrictions imposed by the Foreign Corrupt Practices Act (FCPA) as well as trade sanctions administered by the Office of Foreign Assets Control (OFAC) and the Commerce Department. The FCPA is intended to prohibit bribery of foreign officials or parties and requires public companies in the United States to keep books and records that accurately and fairly reflect those companies' transactions. OFAC and the Commerce Department administer and enforce economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign states, organizations and individuals. If we fail to comply with these laws and regulations, we could be exposed to claims for damages, financial penalties, reputational harm, and incarceration of our employees or restrictions on our operations. We have received an administrative subpoena with respect to our historical business practices in Iran and Sudan. We are conducting a review of our business activities involving Iran and Sudan, and are actively pursuing the termination of all business activities in Iran and Sudan. While the nature and scope of issues that may emerge from this review are yet to be determined, there is a risk that we could identify violations of U.S. sanctions laws, which if pursued by regulatory authorities, could result in administrative or criminal penalties which in certain circumstances could adversely impact our results of operations, financial condition and cash flows.

Our business may be affected by market or regulatory responses to climate change.

Climate change and greenhouse gas emissions are the subject of a significant attention within and outside the United States. Future environmental regulatory developments (such as restrictions, caps, taxes, or other controls) could adversely influence the cost of and demand for oil and natural gas. A reduction in demand for these commodities may

result in a decline in exploration and production spending by our customers, which in turn could adversely impact demand and pricing for our products and services. Additionally, restrictions on emissions or other climate change related mandates could result in significant increases in the cost of our goods and services. There is no assurance that in response to escalating expenses, we could increase our prices to customers sufficiently to mitigate the financial impact

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of such cost expansion. These factors, individually or together, or other unforeseen impacts of climate change regulation could have a material adverse effect on our results of operations, financial condition and cash flows.

Risks Related to the Pending Merger with Schlumberger

Our ability to complete the Schlumberger Merger is subject to stockholder approval, certain closing conditions and the receipt of consents and approvals from government entities which may impose conditions that could adversely affect us or cause the Merger to be abandoned.

The Merger Agreement contains certain closing conditions including approval of the Merger by Smith stockholders, the absence of injunctions or other legal restrictions and that no material adverse effect shall have occurred to either company. In addition, we will be unable to complete the merger until we receive approvals from the Department of Justice, the Federal Trade Commission, the European Commission and various other governmental entities. Regulatory entities may impose certain requirements or obligations as conditions for their approval. The Merger Agreement may require us to accept conditions from these regulators that could adversely impact the combined company. We can provide no assurance that we will satisfy the various closing conditions and obtain the necessary approvals or that any required conditions will not materially adversely affect us following the Merger. In addition, we can provide no assurance that these conditions will not result in the abandonment or delay of the Merger.

Failure to complete the Merger could negatively impact us.

If the Merger is not completed, our ongoing businesses and the market price of our common stock may be adversely affected and we will be subject to several risks, including being required, under certain circumstances, to pay a termination fee of \$340 million; having to pay certain costs relating to the proposed merger, and diverting the focus of management from pursuing other opportunities that could be beneficial to us, in each case, without realizing any of the benefits of having the Merger completed.

The pendency of the Merger could adversely affect us.

In connection with the pending Merger, some of our customers may delay or defer purchasing decisions, which could negatively impact our revenues, earnings and cash flows regardless of whether the Merger is completed. Additionally, we have agreed in the Merger Agreement to refrain from taking certain actions with respect to our business and financial affairs during the pendency of the Merger, which restrictions could be in place for an extended period of time if completion of the Merger is delayed and could adversely impact our financial condition, results of operations or cash flows.

The combined company could incur substantial expenses related to the integration of the Company and Schlumberger.

We expect that the combined company will incur substantial expenses in connection with integrating our business, policies, procedures, operations, technologies and systems with those of Schlumberger. There are a large number of systems that must be integrated, including information management, purchasing, accounting and finance, sales, billing, payroll and benefits, fixed asset and lease administration systems and regulatory compliance. While we have assumed that a certain level of expenses would be incurred, there are a number of factors beyond the control of Schlumberger or us that could affect the total amount or the timing of all of the expected integration expenses. Moreover, many of the expenses that will be incurred, by their nature, are difficult to estimate accurately at the present time. These expenses could, particularly in the near term, exceed the savings that we expect to achieve from the elimination of duplicative expenses and the realization of economies of scale and cost savings and revenue enhancements related to the integration of the businesses following the completion of the Merger. These integration

expenses may result in the combined company taking significant charges against earnings following the completion of the Merger.

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Following the Merger, the combined company may be unable to successfully integrate our business and Schlumberger's business and realize the anticipated benefits of the Merger.

The Merger involves the combination of two companies which currently operate as independent public companies. The combined company will be required to devote management attention and resources to integrating its business practices and operations. Potential difficulties the combined company may encounter in the integration process include the following:

the inability to successfully integrate our business into Schlumberger's business in a manner that permits the combined company to achieve the cost savings and operating synergies anticipated to result from the Merger, which would result in the anticipated benefits of the Merger not being realized partly or wholly in the time frame currently anticipated or at all;

lost sales and customers as a result of certain customers of either of the two companies deciding not to do business with the combined company;

integrating personnel from the two companies while maintaining focus on providing consistent, high quality products and customer service;

potential unknown liabilities and unforeseen increased expenses, delays or regulatory conditions associated with the Merger; and

performance shortfalls at one or both of the two companies as a result of the diversion of management's attention caused by completing the Merger and integrating the companies' operations.

In addition, we and Schlumberger have operated and, until the completion of the Merger, will continue to operate, independently. It is possible that the integration process could result in the diversion of each company's management attention, the disruption or interruption of, or the loss of momentum in, each company's ongoing businesses or inconsistencies in standards, controls, procedures and policies, any of which could adversely affect our ability to maintain relationships with customers and employees or our ability to achieve the anticipated benefits of the Merger, or could reduce the earnings or otherwise adversely affect the business and financial results of the combined company.

We and Schlumberger may be unable to retain key employees.

In connection with the pending Merger, our current and prospective employees may experience uncertainty about their future roles with the combined company following the Merger, which may materially adversely affect our ability to attract and retain key personnel during the pendency of the Merger. Additionally, our success after the Merger will depend in part upon our ability to retain key Schlumberger and Smith employees. Key employees may depart either before or after the Merger because of issues relating to the uncertainty and difficulty of integration or a desire not to remain with us following the Merger. Accordingly, no assurance can be given that we will be able to retain key employees to the same extent that we or Schlumberger have been able to in the past.

Item 1B. *Unresolved Staff Comments*

None.

Item 2. *Properties*

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The Company is headquartered in Houston, Texas and owns or leases numerous facilities in the United States and other countries in which we operate.

The Company's principal manufacturing plants are located in: United States – Houston and Odessa, Texas, Ponca City and Tulsa, Oklahoma, Florence, Kentucky, Macon, Georgia, Provo, Utah, and Rancho Cucamonga, California; South America – Neuquen and Villa Regina, Argentina; Europe – Aberdeen and Edinburgh, Scotland, Berra, Saline and Scurelle, Italy, and Nivellas, Belgium; and Middle East/Asia – Jebel Ali, Dubai, and Changzhou, China.

The Company's major mines and ore, drilling fluid and production chemical processing centers are located in: United States – Battle Mountain, Greystone and Mountain Springs, Nevada, Greybull, Wyoming, Amelia and Port

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Fourchon, Louisiana, and Galveston, Texas; Canada Spruce Grove, Alberta; and Europe Aberdeen, Foss and
Aberfly, Scotland, Karmoy, Norway, and Salzweld, Germany.

The principal distribution facilities of pipe, valves and fittings are located in: United States LaPorte, Texas, Long
Beach, California and South Plainfield, New Jersey; Canada Edmonton, Alberta.

The Company