THOMSON REUTERS

EDITED TRANSCRIPT

Q3 2019 Schlumberger NV Earnings Call

EVENT DATE/TIME: OCTOBER 18, 2019 / 12:30PM GMT

CORPORATE PARTICIPANTS

Olivier Le Peuch *Schlumberger Limited - CEO & Director*
Simon Ayat *Schlumberger Limited - Executive VP & CFO*
Simon Farrant *Schlumberger Limited - VP of IR*

CONFERENCE CALL PARTICIPANTS

Angeline Marie Sedita *Goldman Sachs Group Inc., Research Division - Senior Managing Director*
Chase Mulvehill *BofA Merrill Lynch, Research Division - Research Analyst*
Connor Joseph Lynagh *Morgan Stanley, Research Division - Equity Analyst*
James Carlyle West *Evercore ISI Institutional Equities, Research Division - Senior MD*
John David Anderson *Barclays Bank PLC, Research Division - Director and Senior North America Oilfield Services & Equipment Analyst*
Kurt Kevin Hallead *RBC Capital Markets, LLC, Research Division - Co-Head of Global Energy Research & Analyst*
Scott Andrew Gruber *Citigroup Inc, Research Division - Director and Senior Analyst*
Sean Christopher Meakim *JP Morgan Chase & Co, Research Division - Senior Equity Research Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Schlumberger earnings conference call. (Operator Instructions)

As a reminder, today's conference call is being recorded.

I would now like to turn the conference over to Simon Farrant, Vice President of Investor Relations. Please go ahead.

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

Good morning. Good afternoon. Good evening, and welcome to the Schlumberger Limited Third Quarter 2019 Earnings Call. Today's call is being hosted from New York City following the Schlumberger Limited Board meeting held here this week.

Joining us on the call are Olivier Le Peuch, Chief Executive Officer; and Simon Ayat, Chief Financial Officer.

Our earnings call will take a slightly different format. We've shortened our prepared remarks in order to leave more time for your questions. Olivier will start the call with his perspective on the quarter, after which Simon Ayat will give more details on the financial results. Then we'll open up for your questions.

As always, before we begin, I'd like to remind the participants that some of the statements we're 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 filing 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 third quarter press release, which is on our website.

Now I'll turn the call over to Olivier.

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

Thank you, Simon. Ladies and gentlemen, good morning. I would like to add to the earnings release my comments on the quarter before covering some of the points critical to our business.

First of all, as you have seen in our release this morning, we have taken a largely noncash $12.7 billion charge. This charge reflects the impact that market conditions have had on the valuation of our goodwill, intangibles and fixed assets. None of this changes our ability to generate strong cash flow at this quarter, as once again demonstrated, giving us flexibility to navigate the more uncertain market landscape. Simon Ayat will discuss the charge during his remarks.

I will now comment on our Q3 operational performance followed by the short-term outlook and conclude with a brief update on our strategy implementation.

Our third quarter results were very positive in a mixed market environment driven by strong international performance. The international margins improved, and we delivered more than $1 billion in free cash flow. Additionally, we recorded the best ever -- the best ever -- quarterly safety performance for the company, an outstanding achievement, setting new safety performance benchmark for our industry.

All in all, a very solid quarter, aligned with our performance vision and our focus on returns. I'm very pleased with the results, and I'm proud of the Schlumberger team that delivered this performance.

The financial results this quarter were driven by the strength of activity in the key international markets. Summer activity peaked in Russia, the CIS and the North Sea. The Far East and Asia regions also saw strong growth, and new project began in Sub-Sahara and North Africa. Only Latin America revenue was lower on reduced activity in Mexico and Argentina. In North America, we experienced strong offshore sales, offset by minimal growth on land. OneStim activity was modestly higher, recovering from the spring breakup in Canada during Q2. Towards the end of the quarter, however, we saw lower pricing and increased gaps in the frac calendar as customer work programs were constrained by cash flow. North America land drilling revenue was essentially flat despite rig count reductions as our fit-for-basin technology-access approach on equipment sales and leasing helped offset declines.

Cameron results closed in line with expectations. This included robust operating margins, building on sequential growth in most international regions, which were offset partially by declining activity in North America at the end of the quarter.

Our international performance this quarter was very solid with a high, double-digit basis point improvement in our margin on the back of 3% sequential revenue growth. More than 2/3 of our product lines and GeoMarkets posted both sequential revenue growth and margin expansion, leveraging in particular the favorable offshore and exploration activity mix and the deployment of new technology. At the closing of this quarter, half of our international GeoMarkets have posted year-to-date double-digit revenue growth. This improvement in international margins was achieved despite the lingering and sustained effect of a handful of contracts that are highly dilutive. Without the effect of these underperforming business units, our growth in international margin would have been even greater. We are making progress engaging with our customers on those contracts, working collaboratively to improve terms and conditions and to enlist their support to improve our operations.

As part of this plan, I've been taking personal action during the last few weeks and anticipate visible progress during the coming months and quarters.

Margin improvements and stringent capital deployments are both part of our increasingly returns-focused approach under the new capital stewardship element of the strategy. As international activity increases, our deployment of CapEx will be further prioritized towards the business units with higher returns. This action, together with increasing activity, is starting to create some tightness in the market, which is a catalyst for pricing improvement.

Now I will move on to the short-term outlook for our business. Based on our Q3 year-to-date results and our outlook for Q4, we still expect full year high, single-digit international revenue growth, excluding Cameron. Sequentially, however, Q4 will include the seasonal activity decline in the Northern Hemisphere, and we anticipate only muted year-end sales. We are also closely monitoring the situation in Ecuador following the recent events and are preparing for further decline in Argentina. In addition, we expect seasonal weakness in North America as the fourth quarter develops. We were anticipating a year-end slowdown in North America similar to last year due to operator budget constraints. However, this year, the activity reduction has started earlier than last, and we anticipate the sequential decline in Q4 to be more pronounced than last year.

Moving on to the macro and medium-term view. The market environment remains challenged with limited visibility, particularly in view of the global trade concerns that are challenging world economic growth and the rate of oil demand growth. At the same time, the U.S. production growth rate has declined for the last 8 months, and it is expected to drop further in 2020 as a result of the reduced activity this year. Therefore, and absent of a recession, the prospects for international activity growth remain firmly in place.

In this market context, our approach to North America land is under evaluation for both the medium and the long term. We are already scaling to fit the OneStim business, and we will be stacking fleets as the market contracts during the fourth quarter. At the same time, a strategic review of this market is well under way and will be completed during the fourth quarter for execution early next year. This gives me the opportunity to update you on our strategy execution.

Last month, we presented 4 key elements of that strategy that included leading and driving digital transformation in our industry, developing fit-for-basin solutions, capturing value from the performance impact for our customers, and fostering capital stewardship. Performance is at the heart of this new strategic direction.

We are already off to an excellent start on digital. We presented our vision of the E&P industry to 800 customers and technology partners at the Global SIS Forum (sic) [SIS Global Forum] in September. There, we demonstrated our firm commitment to an open digital environment that we believe can unlock further customer performance. This forum marked a new chapter for the digital future of our industry.

The interest from our customers and digital partners was far beyond our expectation and is already translating into sizable opportunities.

The Sensia JV is also an important part of our digital strategy, and the announcement of its closing reinforces our leadership of and commitment to the industry digital transformation.

We are also making progress with our new fit-for-basin strategic approach. In the release today, there are multiple examples of fit-for-basin technology, all of which drive our customer performance such as NeoSteer at-bit steerable system and Aegis drillbit technology.

In addition, in North America, I'm pleased to report early success of the technology-access strategy with sales and leasing of rotary steerable tools. This is a new channel that access the new market where our participation was previously minimal.

Also in North America, our flagship project with Oxy in the Aventine basin is now operating at scale with continuously improved operational efficiency, setting new frac records in the Delaware. The value being created is shared through an aligned commercial model and is a good example of our new strategy performance model approach.

Finally, an update on our SPM strategy, we have made progress in our divestiture of Argentina asset as we have a few offers in hand that we are reviewing with the anticipation to finalize with the other party during the upcoming [weeks] (corrected by company after the call).

Since taking the role as CEO for Schlumberger, I've made a point of visiting many of our customers, our people and our locations. The reception by our customers to both our engagement and strategic direction has been very positive. The enthusiasm of our people has been highly motivating, and their commitment is evident. The industry is acknowledging the need for higher performance in a new era.

All in all, I'm very pleased with the initial steps of our strategy execution and with the internal and external alignment with our vision to become the performance partner of choice in our industry.

I will now pass the call over to Simon.

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

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

Third quarter earnings per share was $0.43 excluding charges and credits. This represents an increase of $0.08 sequentially and a decrease of $0.03 when compared to the same quarter last year.

During the quarter, we recorded $12.7 billion of pretax charges driven by market conditions. These charges primarily relate to goodwill, intangible assets, and fixed asset impairments. As such, this charge is almost entirely noncash. Details of the component of this charge can be found in the FAQs at the end of our earnings press release.

These impairments were calculated as of August 31, 2019. Accordingly, the third quarter's results benefited from a $27 million reduction in depreciation and amortization expense. Approximately $21 million of the -- this $27 million monthly reduction relates to the Production group. The remaining $6 million is reflected in our corporate and other line item. The after-tax impact of this one-month reduction is approximately $0.015 in terms of EPS.

Our third quarter revenue of $8.5 billion increased 3% sequentially largely driven by our international operations. Pretax segment operating margin increased by 113 basis points to 12.8%.

Highlights by product group were as follows. Third quarter Reservoir Characterization revenue of $1.7 billion increased 6% sequentially, while margins increased 149 basis points to 21.8%. These increases were primarily driven by strong international Wireline activity and higher WesternGeco multiclient license sales in North America. Drilling revenue of $2.5 billion increased 2% driven by stronger drilling activity in Russia, China and Australia. However, this was partially offset by lower revenue in North America land and Saudi Arabia. Margins were flat at 12.4%.

Production revenue of $3.2 billion increased 2% sequentially primarily driven by strong international Completions activity. Margin increased 148 basis points to 9.1% primarily driven by improved international margins from higher activity. The reduction in depreciation and amortization expense as a result of the third quarter impairment charge accounted for just under half of the margin improvement.

Cameron revenue of $1.4 billion increased 3% sequentially primarily driven by OneSubsea; margins increased 29 basis points to 12.7%. The book-to-bill ratio for the Cameron long-cycle business was 0.8 in Q3. The OneSubsea backlog increased -- decreased to $1.8 billion at the end of the third quarter. This decrease reflects a canceled project in the North Sea.

Now turning to Schlumberger as a whole, the effective tax rate, excluding charges and credits, was 16% in the third quarter as compared to 16.7% in the previous quarter. We generated $1.7 billion of cash flow from operations during the third quarter. Our net debt improved by $347 million during the quarter to $14.4 billion. We ended the quarter with total cash and investments of $2.3 billion. We received $250 million in cash just after the quarter as a result of the closing of the Sensia joint venture.

During the third quarter, we issued 3 tranches of EUR 500 million notes each: the first due in 2024 at 0%, the second due in 2027 at 0.25% and the third due in 2031 at 0.5%. These notes were subsequently swapped into U.S. dollars with a weighted average interest rate of 2.5%.

During this quarter, we also repurchased $783 million of our outstanding 3% notes due in 2020 and $321 million of our outstanding 3.625% notes due in 2022. These actions have served to improve the company's capital structure.

During the quarter, we spent $79 million to repurchase 2.2 million shares at an average price of $36.64. Other significant liquidity events during the quarter included CapEx of $413 million and capitalized costs relating to SPM projects of $194 million. During the quarter, we also made $692 million of dividend payments.

Full year 2019 CapEx, excluding SPM and multiclient is expected to be between $1.6 billion and $1.7 billion.

And now I will turn the conference over to operator for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First, we go to the line of James West with Evercore ISI.

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

So Olivier, as you exited the third quarter, could you describe what the market conditions were, how we should think about the fourth quarter? It sounds like sequentially down. And then also, how has 2020, in your view, started to shape up?

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

Yes. No, let me comment on this, James. So I'll separate my comments between international and North America land specifically. So first, on the international side, I think similar to what we see every year, there is a seasonal effect in the Northern Hemisphere due to the winter season that affects primarily Russia, lesser extent China and the North Sea. And we see an effect every year on the rig activity and our revenue that we collect from those region. So this is not unusual. We don't expect any more impact than we have every other year, but I think this is something to account for.

We typically on year-ends also have year-end sales of products, equipment. And we believe this will happen, but this will be as we have seen in the last 2 or 3 years, fairly muted annual sales, as the operator will remain cautious on their budget in preparation for 2020.

On the flip side on the North America land, as I did comment in my introductory remarks, I believe that the rate of decline will be at the risk to be higher than last year as -- for 2 reason. The usual holiday season break in the winter, I think, is looming. But also, we have seen that the budget exhaustion and the discipline on operating within cash flow has led operator to cease operation earlier than they did last year. We have started to get notice of a operation gap from September, and the rate of this decision has been accelerating. So we expect as a consequence that the rate of decline quarter-on-quarter in North America might be higher than last year sequential decline.

Now turning to next year. I think absent of a major -- as I commented, a major recession or a major event, geopolitical or economic event, we foresee that the international growth will remain in place, albeit possibly at a different lower rate possibly. But we believe that there are signs of offshore activity. Deepwater or shallow will not cease overnight and will continue to support 2020 international growth.

When it comes to North America, it's too early to call. I believe that the market still lacks the visibility, and we can only comment on the rebound in Q1 that is a usual rebound from the holiday season that we foresee happening with strengthening of activity from January and possibly a strengthening of pricing, but this is too early to call.

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

Okay. That's very helpful, Olivier. And with respect to the charges that were taken during the quarter, understanding they only helped EPS by about $0.015 here, what drove the timing here of the -- of taking these charges, especially at kind of midyear? Why not end of last year?

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

James, Simon Ayat here. I'll take this. Basically, during -- there are 2 events that took place in the third quarter that made us look at -- closely at the carrying value of our assets. One is the new strategy by Olivier which has been publicly announced and discussed, and we'll continue to develop those as we go forward. The other one is the market valuations that we have seen. Although we have touched lower points before -- I'll take the second reason first and then discuss the first one.

Although we -- we've seen lower valuations before but during the third quarter were more consistent and, frankly, very low point unfortunately. That forced us to look at our goodwill and intangible carrying value. As you are aware, most of the goodwill and intangible comes from 2 major acquisition. In 2010, we did the Smith acquisition, which is -- was almost 100% paid by stock. We issued 138 million shares at that time. And then Cameron in 2016, where we paid almost 78% in stock. The book value of those 2 acquisitions were booked for Smith at $56 per share, for Cameron at $72 per share. As such, our carrying value of the goodwill and the intangible is inflated given where our current valuation is, and this has taken very long analysis, pretty scientific actually, and we reached to this number.

Why it is in Q3? As -- because it is a Q3 event. So we record things as they happen. We don't -- we're not influenced by timing. Yes, normally at the end of the year, you do a more thorough review. But given the changes we've seen in Q3, we did this thorough review in Q3.

The other items that you've seen, which is mainly fixed asset impairment and mainly in OneStim North America, is a reflection of our actions toward this activity. As Olivier mentioned, we're looking at this activity. We have excess capacity there, and we've taken the decision that this is impaired. We don't see it as reactivated in the near future, and we took the decision to write it off. So I covered the reasons behind it. I know I answered more than what you asked, but I wanted to make sure that everybody understand our approach and why it is in Q3. It's not just because we have a change of mind. It is a reflection of real issues that took place in the third quarter.

Operator

Next we go to Angie Sedita with Goldman Sachs.

Angeline Marie Sedita ***Goldman Sachs Group Inc., Research Division - Senior Managing Director***

So I appreciate the color on the international markets, and a little bit of a follow-up there on the pace of growth for 2020. I know it's early, but do you still feel comfortable with mid-single-digit revenue growth in 2020? Or is it still a bit early to tell for sure? And then also, I would guess I would add to that the asset sales that occurred in 2019, the impact on both revenues and margins.

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

Yes. Let me take the first and then address the second one. So the -- it is, I think, to be created of mid-single-digit rather than low or high. I think it's too early to pull and call at this point. Not that we don't have good visibility, but I think the customer are still in the process of setting their budget for 2020 and are observing the macroeconomic factor that you all know about. And I think we'll have to be cautious here. We believe that the continuum of offshore activity and the momentum that the industry has set there is not here to stop, particularly on the deepwater side. But I think some other region or some of our basin will be more at risk of a decline in activity or decline in budget for next year. So still early to call, but clearly, we see growth international next year.

So when it come to the impact of the announcement -- announced divestiture, so we have 3 divestiture under way. One is already closed. The Sensia divestiture has been closed 2 weeks ago. The second one relates to a divestiture of asset to a JV that we own with ADC. And the third one relate to our drilling and tubular accessories tools, fishing that we are divesting. So when you look at the impact of these 3 on a yearly basis, the revenue will be short 2% of global revenue as an impact. Then when you combine the 3, when the 3 will be completed, closed and exited, and the impact on the earnings will be $0.01 to $0.02 for the year. So -- and Simon may want to elaborate a bit more, but that's the impact on a full year basis.

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

I just want to explain that 2 of the transactions or the divestitures are basically creating JVs. Or one is creating the JV of Sensia. The other one, enhancing the JV of ADC drilling in the Middle East. So we're losing the revenue, and the reason we're not losing as much in earnings because we will have a higher pickup of our equity participation in the 2 JVs. And the third one has a -- really a minimum impact on the profitability. And therefore, as Olivier mentioned, it's a $0.01 to $0.02 per year impact on margin. However, the revenue has a larger impact, less than 2% of the total amount.

Angeline Marie Sedita ***Goldman Sachs Group Inc., Research Division - Senior Managing Director***

Okay. Perfect. That's very, very helpful. I appreciate the color. And then I guess a little bit further on the international side. Thoughts around the pace of margin growth for 2020 given your initiatives on the transformation in digital and these -- obviously these asset sales as well, but -- and then these contracts that you're trying to address in the Middle East. So just talk about margins for next year on international and the pace.

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

So I will not comment on the targets -- the target is not set. The ambition we have is to continue to grow and expand our margins internationally. And you have seen that we comment that we have a high double-digit basis points improvement during the quarter. I will continue to look and work using the strategy to execute 2 parts of margin expansion for the following years. So if you look at it from a very high level, there are 3 buckets that we see. The first one relates to our ability to resolve some of the underperforming business units, the highly dilutive contracts that are lingering and impacting our results. Now we are have made some progress, not to the pace we have expected necessarily on being very ambitious this year, but I think I'm confident that we have a path to improve this that will impact the results next year. Similarly, in the first bucket, then we'll, of course, continue to execute using our new modernized platform of operating system. And I think we are setting a 2-year rollback to complete our transformation internationally. And I look forward to have also some pull-through on that operating model with efficiency or self-help, as we call it, impact on our margins.

And next bucket is obviously the -- I will call it the digital and/or the technology access, trying to replicate some of the success we have seen in North America, overseas, in technology access to third-party regional players who are accessing our technology and using it with -- in lieu of CapEx in terms of the market; and digital where we expect that the outcome of what we have just done last month and the momentum that we have gained in the industry will give us an increased share of the digital market and as such will be contributing to our margin.

So last will be further long-term outlook on the performance model and other horizon of growth that we will disclose later, but I believe these 2 buckets will clearly impact the next 2 or 3 years. But it's difficult to say at this moment. But I have the ambition to grow international margin next year indeed.

Operator

Next, we go to David Anderson with Barclays.

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

So on your fit-for-basin strategy, you're -- obviously, you're focused on the North American business right now. And after writing down assets during the quarter, you talked about more of a strategic review in the fourth quarter. We're talking about 2020 numbers, but it's kind of hard to get there with all these changes happening in North America. I was wondering if you could just kind of just lay out a little bit kind of what you guys are looking at. Like what parts of the North America business are under the strategic review? And should we expect kind of a broader retrenchments in certain parts of the U.S. land business next year?

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

No. A very good question, Dave. So as we have explained during the strategy presentation back 1.5 months ago, we are doing a deep review of the entire business we are operating in North America land. And this is not only OneStim but every part of our business there. And the first thing we are doing is we are doing a scale-to-fit approach to the market review, meaning that we are not going after scale, we are going after what we believe is fit for every business in every basin. So this is what we are in the middle of doing, as we speak, for OneStim in each of the basin we operate and for each of the product line where we are currently operating in the North America land. So that's the scale-to-fit approach to our strategy: to review the outlook, to review our market position, to review our strengths, anticipate the technology and the opportunity with customers and making a decision at that point on how to treat this portfolio and move forward with a reduced portfolio, more fit to one or multiple basin as opposed to all basins or make a decision to change our business model to go for technology access, setting up technology as opposed to operating our technology. So that's, I think, the approach we are taking as we speak. We are complementing it this by recognizing that there are some technology that we have developed that are highly successful, and we continue to feed our technology team with what is needed to differentiate in-basin to create a performance impact. And you have seen in some of the release of the success we have had have helped us actually maintain, if not last quarter slightly improve, our margin, excluding impairment effect in North America land, due to the effect of this technology success. So we will continue to (inaudible) technology and working with our portfolio of business units in North America and making decision to exit or continue and expand or move to a new business model.

So too early to say. But yes, all option are on the table, particularly for the OneStim as it is certainly, as you know, they are a dilutive business to our whole business in North America.

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

Kind of a slightly different question on North America. You highlighted some offshore strength, which is a bit of a surprise, and granted there is some seismic here. But you made a few comments about offshore sort of being a support for the market next year. You actually highlighted international there. But I'm just wondering if this is a harbinger of things to come for offshore in general. And just trying to tie that into the lower subsea Cameron orders this quarter, how do you see that trending over the next few quarters? It sounds like you're somewhat optimistic on offshore, but I don't want to put words into your mouth there.

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

So let me comment on this. So I'm -- the view I have is that the offshore market is a market that doesn't contract and expand on a monthly or on a quarterly basis. It's more steady and it's more longer -- a longer -- long cycle. And that's particularly true for deepwater. So we have seen growth. We're slow because we have deepwater for the last 18 months. We have seen faster recovery of the shallow in the last 12 months. So we believe that some of this fundamental will stay in place. Now not necessarily long term. It's early -- too early to call. But to the mid -- the medium term, it is the case. So I believe that the momentum that this market has is here to stay for the foreseeable 6 to 9 months. Beyond that is too early to say.

The FID and the rate of FID for subsea has not necessarily slowed down. I think some of them have been delayed for technical reasons. But we expect the -- some of the key FID to be approved in the later part of this year or early next year. The subsea or OneSubsea low booking this quarter, I think, is a matter of scheduling of how and when this booking come in [seconds]. We are still having a book-to-bill ratio year-to-date last year goal of 1 for OneSubsea, so I feel confident that the subsea recovery is still in place and will continue to unfold.

Operator

Next, we go to the line of Scott Gruber with Citigroup.

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

Can you provide some color around the outlook for improvement under the new strategy in EBITDA dollars and free cash dollars? Since assets are being removed from the portfolio to optimize around the core, margins will obviously improve. But can you provide some color around your ability to grow cash flow and free cash dollars assuming limited market assistance?

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

I think the first and foremost ability that we have to grow cash flow is to improve our margins clearly, and that's the first, foremost. The next one for our cash flow is our ability to improve our working capital efficiency and both of which we have demonstrated this quarter. Long term, obviously, it depends on the mix and where we have -- we see growth and margin improvement. So we believe that it's a matter of international growth that we see still in place where we have a premium on margin compared to North America. The effects and execution of our strategy, scale to fit, to fix North America and to enhance our net margin in dollar as well as in percentage, will both combine to improve our margins. We believe that the asset efficiency that we have improved over the last couple of years due to our transformation, combined with modernization of our working platform to -- will continue to have positive effects on working capital efficiency. So you combine all this, we believe that the ability to deliver cash will only improve and the total cash conserving, absent of a recession, will improve going forward. Do you want to add anything, Simon?

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

No. I mean you said most of the things. The issue of the cash flow, definitely it is earnings first and then management of our capital structure and working capital. We normally do very well in the second half, as you have seen. Third quarter was $1.1 billion, and we anticipate the fourth quarter to be even better than this performance.

In terms of next year, we have a plan to continue to be very cautious in our capital deployment, and this will help the free cash flow and continue the performance on our working capital. Our working capital is normally subject of receivables, inventories. We know where we stand. We always have pockets of collections here and there, and we intend to solve them. And we feel comfortable between our generation of cash from operation, and the -- some of the divestitures that are coming will be more than sufficient to meet all our commitments including the dividend.

One more thing to add about next year. You're going to see lower SPM investments because of what we already announced, that we're going to divest and we're going to -- it doesn't require as much as we have done in the current year.

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

(inaudible) at this point, are you comfortable mentioning the drop in SPM CapEx?

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

I'm sorry, your question again?

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

Are you willing to mention where SPM CapEx is going next year?

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

Well, SPM CapEx this year is around $750 [million], and we anticipate that this will be quite much lower next year. I mean when -- I don't know exactly where. We have not finalized all the plans. But the -- start of $500 [million], $400 [million] probably.

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

Got you. And then one additional question. One tweak to the strategy seems to be a willingness to selectively sell or lease technologies in various markets to third parties, which will then provide the service of well site deployment. Can you provide some color on this tweak to the strategy? What is the breadth of the strategy by product line? Which geographies are you looking at deploying the new strategy? And importantly, how do you get comfortable around not creating additional competition in these various markets?

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

Yes, Scott. This strategy, we call it technology access, is a subset of fit-for-basin where we believe that in target basins, particularly the high-volume basin, the capital intensity that is required to fulfill, particularly within the basin, and the high competitiveness by local players is -- are -- carry in both condition that it is capping our market access. So we have realized and we have tested this in North America. And we are accelerating the opportunity to lease or sell selected technology that we believe can help us access markets that we were not accessing before. So these are 2 consequence. First is create a new business model that is accretive to our goal and our returns. And secondly, we need to lower capital intensity as we typically sell these assets -- possibly lease -- so we don't require CapEx to expand in this marketplace.

So where we do this? Typically, where there is a set of local competitor for one, which is highly located in North America, where, if you'd like to take the drilling space, there more than 50 local competitors that are competing into the drillings services. We expect this to be the case in Middle East, where there are regional players, and in other part of the world where there are characteristics of high-volume basins.

When it comes to pipeline, the drilling is one. Obviously this is where we started, but we'll not stop there. We are doing it for some of our perforating equipment in Wireline and continue to expand. And we are currently assessing. And as part of the strategy for every product line, the portfolio that we are ready to sell, possibly design for sale and/or lease to third party. This digital capability we have as well helps here because we provide these tool services and monitoring of those equipment so that we are sure that the performance of this technology is up -- on par with the capability of this technology.

So am I comfortable? Yes. When we put the right terms and conditions with those third-party company to provide defined scope and with a defined set of customer, we are clear. And we are becoming increasingly comfortable as well as they are as they are successful in deploying our technology and we are successfully supporting them and hence expanding our market access.

Operator

Next, we go to Connor Lynagh with Morgan Stanley.

Connor Joseph Lynagh ***Morgan Stanley, Research Division - Equity Analyst***

I wanted to stick with the CapEx theme here. In the core oil services business, how would you think about how much you can take out in 2020 spending? Obviously, with Production Group activity coming down, I would think there would be a decent amount of sustaining CapEx reduction there. But any thoughts around that?

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

I think it's still too early to be specific and granular down to the Production group at this stage. (inaudible) It depends on how we execute the strategy in North America where there are still several elements of the Production group operating there. And this is too early as some of the activity level is not set yet for North America in particular.

Now globally speaking, our guidance that we shared before has been 5% to 7% of revenue. We believe with the mix of product line that we have, the recent divestiture of some asset-heavy product line, combined with what we anticipate in North America, I would say almost independently of the strategy execution, we mean that we will stay within the guidance.

Connor Joseph Lynagh ***Morgan Stanley, Research Division - Equity Analyst***

Okay. That's helpful. I guess a broader question here. You've continued to highlight your digital strategy. I think many investors have a hard time thinking through the addressable market or how big a business this could be for you. How do you think about what the opportunity set is in a multiyear view for that business?

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

Actually, it's a very big market. I think indeed it's long term for the oil and gas industry it's one of the biggest market that will grow over the next 5 to 10 years. I believe if I have to judge by the response from all customers, the desire they have to work with us and the alignment from old partners, industry leaders in this whole technology across our industry, which are all aligning to work with us. So the prize is big.

Now the challenge is to monetize it. So as we said, there are 3 factor and 3 direction there. One is what we are doing with SIS, is establish a leadership in digitalworkflows, and we believe that will only expand the adoption of DELFI by 100 customers to date is only about to grow, and this expansion will mean accelerating the rate of growth of SIS as a segment in our portfolio. And it comes at margins that are accretive to our business everywhere. So I believe this will only continue and accelerate.

WesternGeco is the data digital branch of our product line, of our business. And I think we have turned and transformed with success WesternGeco from an asset-heavy into an asset-light product line last year. And we are complementing it with a, like I said, this tool strategy where we are establishing a data platform, GAIA, that we have released that will become the industry reference for exchanging and monetizing data, as you have seen with the announcement of IHS Markit joining us on this platform.

And finally, we will continue to deploy digital at the edge in operation. The Sensia JV is part of this ambition for the Production space and you have seen that we are expanding it beyond Production into Drilling. You will see that we'll continue to make announcement in that space, Drilling operation. And Ora, the Wireline, latest generation of fluid sampling characterization downhole, is becoming full digital, and its success and expansion will become a key factor of digital success. So it's multidimension. It's large and it's long term, and we are leading in this space.

Operator

Next, we go to Kurt Hallead with RBC.

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

A follow-up question I had kind of dovetails back to the strategy presentations on the 1.5 months ago. And in that presentation, you -- Olivier, you clearly stated the intention to increase international, North American margins by at least 500 basis points. And so my curiosity is that -- in the context of that 500 basis point improvement, how much of that can be maybe attributed to the improvement in the current contractual dynamics vis-a-vis the execution of the strategy you outlined, specifically the digital, the fit-for-basin, and the performance model. So if you can provide some additional color on how you see that kind of mapping through, that'd be great.

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

No, Kurt. I think as I did comment to Angie before, I see that the expansion of the 500 bps would come from 2 or 3 buckets. And one of them is short term, and it's the one addressing -- it's operational and contractual. It's the one addressing our underperforming business units and its ability to operate at the benchmark, being performance, and that's the performance transformation we are doing internally.

That's a self-help, if you want. So that is the target of all of our team, and the focus is very high on this. And I have personal overview on each of these every quarter.

So the next -- you mentioned the next bucket and I think the one that most certainly has the most impact in the next 2 to 5 years will be the mix of digital, fit-for-basin and technology access internationally. We'll have technology access in Middle East. We'll have digital everywhere. And we'll have some fit-for-basin from Russia to Latin America, from China to Mexico. So that's what we expect. So I'm confident that as we deploy this over the next few years, these 3, fit-for-basin, performance model and digital, will contribute on this.

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

Right. Appreciate that. And then a follow-up I have was on the -- is on broad general guidance on -- in terms of business direction. So I'm just kind of curious. When you look at the lower depreciation, it was about a $0.015 impact for the quarter. That, I would guess, was only 1 month. So once you annualize that, you also get a positive $0.18 per share benefit from lower depreciation. I don't know. It seems to me like the headwinds on the market could potentially offset that benefit as you head out into 2020. Do you have any kind of initial perspectives on that? Do you think my assumption is -- kind of my gut instinct is correct on that?

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

So first, I think your math are correct. I think the -- analyzing this $0.015 will generate more or less $0.18 net impact at -- in cents scope. Now will it be offsetting to the decline? I think it's too early to say. I think, again, we are looking at the outlook. As I commented before, the outlook in international remain likely positive on growth. The outlook on NAL is that is it's too early to call at this point. Have we reached the bottom in NAL, and we're expecting to expect the 2020 flat from 2019 or we'd reach another bottom in 2020? It's too early to say.

So I will remain cautious about calling this at this point, but I think your assumption are correct for the impact on this.

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

Okay. Great. Now one -- maybe one last one. I noticed in the press release you mentioned that there was a project cancellation in subsea. Was that a project that came through earlier in the year? Or was it kind of a dynamic your -- yes.

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

No. No. Actually, no. It's an old booking that was awarded to OneSubsea some time ago -- more than 1 or 2 years ago. That was put on the back burner for future FID. And this asset was actually subsequently sold from one operator to the next. And the next operator, rather than carrying on, decided to (inaudible) rethink its option for the FID. And as such, we have to remove the booking from the...

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

The backlog.

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

The backlog. That's as simple as that.

Operator

Next, we go to Sean Meakim with JPMorgan.

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

So Olivier, to follow up on SPM. It's been a challenging few months in terms of the macro in Argentina and Ecuador. Based on your comments of lower CapEx spend next year, does that suggest you're still confident in effecting the asset sale in Argentina in the near term? And then also, just you wrote out some smaller SPM assets. Can you maybe elaborate on their impact in terms of CapEx? And just are we still confident that cash flow for SPM as a whole is exiting 2019 positively now that we have some -- an impact on production in Ecuador?

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

Yes. So let me comment one by one. So first, the process of the asset divestiture in -- for Bandurria Sur in Argentina is progressing. We have completed the first phase where we received actually an offer and we have offers -- a few orders in hand that we're reviewing as we speak. So we still do anticipate and we'll work every step to get to signing and closing in the following months. So yes, we'll account for this as an impact for 2020.

We are not making any decision at this point to divest any other assets. The Ecuador -- the Torxen will be the main asset that will remain on the SPM portfolio. The other assets that we are working with to -- in the (inaudible) are much smaller were initiated a few years back and are not meaningful in term of their impact on CapEx nor in term of production revenue for SPM.

So in term of cash flow, yes, our commitment is still to operate within cash flow, and the cash flow will be positive and improving next year compared to this year considering the divestiture we are making. And we are committed to continue to keep it as is. So it will mean lower CapEx and increased cash flow from the SPM contribution.

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

That's very helpful. And then just given the growing importance of digital in your go-forward strategy, are you able to quantify the baseline of digital contribution today? I know some parts will be difficult to quantify, but reference point is a common investor question and with respect to the margin impact, is it mostly accretion from software? Or is it just higher-margin product? Or are there internal OpEx benefits you can get as well?

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

So Sean, I think we look at it from -- digital is a business that has 2 characteristics. First, it is something that is transformative for the industry. And it is something that is having a high price for all operator. So we need to be in this business. And we believe the rate of growth of digital is here to stay and only accelerate. So we'll be part of that. And that's the leader, the one -- the most important factor.

The other characteristic is that when we operate it well and we have the right IP and operating model there, we have been able to be generating margin that are highly accretive, which has been the case for the last 10 to 15 years with SIS.

So it will continue to increase its contribution going forward, but I cannot comment at this point until we see the 2020 plan and we see the outcome of all the leads and opportunity that we have reached during the last months following the SIS Forum.

Operator

And ladies and gentlemen, our final question will come from Chase Mulvehill with Bank of America.

Chase Mulvehill ***BofA Merrill Lynch, Research Division - Research Analyst***

I guess first one, I'll start on 4Q. I'm just trying to think about the outlook for fourth quarter. I guess 3Q, you were at $0.43. If we kind of gross it up for the $0.03 of the lower D&A for the full quarter, that's a $0.46 number. And it sounded like North America will be significantly down in the fourth quarter. And I wasn't sure about international, if it will be up or not from your commentary. But can you maybe help us kind of bridge the gap from that $0.46 number and how much EPS could potentially be down?

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

I will comment on the activity. I will not give a quantitative guidance on the EPS at this point. And I will repeat what I shared during my introduction remarks.

The -- what we see on international is sequentially, we see the -- an anticipated activity decline in rigs, and activity -- at large will be down due to seasonal effect, winter season in north -- for the Northern Hemisphere. That is here to stay happens -- every year due mainly to the effect we have found in Russia. Particularly in the North Sea, Russia and China to this extent have this effect. We don't anticipate to see a sizable, if any, year-end sales that could offset this partially, hopefully. And we have some exposure, as mentioned and as pointed before, in Argentina that could also further decline due to the investment climate that has moved there. And finally, you heard about the Ecuador -- Ecuador civil unrest that happened 1.5 weeks ago which had some consequence on our operation for about 1 week or a bit less than a week where we restored production at this stage, but -- so this is a combination of impacts that we foresee for international that means not activity increase for sure.

Now in the North America, I think it's more difficult to exactly pinpoint where the market would end up in term of activity. But the rate of decline on the permits, the rate of decline on the rigs that has accelerated from July to September, the rate of decision in the last few days and weeks on the pulling prior commitments for the following 3 months has accelerated. And as such, we anticipate that the year-on-year sequential decline from Q3 to Q4 in North America will be greater than it was last year.

Chase Mulvehill ***BofA Merrill Lynch, Research Division - Research Analyst***

Okay. Right -- understood. Got all that. And then just coming back to Sean's question on the digital side, it sounds like that you've got a lot of revenue opportunity on the digital side as we kind of move forward over the medium to longer term. Could you talk about which businesses you see the most opportunity to leverage digital? And then ultimately, how meaningful of a revenue opportunity do you think this could be for Schlumberger?

Olivier Le Peuch ***Schlumberger Limited - CEO & Director***

The one -- first and foremost, the business line that will benefit is SIS and then WesternGeco, which are already fully invested it into digital workflow and digital data marketplace. So that will continue to expand. Relative growth, I think, is to be seen, but the momentum is there and the early success -- early indication are quite encouraging.

The next one, I would say, is Drilling. We happen to have a platform including the Rig of the Future. And some software, including DrillOps and DrillPlan will develop a drill plan that we announced commercial during the SIS Forum that when combined give the opportunity to create digital automation at the scale of a rig of full operation or at the scale of the subprocess in a drilling rig. And this can be productized and applied to platform offshore, to platform and the rig inland. And we are working with operator as we speak to accelerate this productization and to make it a meaningful impact onto the drilling.

And finally, Production. We'll be building on the success we are building to create with the JV, Sensia JV and working very closely with Rockwell Automation. I will be participating to their automation fair in a month in Chicago and using both to make sure that we are fully aligned to build the support to this Sensia JV.

Thank you very much. So before we conclude the call today, I would like to reiterate 3 key points. First, our Q3 performance was very solid. We expanded international margins while mitigating the North America land activity headwinds. We delivered strong free cash flow and record safety performance.

Second, the new company vision is gaining industry-wide acceptance, and the initial progress on the strategy execution is very encouraging.

Third, we have adopted capital stewardship as an operational mindset, to deliver increased terms through investment discipline, optimization of working capital, and overall margin expansion.

Ladies and gentlemen, thank you very much for your participation today. Leah -- you may now conclude the call.

Operator

Thank you. Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation. You may now disconnect.

DISCLAIMER