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EDITED TRANSCRIPT

Q1 2019 Schlumberger NV Earnings Call

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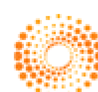

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Schlumberger earnings conference call. (Operator Instructions) As a reminder, today's call is being recorded. I would now like to turn the conference over to our host, Vice President of Investor Relations, Mr. Simon Farrant. Please go ahead.

Simon Farrant ***Schlumberger Limited - VP of IR***

Good morning, good afternoon, and welcome to the Schlumberger Limited First Quarter 2019 Earnings Call.

Today's call is being hosted from Quito, Ecuador, following the Schlumberger Limited board meeting.

Joining us on the call are Paal Kibsgaard, Chairman and Chief Executive Officer; Simon Ayat, Chief Financial Officer; and Olivier Le Peuch, newly appointed Chief Operating Officer. We will, as usual, first go through our prepared remarks, after which we'll open up for questions.

For today's agenda, Simon will first present comments on our first quarter financial performance before Olivier reviews our results by geography. Paal will close our remarks with a discussion of our technology portfolio and our updated view of the industry macro.

However, before we begin, I'd like to remind our participants that some of the statements we'll be making today are forward-looking. These matters involve risks and uncertainties that could cause our results to differ materially from those projected in these statements. I, therefore, refer you to our latest 10-K filings and other SEC filings.

Our comments today may also include non-GAAP financial measures. Additional details and reconciliations to the most directly comparable GAAP financial measures can be found in our first quarter press release, which is on our website.

(Operator Instructions) Now I'll hand the call over to Simon Ayat.

Simon Ayat ***Schlumberger Limited - Executive VP & CFO***

Thank you, Simon. Ladies and gentlemen, thank you for participating in this conference call.

First quarter earnings per share was $0.30 excluding charges and credits. This represents a decrease of $0.06 sequentially and $0.08 when compared to the same quarter last year. There were no charges or recredit recorded during this quarter.

Our first quarter revenue of $7.9 billion decreased 4% sequentially largely driven by seasonal declines. Pretax operating margin decreased by 30 basis points to 11.5%.

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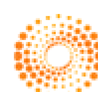

Highlights by broad product group were as follows: First quarter Reservoir Characterization revenue of $1.5 billion decreased 7% sequentially due to a seasonal decline in Wireline activities, primarily in Russia, and lower SIS software and multiclient license sales following their traditionally strong fourth quarter performance. Margin decreased 308 basis points to 19% due to the lower contribution from Wireline, SIS, and multiclient.

Drilling Group revenue of $2.4 billion decreased 3% sequentially driven by seasonally lower drilling activity in the International Area. Margins were essentially flat at 12.9%.

Production Group revenue of $2.9 billion decreased 2% sequentially due to a decline in OneStim revenue in North America land. Margins improved slightly by 76 basis points to 7.5%.

Cameron Group revenue of $1.2 billion decreased 7% sequentially. This decrease was primarily due to lower project volumes and reduced product sales of long-cycle businesses of OneSubsea and Drilling Systems. Lower Surface System revenue also contributed to the decline.

Despite the revenue declines, margin increased 161 basis points to 11.6% driven by improved profitability in Drilling Systems and Valves & Measurements. The book-to-bill ratio for Cameron long-cycle business was 1.5 in Q1. The OneSubsea backlog increased to $2.1 billion at the end of the first quarter.

Now turning to Schlumberger as a whole. The effective tax rate excluding charges and credits was 15.5% in the first quarter. This was essentially flat with the previous quarter.

Our corporate and other expense line item increased sequentially by $35 million to $273 million in Q1. This increase was largely attributable to certain exceptional accounting for stock-based compensation cost in the quarter. In the second quarter, we expect these costs to return to a level more in line with where we were in Q4.

We just recently completed a very successful debt exchange offer. As a result, we issued $1.5 billion of notes due in 2028 that bear interest at 3.9%. These new notes were exchanged for a similar amount of notes that were scheduled to be repaid in 2020, 2022, and 2025. This debt exchange, combined with other refinancing activities we completed during the quarter, serves to improve our debt maturity profile going forward.

As a result, the net interest expense at the corporate level is expected to increase by approximately $10 million to $15 million next quarter.

We generated $326 million of cash flow from operations during the first quarter. This is despite the consumption of working capital that we typically experienced during the first quarter, which is driven by the annual payments associated with employee compensation. Our inventory levels also increased in anticipation of higher activity levels in the coming quarters.

Our net debt increased $1.1 billion during the quarter to $14.4 billion. We ended the quarter with total cash and investment of $2.2 billion.

During the quarter, we spent $98 million to repurchase 2.3 million shares at an average price of $42.79. Other significant liquidity events during the quarter included: capex of approximately $413 million; and capitalized costs relating to SPM projects of $151 million. During the quarter, we also made $692 million of dividend payment.

Full year 2019 capex, excluding SPM and multiclient investments, is still expected to be approximately $1.5 billion to $1.7 billion.

And now I will turn the conference call over to Olivier.

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Olivier Le Peuch ***Schlumberger Limited - COO***

Thank you, Simon, and good morning, everyone. I am very pleased to be here today in my new role to give you an update on our global operations. I would like to start with our international business with Reservoir Characterization, Drilling, and Production combining to deliver year-on-year revenue growth of 8% for the first quarter of 2019. This year-over-year increase was led by Latin America, Africa, and Asia where we continue to see a ramp-up in activity supporting our expectations of high single-digit international revenue growth for the year.

My comments on geographies will exclude Cameron, which I will discuss separately. In Latin America, revenue increased 7% sequentially, driven by strong growth in the Mexico & Central America GeoMarket, which posted nearly 50% year-over-year revenue growth. This was driven by high offshore exploration-related activity for the international operators, multiclient seismic sales, and intensifying onshore IDS work for PEMEX.

In the Latin America North GeoMarket, revenue increased from higher SPM activity together with increased production from the Shaya Field in Ecuador where, over the course of last year, we have ramped up the water injection program. We're extremely pleased with the progress of this SPM project, as it does position the Shaya field as a top oil-producing Field in Ecuador.

In Argentina, revenue increased slightly from improved efficiency of hydraulic fracturing and SPM activity. On the SPM shale-oil pilot in Bandurria Sur Block, drilling time has been reduced by 20% in the first year of activity, and four of our new wells ranked within the top 10 producers of all wells drilled in Vaca Muerta. Impressive results, much to the credit of the integrated project approach, application of the reservoir domain knowledge, and finally, the deployment of new technology.

Seasonal activity slowdowns in Europe, CIS, and Africa decreased revenue 5% sequentially, primarily in the Russia & Central Asia. Lower seasonal activity in the North Sea was compounded by weather and maintenance-related delays. This was partially offset by the very successful startup of an IDS project in Turkey and strong coiled tubing activity in Ukraine.

Revenue in Sub-Sahara Africa was slightly lower sequentially due to reduced product sales in Mozambique and Angola. Despite this, the Sub-Sahara Africa GeoMarket increased revenue 30% year-over-year, from increasing activity on exploration projects, resulting in new technology uptake and multiclient seismic licensing.

Though revenue in the Middle East & Asia decreased 4% sequentially, IDS projects activity across the area continued to grow. LSTK projects in Saudi Arabia are progressing, with the first full quarter of drilling, from all the 25 rigs mobilized last year.

During the quarter, we drilled no less than 30 wells, equivalent to a third of the total number of wells drilled last year. These projects are moving up the learning curve with improved efficiency and new technology deployments. However, some are currently dilutive to area margins. The Saudi Arabia results were also affected by unusual flooding that delayed WesternGeco land seismic operations.

In South East Asia GeoMarket, India revenue increased also on higher IDS activity. The Far East Asia experienced a sequential revenue decrease, with activity slowdown in Australia, due to cyclone season. This was offset partially by operations in China, which performed better than expected, due to milder winter weather conditions. Overall, Far East Asia and Australia GeoMarket showed strong year-on-year revenue growth of 27%.

Now let us turn to North America. Our first quarter revenue in North America was 4% lower on a sequential basis, excluding Cameron, from the combination of lower overall activity and weaker pricing for both our hydraulic fracturing and drilling-related business, while our artificial lift revenue was flat. Although hydraulic fracturing stage count in North America land increased nearly 5% sequentially, largely from the Western Canada winter ramp-up, softer pricing pushed overall revenue sequentially lower.

However, if we look closer into our OneStim operation, we can see that effective cost management and operational agility have supported productions margin. Late last year, as the WTI oil price collapsed, we warm-stacked frac fleets and accelerated in Q1 tendering season to bridge the year-end activity decline. The redepoloyment of these fleets under our new contracts during January combined with

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our vertically integrated supply chain, operational efficiency, and cost control, effectively protected margins. Pricing, however, remains depressed, with limited visibility into the second half of the year. Our approach for frac fleet deployment this year is operational flexibility focused on improving returns and cash generation.

North America offshore revenue was flat sequentially with increased wireline activity in the Gulf offset by lower multiclient seismic sales. As an example, I would like to highlight the deepwater project for our customer in the Gulf of Mexico, where we have significantly reduced drilling and well construction time using new technology and a collaborative business model. This project resulted in six of the most complex wells ever drilled in the Gulf, yet reducing operational cost by over 40%, and accelerating project execution by eight months, hence, generating significant value for our customer.

As the offshore development and exploration markets gradually recover, we will focus on deploying new technology that impact the operational performance for the benefit of our customers.

Finally, I would like to discuss the results of Cameron. Cameron revenue was down sequentially following the usual strong year-end sales. The sequential decline in revenue was 7%, most of which was in international markets, offset partially by sequential increase in North America.

With this backdrop, we continue to see the trend of strong OneSubsea bookings that began in the second half of last year, keeping the book-to-bill ratio materially above one. These bookings included one major multiphase boosting solution highlighting the success of this technology for short-cycle offshore projects, particularly with tiebacks.

Together with our partner Subsea 7, we were also awarded two integrated projects during last quarter. We are very pleased with the progress of the Subsea Integration Alliance and continue to receive excellent feedback from our customers on projects under joint execution.

Cameron Surface Systems revenue declined on lower activity in Australia and Southeast Asia while bookings were up slightly year-over-year. Short-term growth is currently driven by the uptake of wellhead technology and frac services for North America land and Argentina customers.

Cameron Drilling Systems declined sequentially, following strong product and service delivery during the fourth quarter in North America. By contrast, Valves & Measurements revenue was up on strong demand from distributors, stocking inventory to support upcoming completions activity and the continued upstream infrastructure build-out of Permian takeaway capacity.

The Cameron Group margins did increase sequentially in Q1 2019 through improved project execution and fall-through from the North America product sales. We did comment earlier that the trough of the cycle for both Cameron revenue and margins will happen during the first half of 2019, I believe that the current momentum on margins recovery and book-to-bill ratio will confirm that we are on the right path.

To conclude, we have started the year on a very positive note, with 10 of the 16 GeoMarkets showing double-digit year-on-year revenue growth. Some of these were GeoMarkets that had experienced the greatest revenue compression, they are now seeing stronger activity trends that support our high single-digit revenue growth outlook for international market this year.

And with that, I will turn the call over to Paal.

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Thank you, Olivier. Following the review of the Cameron Group results, let me next comment on the first quarter performance of the Reservoir Characterization, Drilling, and Production Groups.

In Reservoir Characterization, our Wireline business recorded a year-over-year increase in exploration-related revenue of 17% in the first quarter. That's below the total of 105 offshore exploration wells, which is 40% higher than the first quarter of last year.

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New technology sales in Wireline were also up significantly, reaching 31% of total revenue, driven by our newly introduced reservoir fluid sampling and pressure measurement services, which are essential to reservoir description in both exploration and development wells.

In other exploration-related activities, multiclient seismic sales remain solid in the first quarter, while they also showed solid year-over-year growth in Testing Services, and we expect our exploration-related product lines to continue to build momentum over the course of this year.

In the Drilling Group, new technology sales were again strong, driven by Drilling & Measurements, where we, in the first quarter, posted a 50% year-over-year increase in footage drilled for our latest generation of rotary steerable technologies. We also recorded 20% year-over-year growth in footage drilled for our total rotary steerable systems offering, which now comprises five customized technology solutions that effectively cover all our key markets around the world, with particular focus on the Middle East, the North Sea, the Permian, and DJ basins in the US land, and the Sichuan and Tarim Basins in China. Still the largest contributor to the 12% increase in year-over-year revenue growth for the Drilling Group was our Integrated Drilling Services projects. At present, all the rigs we deployed in 2018 are now fully operational and steadily advancing up the learning and performance curve in our various projects.

In the first quarter, we saw very strong performance improvements in our IDS projects in Latin America, while in the Middle East & Asia, challenging drilling conditions on some projects partly offset solid efficiency improvements on others. Still, we have clearly established technology and process improvement plans for all our integrated drilling projects, and we expect our IDS product line to be accretive to Drilling Group margins by the time we exit 2019.

In the Production Group, we have over the past 4 years significantly built out our technology offering and our presence in the global production market, and through that further expanded the growth platform for Schlumberger going forward. This includes our artificial lift and coiled tubing businesses where we today are global market leaders; completion products, where we, in addition to our leadership position in the high-end market, continued to build out our land offering through organic R&E investments; and hydraulic fracturing, where we are now have established the needed scale and execution expertise to effectively compete in the North America land market.

Our focus going forward for the Production Group is now to deliver improved financial returns in all parts of our global operations after having completed our multiyear investment program. We will do that by reaping the benefits of our modernized operating platform and by deploying a rich set of new technologies that drive cost efficiency and quality for both our operations and for our customers.

In line with this focus, we are pleased with the first quarter sequential margin performance in the Production Group, and we expect to see continued progress in both operating margins and earnings contribution from our production-related businesses going forward.

As we continue to build the top line growth momentum in our overall international business, we are now also actively deploying our well-defined playbook focused on increasing incremental margins. Looking closer at our first quarter results, around half of our international legacy revenue is already producing highly accretive year-over-year incremental margins, driven by new technology sales, solid contractual terms and conditions, higher volume of activity and the benefits from our internal modernization program while still excluding any material price book increases.

Around a quarter of our international legacy revenue is yielding moderately accretive incremental margins impacted by lower base pricing, and so far, less scale and efficiency benefits, while the last quarter of our international legacy revenue is at present highly dilutive to both current and incremental operating margins, due to low pricing on favorable contractual terms and lack of critical mass. At present, this remains the most noticeable headwind to our international financial performance. Granted, we have, over the past few years, knowingly decided to enter into these contracts in order to protect our geographical footprint and provide future business opportunities and optionality. Still, most of these low-return contracts are callout-based, which means there is no firm scope offered from our customers, and we are, hence, free to respond to their callout request based on our available capacity, which today is already stretched.

As for capital deployment, we maintain our capex guidance of $1.5 billion to $1.7 billion for 2019 with our capex deployment being

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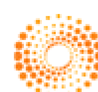

entirely focused on the half of our international revenue that is already yielding the required incremental margins.

For the other half of our international business, our near-term priority is to engage with our customers to establish pricing, contractual terms, and a work scope that will provide us with the opportunity to quickly establish the needed financial returns. As part of this process, we will look to high-grade our contract base as needed and potentially redeploy existing capacity to contracts and customers who offers higher profitability until operating and incremental margins also have reached the required levels. Only at that stage will we consider deploying fresh capital into this part of our international business.

Turning lastly to the industry macro where we continue to expect oil market sentiments to steadily improve over the course of 2019. Our view is backed by a solid demand outlook, the full effects of the OPEC and Russian production cuts, the slowing shale oil production growth in North America, and the further weakening of the international production base as the impact of four years of underinvestment becomes increasingly evident. The recent strength in the price of crude oil, with Brent again breaking through the $70 per barrel level, is supporting this outlook.

We also see clear signs that E&P investment sentiments are starting to normalize as the industry heads towards a more sustainable financial stewardship of the global resource base. Directionally, this means higher investments in the international markets, simply to keep production flat, while North America land activity is set for lower investments with a likely downward adjustment to the current production growth outlook.

In the international markets outside the Middle East and Russia, the inevitable production decline resulting from the record-low investment levels seen in the past four years is now becoming increasingly visible. First quarter oil production in the international markets outside OPEC was down 400,000 barrels a day versus Q1 of 2018 and 900,000 barrels a day versus Q1 of 2017. While the underlying decline in the aging production base in key oil-producing countries such as Norway, UK, Brazil, and Nigeria has so far been offset by new project startups, the need for a stronger supply-side response is becoming increasingly evident.

Strong new investments are also needed in countries like Mexico, Angola, Indonesia, and China where total production has been in noticeable decline for several years. Within this industry backdrop, we continue to execute our plan for 2019, targeting high single-digit international revenue growth with a business focus and capital deployment strategy as I have already outlined.

Looking at the first quarter, the growth in the international rig count, both on land and in particular offshore, the rise in the number of new project FIDs and subsea tree awards and a renewed interest in exploration is all supporting our outlook. Conversely, in North America land, the higher cost of capital, lower borrowing capacity, and investors looking for increased returns suggest that future E&P investments will likely be at levels dictated by free cash flow. We, therefore, see land E&P investment in North America down 10% in 2019.

In addition to the lower investments, increasing technical challenges from well interference, step-out from core acreage, and limited further growth in lateral length and proppant per stage, points to a more moderate growth rate in the US shale oil production in the coming years.

The normalization of global E&P spending with increased international market investment and a reduction in North America land capex represents a positive market shift for Schlumberger, and we welcome the return of a very familiar opportunity set given our unmatched global strength.

With the efforts in investments we have made in recent years to modernize our execution platform, expand our technology offering, drive digital and technology system innovation, evolve our business models, and strengthen our global footprint, we are better positioned than ever to capitalize on the opportunity set we now have in front of us, which at present is the overriding goal of the entire Schlumberger organization.

That concludes our prepared remarks. Thank you very much. We will now open up for Q&A.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question is from the line of James West with Evercore ISI.

James Carlyle West ***Evercore ISI Institutional Equities, Research Division - Senior MD***

So Paal, it appears you've got the Board down in Latin America, in Quito right now. I'm curious similar to when you've held Board meetings in Saudi and Moscow and other places, there's usually a build up to the actual meeting, a lot of stuff that you guys do and see and talk about on the operational side. Could you maybe give us some color on what the Board saw, what you guys did this week in Quito or broader Latin America?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Yes. Thanks, James. So as you know, as you said, we always conduct our April Board meeting in one of our operating R&D locations. Last year, we were in Silicon Valley. And in previous years, as you referenced, we've been in Saudi and Moscow. So this year, we picked Ecuador mainly because we have a big operation here. We have three major SPM projects, which we review regularly with the Board. So part of the objective of our meeting in Ecuador this week is for the Board to see the projects up close and also meet the great people we have on the ground here, both executing these projects and also supporting the rest of our operations in Ecuador and in Latin America North. Now, in addition to this, we also have an excellent working relationship with the Ecuadorian state oil company, Petroamazonas, as well as the key ministries. So part of the purpose of this week's visit as well is to reinforce our commitment and strong ties to Ecuador and have the Board meet some of the key external stakeholders. So we are spending a couple of days in Quito concluding the Board meeting. Then we're also going to the field to give the Board a firsthand look at some of our operations. So this is in line with what we do in the April Board meeting.

James Carlyle West ***Evercore ISI Institutional Equities, Research Division - Senior MD***

Got you. Okay. And then, Paal, you talked about in the press release and in your prepared comments about higher returns. We did notice a change -- some changes to the proxy as it came out. And how was Schlumberger -- how are you guys thinking about focusing on driving higher returns as the industry gets back to more normalized spending patterns?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

So, I mean, if you look at the focus we have as a company, today, growing the top line is obviously the key to all that what we do. But beyond that, getting our return on capital employed and our operating margins back up to the levels we had in 2014 is a key objective. Higher revenue is going to be part of it. But beyond that, it is being very prudent in how we deploy capital and also how we manage costs in the operation as we now start to grow. And beyond that, we will also need to get some of our pricing concessions back in order to drive profitability. So we have a very comprehensive playbook and focus on this to drive all these aspects of returns in addition to the cash flow, which we are in the midst of deploying and focusing on in 2019. It is reflected in the objectives of the senior management team and also in the day-to-day activity of what we do.

Operator

Next we go to line of Angie Sedita with Goldman Sachs.

Angeline Marie Sedita ***Goldman Sachs Group Inc., Research Division - Research Analyst***

Nice to see a solid quarter here. So maybe, Paal, we can go into your comments that you made on the international market as well as what was in the press release and give us a little bit of color and maybe specifics around your visibility for high single, double-digit revenue growth in international markets and maybe in the context of normalized spending, exploration spending, and the technology take up.

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Yes. Thanks, Angie. So I would say high-level summary, the year has started off, internationally, pretty much in line with what we were expecting. So we have indicated high single-digit revenue growth for us internationally. And with the 8% we posted in Q1, I think we are pretty much in line with that outlook. The key driver for this year-over-year growth is offshore, in particular shallow water. We've seen about a 20% increase in shallow water rig count year-over-year Q1 to Q1, which is obviously very good for us. We still have a very strong

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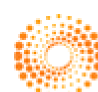

position in these markets. But in addition to this, we're also seeing a renewed focus on offshore exploration. I referenced some of the Wireline information that obviously is a key proxy for how we do in offshore exploration. So this is also very good news. Where we see the revenue growth coming, it is going to still be from the areas where we have had the highest revenue compression like Latin America, Africa, and Asia. But also in the North Sea, Russia, and the Middle East, we expect to see solid revenue growth off a large revenue base in these areas, right? So what's going to drive the year is offshore and with some increased focus that we see on exploration as well. And what's driving the offshore, I think, is there's a rich opportunity set around four cycle projects. And we also see now that the number of FIDs is increasing fairly rapidly. There was about 50 offshore FIDs last year, and we see now, on the horizon, about 80 of this year. And these are not only step-outs and brownfield kind of upgrades. This is also greenfield activity. So I think we have a fairly reasonable visibility on the year. And so far, it shaped up pretty much in line with what we were expecting.

Angeline Marie Sedita ***Goldman Sachs Group Inc., Research Division - Research Analyst***

Okay. That's very helpful. And I guess as a follow-up, two items, is do you think that we're going to see a shift? You talked about shallow water 20% growth year-over-year. Do you think we're going to see a shift as we go into '19 and '20 to more deepwater? And then can you also touch on the confidence around pricing opportunities around the world, both land and offshore internationally?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Yes. I think it's a bit early to kind of make those, I would say, projections on deepwater. We are seeing some increase in deepwater exploration, but I would say that the 2019 will be shallow water. And I think as that continues to mature, I expect that we will see more on deepwater in 2020 and beyond.

Operator

And we will move on to a question from the line of Scott Gruber with Citigroup.

Scott Andrew Gruber ***Citigroup Inc, Research Division - Director and Senior Analyst***

So I want to follow on Angie's question and stay on the international side, looking at the growth potential. I'm really curious about how you see long-term growth shaping up. So if we paint a scenario and take a look at the forward curve, its accrued space around the $65 to $70 level on Brent. How many years of reasonable growth, call it, mid-single-digit can be reasonably expected as reinvestment rates normalize, and I'm assuming no major change in crude?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Well, I think if you look at where investment levels were back in the period, 2010 to 2014, obviously internationally now we are still almost around half of those investment levels. And if you were to say that the new normal is somewhere in between where we are and where we used to be, you still need multiple years of not even single-digit but probably double-digit growth in order to get back to the -- even the halfway point between investment levels in 2014 and investment levels as of today. So we still see a fairly decent runway for increased international investments. And you also see the need for this in the production declines that we are now seeing in the mature production base internationally.

Scott Andrew Gruber ***Citigroup Inc, Research Division - Director and Senior Analyst***

Got it. And you guys did a great job on margin performance in the first quarter, and I appreciate all the color on margins and the drivers of margins going forward this year. Can you just provide some color on the impact on incrementals going forward? Consensus says sub-30% incrementals in 2Q, and then moving to the high 30% incrementals in the second half of the year. Is it reasonable to expect incremental improvement of that order of magnitude in the second half could be better on some of the job mix and exploration and some of the start-up costs fading? Could you actually see incrementals above 40% in the second half of the year?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

That's a good question. Olivier, do you want to comment on that?

Olivier Le Peuch ***Schlumberger Limited - COO***

Yes. Thank you. So indeed, I think it's good to see that our top line sales is increasing in international market, and the mix is improving towards more offshore and more exploration. So that is certainly a play that is good and alarming for our strengths. This being said, I think the pricing environment internationally is still depressed compared to where we were and used to have in two or three or five years

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ago. And as Paal did comment, about half of our revenue is, indeed, getting a fall-through that is accretive to our margin and certainly in the expected fall-through that we have anticipated. But we still have one quarter of revenue base that is changed based on contract condition, based on execution, and based on pricing constraints that we have, highly competitive environments that is challenging us to add a full mix, that is accretive as we could hope. So we are resolute to fix and to focus on this quarter revenue that is not building the right margins. And we are hoping that this mix, with the increase offshore, increased exploration, will gradually improve our fall-through for the coming quarters, but I would not expect this to be a step change compared to what we have seen in the last two quarters.

Operator

Next we go to the line of Sean Meakim with JPMorgan.

Sean Christopher Meakim ***JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst***

I thought I'd ask a little more on Cameron. The business showed a really good order rate in the first quarter after a nice pickup in the second half of last year. I think it's maybe one of the best quarters for the industry in terms of awards that I can remember. Could you maybe give us a little more forward detail on the outlook for orders for the balance of the year, maybe a mix of small versus large opportunities and your confidence in a bottom here by the middle of the year in terms of the P&L?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Olivier, you want to comment?

Olivier Le Peuch ***Schlumberger Limited - COO***

Thank you. Good question on Cameron. So as I did comment in my prepared remark, we do see, indeed, a gradual improvement of our book-to-bill ratio, the bookings part in subsea is supported by the shift to a more FID, offshore FID. The pipeline of offshore FID is increasing. As Paal did comment earlier from 50 last year, the pipeline is in excess of 80 this year. So we do expect that the subsea trees award this year will be north of 300, similar to what we have last year. So that will fall-through into a set of bookings for integrated project or nonintegrated. So we believe that the subsea will maintain its book-to-bill full year ratio materially above one. This will include some step outs infield with existing customer, and this will include integrated new field -- larger greenfield project like the two that we have won recently with Woodside, one of which forecast development in Senegal. So we believe that the outlook is strong on the back of Subsea. With regards to Drilling Systems, I think that this is a bit different, as it is still a market where we benefited last year from quite a large set of land rig equipment and BOP take up, combined with mobilization and remobilization of deepwater rigs that we're preparing for the offshore companies. This will certainly change a bit going forward. But our land rig equipment will increase further as we step going forward. So I believe that the outlook is strong. Book-to-bill ratio above one for the remainder of the year and aligned with the subsea offshore development and, to a lesser extent, with the further mobilization of rig and the land activity being steady.

Sean Christopher Meakim ***JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst***

Great. Thank you, Olivier, for all that detail. Thinking about also the cash flow in the quarter, some of it to rely on the detail and the working capital swing was as expected. But perhaps we could just come back to your confidence level in terms of free cash flow for the year at or above 2018 levels. I think that's been the expectation that you've set out there. And looking beyond free cash, beyond the SPM divestitures that you're working towards, are there any other noncore asset sales that could be contemplated? I'm thinking of that -- a little bit in the context of Sensia JV and the SPM process that you've laid out.

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Simon, you want to comment?

Simon Ayat ***Schlumberger Limited - Executive VP & CFO***

Sure. Look, in summary, if you look at the working capital deterioration beyond what we used to see in Q1, it's basically two things: pockets of delays in receivable collection, which is not very big, but it's already sorted out itself in the second quarter; and the other one is the build of inventory, which we experienced normally in Q1, and it was higher because what you heard about Cameron book-to-bill and the preparation for the projects to come. So that's in summary, right? Normally, free cash flow in the first quarter, we struggle to keep it even because of the seasonality. Now as far as the total year is concerned, we're very confident on the free cash flow. We -- as we already reported or declared that we will satisfy all our commitments from the cash that we will generate, and it's still the case. Actually, as I see

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it, is it's slightly improving as we go with our outlook. Now you spoke about some divestitures. There are divestitures in the pipeline. We're working on them, but there is nothing concrete to tell you about the timing. But it is certainly, it will be a positive, and we're keeping this for -- further the growth of the business or anything else. As far as Sensia is concerned, Sensia, we signed it. We will hopefully close before -- by the latest by Q3, and there is about $250 million of this will be coming as part of the valuation and the split within the joint venture.

Operator

Next we move on to line of Kurt Hallead with RBC.

Kurt Kevin Hallead ***RBC Capital Markets, LLC, Research Division - Co-Head of Global Energy Research and Analyst***

So Paal, a lot of emphasis rightly so on the international market. So I might want to maybe shift to Q&A and you mentioned what's going on in North America and activity level being down 10%. It sounds like that's maybe at the lower end of what you had previously discussed. So I was wondering if you could just give us some insights. Are you getting any better visibility now that oil prices have been higher than what these E&P companies had been budgeting for? And can you give us an update? I think you idled a couple of frac crews during the course of the fourth quarter and whether or not there's been sufficient enough activity now to kind of bring those crews back in. And generally maybe just -- you talked about potential for pricing improvement internationally, so could you give us similar kind of context around pricing dynamics in the North America market?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Yes. Okay. So I will say, first of all, we see a fairly consistent discipline from the customer base at this stage around living within or at least much closer to their free cash flow. This, I think, is partly driven by the management teams as well as from the investors side. So with that, that's really what's driving our prediction of about 10% down in the E&P investments in North America land. As we go forward into the full year, visibility for the second half of the year is still fairly limited. For Q2, we are expecting the number of frac stages to go up, but a fair bit of that activity increase is going to be offset by the full impacts of the pricing concessions that we gave in the fourth quarter and the first quarter. We do expect hydraulic fracturing pricing to stabilize in terms of the bid pricing in the second quarter. Now how this is going to evolve for the second half of the year, lack of visibility, I think, is still the case. I don't think though at this stage, that if we have a further run up of the oil price we're going to see the same, a rapid increase in spending as we've seen in previous years. There might be some increase but probably not as much as we saw, for instance, in 2018. So I think that calls for another challenging year on hydraulic fracturing. Our focus here is just to continue to drive the efficiency of our operations and then focus on the commercial terms we have with our customers. And the focus here is not necessarily top line or market share. It's about margins, earnings contribution, and cash. We have no capex plans to be deployed this year for fracking. We reactivated all the warm-stacked crews that we had set aside in Q4. They are now back up and running. And we still have another eight fleets that we can deploy without any capex requirements. So that's on the frac side. On the drilling side, we saw the rig count come down a bit in Q1 as expected. It might slide a little bit further in Q2 as well. And for sure, we don't expect any major rebound in rig activity over the course of this year. So that will have some impact on our drilling business and mainly on the basic technologies. And we still see strong uptake on rotary steerable and still solid pricing and profitability on that. So it's a bit of a mixed outlook for US land. I think it's going to be a challenging year. The other thing we are focusing on is to continue to build our position in the technology dialogue with the IOCs that are ramping up both drilling and completions activities. So we're quite excited about the IOCs taking a bigger position in US land. We work very well with them in the international markets. And I think that calls for a much more rich technology discussion going forward in US land.

Kurt Kevin Hallead ***RBC Capital Markets, LLC, Research Division - Co-Head of Global Energy Research and Analyst***

I appreciate that color. Maybe as additional follow-up, the emphasis points here on offshore. I seem to recall that maybe in prior cycle periods, shallow water offshore could generate somewhere like 5x the revenue of maybe a US -- equivalent US land rig, and deepwater could be something around 10x the revenue opportunity. Given some of the changes that we've seen in the context of reservoir drilling complexity in the US land business, wondering if kind of some of those ratios kind of still -- kind of hold up. And as we're kind of hitting down that path, can you give us some insights to kind of differential growth Schlumberger may have relative to some of its peers.

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Yes. I can't confirm your numbers, although I will directionally say that the earnings, I would say potential we have internationally and whether that is on land or offshore, probably more so offshore, is obviously a lot higher than what it is in US land down to the technology,

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down to the -- just the complexity of the operating conditions. And also if you were to kind of look at the E&P dollars spent by our customers, I would for sure say that our earnings potential internationally is about 2x -- sorry, is 4x of what it is compared to our competitors mainly due to the fact that we have twice the market share and roughly twice the operating margins. So the return of international growth and in particular, the return on offshore activity and exploration is what we have been waiting for. It's been quite a while of a wait here. The last year we had growth internationally was in 2014. So this is five years of waiting. So we are more than ready for this.

Operator

Next is the line of Bill Herbert with Simmons.

William Andrew Herbert ***Simmons & Company International, Research Division - MD & Senior Research Analyst***

Yes. You mentioned in segmenting your international incrementals one half of legacy was highly accretive, one quarter was moderately accretive, one quarter was highly dilutive. Can you just segment that geographically for us. The half of the legacy international incrementals that are highly accretive, where is that being generated? Ditto for the quarter that's moderately accretive and ditto for the quarter that's highly dilutive on a regional basis.

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Thanks, Bill, for the question. So I was expecting that to come, and we're not going to give more color on it. It has to do with how we handle this from a competitive standpoint, both what product lines, what geographies. So obviously we know what this is, and we have a very good handle on how we segment the international portfolio of contracts and operations. So I don't really want to go into the details of it. We have specific plans for the contracts that fall into this fourth quartile of our international business. But I don't really want to go into the details of what it is. That wouldn't be beneficial for our business.

William Andrew Herbert ***Simmons & Company International, Research Division - MD & Senior Research Analyst***

Okay. And then similar segmentation question. Lower capital spending outlook [10%]. Referenced from the late public E&Ps, the 40% to 45% rig count. With your discussion (inaudible) KLO for profitabilities was just 40% to 45% (inaudible). Then there's 15% to 20% of rig count. And with the backdrop, oil prices up 40% to 45% year-to-date and markedly improved well economics, not only due to rising oil prices but also well cost inflations. I'm just curious as to whether you think that, that 60% of the rig count is going to be more responsive to cash flows in the second half of the year.

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Well, you're breaking off in part of the question. The way I would answer this is basically -- we see the IOCs will increase their spend, which again I think is good for us. We are obviously quite active in working with them. But we also see the majority of the market, which is still the E&Ps and the smaller E&Ps, are going to stay much closer to cash flow this year, which is really what's driving the reduction in E&P spend. So our number of kind of plus/minus down 10% is pretty much in line with some of the third-party surveys that you've seen as well. With an increase in oil prices continuing over the course of this year, there could be some improvements to this. But I think directionally, I don't see the same significant increase that we might have seen in earlier years mainly because of this newfound discipline on staying much closer to the free cash flow.

William Andrew Herbert ***Simmons & Company International, Research Division - MD & Senior Research Analyst***

Okay. And finally, do you have a comment with regard to the Q2 consensus estimate of $0.35? Do you feel comfortable with that?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Olivier, you want to comment?

Olivier Le Peuch ***Schlumberger Limited - COO***

Yes. So let me start by commenting on revenue outlook. So for Q2, we expect low- to mid-single digit sequential revenue growth in the international business. This is due to the seasonal rebound that we'll see in the North Sea and Russia in contrast with the first quarter. We expect steady growth in Middle East & Asia. And we expect a more nominal sequential growth in Africa and Latin America when we compare to what we have seen in previous quarter against the growth that we have seen. In North America, I think you heard the comment before. We expect limited sequential growth firstly, because of the seasonal breakout -- in break-up in Canada. Next because

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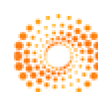

the -- if we see and have other fracturing activity up in stage counts, this will be largely offset by the impact of the lower pricing that was set during the key tendering and during Q1. So for Cameron -- that is Cameron, I think it will be a smaller limited sequential growth on the back of strong OneSubsea, offset partially by Drilling Systems and steady single-digit growth for both V&M and Surface. So that summarizes the increment of revenue from Q1 to Q2. So as it comes from the margin, we continue to improve our operational efficiency and our pricing and contractual terms with customers, so impacting the international business as we discussed. And we hope to start to impact the most dilutive lower quartile for our revenue base. But based on all this, we expect this Q2 EPS revolving towards the current Street consensus. And we don't foresee no real room, at this point, to further improvement and upside revision for that. So (inaudible).

Operator

Next we move on to the line of Jud Bailey with Wells Fargo.

Judson Edwin Bailey ***Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Research Analyst***

Paal, I was wondering if I could get your thoughts on thinking about Reservoir Characterization margins in the path, kind of for this year. First quarter was a little lighter than we thought. But with all the commentary on exploration activity and offshore being so constructive, if you could help us think about the path for margins there. And I guess specifically, is it still feasible we see margins flat maybe year-on-year? Or is there potentially upside given kind of the work scope you're seeing on the exploration and offshore front?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Yes. I would expect our Reservoir Characterization margins to continue to improve this year from what we saw last year. The characterization business should be and will be the business that is typically leading our incremental margin levels. So with the growth that we are foreshadowing, both in terms of offshore activity and even more so offshore exploration, this is all staying straight down the fairway for what we are excellent at doing in Reservoir Characterization. So I expect margins in 2019 for characterization to be up, and that they will be -- being in the leadership of driving our incremental margins in 2019.

Judson Edwin Bailey ***Wells Fargo Securities, LLC, Research Division - MD and Senior Equity Research Analyst***

Okay, I appreciate that. And then if I could, my second -- my follow-up is on capex. Question we get a lot is with the capex guidance this year. There have been concerns that you may be not investing enough in the business on a longer-term basis. Could you maybe give us your thoughts on how you're thinking about for capital spending and the sustainability of maintaining all your earnings power and investing as the cycle kind of continues to grow?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Yes. I'll comment on that. So first of all, what we've done through the modernization program is that we have opened up several new ways of driving effective capacity. In the past, typically, one unit of activity was served by one unit of additional capex. At this stage now, we have done three ways of serving our additional activity growth. One is through capex, but only a subset will be served by new capex. The other one is through the underlying efficiency improvements from the modernization program, and they will be much more visible when we start growing, which is the fact now. And then the third thing that we are also getting much better at, and that is to drive capacity also through higher opex. That could be through running more maintenance shifts to improve our investments, operating investments in logistics to get higher returns, and so forth. So first, we have a much more balanced view on how to drive full-cycle capacity. And obviously the advantage of efficiency improvements and opex-derived capacity is that you can manage that much better in the full cycle. Now for 2019, what we try to do with breaking down the international revenue base, which is basically where we are deploying all our capex this year, it is to show that where we are growing at good incremental margins and good base returns, we are investing. And we are investing sufficiently, accompanied by the opex-derived capacity and the efficiency improvements. Where we are not going to deploy capital is in the part of the business which is not yielding the right returns. And in that part, we will high-grade the contract base. We will potentially move capacity around to get better returns for what we have deployed. And we will not deploy new capital into that part of the business until the returns are adequate. That might create shortages here and there. But at this stage we are prepared to do that. And we will do that in very close dialogue and cooperation with our customers so they know what our position is. But we cannot, and will not, deploy capital into operations which are not yielding the right returns.

Operator

And ladies and gentlemen, our last question comes from the line of Dave Anderson with Barclays.

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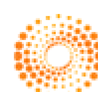

John David Anderson ***Barclays Bank PLC, Research Division - Director and Senior North America Oilfield Services & Equipment Analyst***

So regarding the OneStim business in North America. As you mentioned, the IOCs, E&Ps, private sale spend differently. So I'm just wondering when you think about deploying those eight remaining fleets or perhaps moving some of the others around, do you think about this purely from an equipment utilization pricing standpoint? Or is it important to pull in your sand mines or perhaps some of your higher-margin businesses when you're looking at that -- when you look at each one of those fleets?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Well, generally, we will look at the returns we are going to get for the frac fleets that we deploy. That's partly down to pricing, but it is also down to the operating efficiency and how well we work with the customers where we deploy this capacity, right? So some of these other considerations around the use of technology in frac obviously plays into it. But I think the sand mines at this stage, this is what -- we treat this as a separate business. A fair bit of the sand that we sell today is all the -- independent of the frac operations. It's sold directly to either other frac companies or directly to our customers. So we obviously look at optimizing the whole situation here. But generally, when we deploy these eight additional fleets, it's going to be ensuring that we get the right returns on them by themselves where we deploy them.

John David Anderson ***Barclays Bank PLC, Research Division - Director and Senior North America Oilfield Services & Equipment Analyst***

Great. And then your Sensia JV you announced earlier this year, a really interesting business that seems to be kind of going after your sort of untapped market here. I was wondering if you could perhaps just give us sort of an example of a target application? Conceptually, I get what you're talking about. Maybe if you can -- like give us sort of a field example of what you -- kind of what Schlumberger and Rockwell each bring to the table. I'm also curious as to the business model. Is the goal here to create a performance-based model? It would seem sort of ideally suited for something like that. Is that part of the pitch? Or maybe it's too early to ask these type of questions?

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Olivier, you want to comment?

Olivier Le Peuch ***Schlumberger Limited - COO***

Yes. No. Thank you. So I think it's a fair question. It's a fair observation that some of the business could be and will be driven by performance model. So outside application first for this JV will be existing producing assets, brownfield assets where we believe in the land application, that the power of automation, data analytics, and digital application will increase the efficiency, the amenability, and decrease the maintenance and increase the up line of those assets. So example I think actually is pump surveillance and optimization or at least as well, or existing process productivity where the surveillance and automation could be -- help optimize some of the producing outputs of those operating assets. So we are getting excellent feedback from the joint engagement we have with some customers around the -- what Sensia could bring to the market. It's too early to say because the closing is still some time in the summer where this will start. But we expect the double-digit growth trajectory when we start this venture. And we will certainly get the benefit of the leadership, recognized leadership of Rockwell Automation, process control, and having digital solution for the outfit. And we'll bring our domain -- deep domain expertise, our measurement portfolio, and obviously our digital capability with a debt-free solution. So we believe it's a combination that is unique to the market, very well received, and first application onto producing oilfield assets with, indeed, potential for a performance contract that will give us the upside on this automation opportunity.

Operator

And we'll turn the conference back to the host, right.

Paal Kibsgaard ***Schlumberger Limited - Chairman of the Board & CEO***

Okay. So we before we end, I would like to summarize the main points from today's call. Firstly, I'd like to clarify that we expect the Q2 EPS to be in line with the Street consensus of $0.35, and we don't, at this stage, see any upside to this number. Furthermore, global E&P spending is starting to normalize, which directionally means increased international investments to offset the accelerating production decline, while North America land investments are heading lower due to the E&P cash flow constraints leading to a likely downward adjustments to the current production growth outlook.

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Second, in North America, where visibility into the second half of the year remains limited, we are fully focused on maintaining operational flexibility and improving financial returns and cash generation, leveraging the strong execution platforms we have built over the past years in hydraulic fracturing, drilling, and artificial lift.

And third, we now see clear signs of a broad international activity upturn emerging both on land and in particular offshore, seen by increases in rig count, new project FIDs, and also renewed interest in exploration. All our 2019 capex will be deployed into the 50% of our international revenue base that is already producing highly accretive incremental margins. At the same time, we focus on securing improved commercial terms or return to the high-grading our contracts in the upper half of our international revenue base, which today is highly dilutive to our operating and incremental margins.

That concludes our remarks. Thank you for participating. We now conclude the call.

Operator

Ladies and gentlemen, this conference is available for digitized replay after 9:45 a.m. Central Time today through May 18th at midnight. You may access the replay service at any time by calling 1 (800) 475-6701 and enter the access code of 464084. International participants may dial (320) 365-3844. That does conclude your conference for today. Thank you for your participation. You may now disconnect.

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