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Schlumberger Second-Quarter 2020 Results Prepared Remarks

Simon Farrant *Schlumberger Limited – VP of IR*

Good morning, good afternoon, good evening, and welcome to the Schlumberger Limited, Second-Quarter 2020 Earnings Call. Today's call is being hosted from Houston following the Schlumberger Limited Board meeting held earlier this week. Joining us on the call are Olivier Le Peuch, Chief Executive Officer, and Stephane Biguet, Chief Financial Officer.

For today's agenda, Olivier will start the call with his perspective on the quarter and our updated view of the industry macro, after which Stephane will give more detail on our financial results. Then we will open for your questions.

As always, before we begin, I would like to remind the participants that some of the statements we will 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 filing and our other SEC filings.

Our comments today may also include non-GAAP financial measures. Additional details and reconciliation to the most directly comparable GAAP financial measures can be found in our second-quarter press release, which is on our website. Now I'll turn the call over to Olivier.

Olivier Le Peuch *Schlumberger Limited – CEO*

Thank you, Simon, and good morning ladies and gentlemen. Thank you all for joining us on the call.

Today in my prepared remarks, I would like first to review the company's performance during the second quarter, then offer commentary on the short-term outlook, and finally reflect on where we stand in our performance strategy vision.

As we close one of the most difficult quarters for our industry, I want first to thank the women and men of Schlumberger for their resilience, performance, and dedication during these unique circumstances and express my pride not only in what we have achieved but also in what we contributed for the health of the communities where we work and live.

Reflecting on the quarter's performance, I would like to comment on four key attributes that clearly made this quarter unique in its achievements: operational performance, margins, cash and liquidity, and Digital.

First, our operational performance supported our best-ever safety and service quality performance on record. Indeed, our frequency of safety incidents reduced nearly 50% from a year ago, whilst our service quality improved nearly 40% year-on-year—to reach a new benchmark in integrity performance for our customers. This is an attribute of our performance vision that is becoming a clear differentiator in execution, and very well acknowledged by our customers.

Second is the strength of our operating margins—with 18% decremental margins despite the most severe and abrupt activity drop. These margins resulted primarily from the combination of swift actions on variable costs and the decision to accelerate the restructure of the company. This new organizational structure of four divisions aligned with our customers' key workflows and five key basins of activity, is significantly leaner and more responsive, adapted to the new industry normal, and strategically aligned with our performance vision.

Internationally, the impact of these decisive actions also combined with progress on our capital stewardship program and continued industry adoption of new technology, particularly reservoir evaluation and digital solutions. As a consequence, the margins of our international franchise remained remarkably resilient—flat sequentially—despite the material revenue contraction and the adverse margin impact from the major disruption in Ecuador. As outlined in the earnings release, the majority of our GeoMarkets and three out of four business segments either expanded or maintained margins internationally, clearly demonstrating the strength of our franchise and the resilience of our earnings power.

In North America, we accelerated the restructuring initiated last year—with emphasis on scale-to-fit and the asset-lite business model—with significant permanent reductions to fixed and infrastructure costs. At this point, we have shut down about 150 of our facilities and continued to make progress on the technology access franchise. In short, we readied the business for a market of smaller scale and lower growth outlook but with higher returns.

Third, the cash flow performance was extremely solid during the quarter, building on very strong cash flow from operations and leveraging the aggressive reduction of our capital spending. In fact, cash flow was still strong even when excluding working capital and accounting for the significant negative impact of severance payments during the quarter. Similarly, the liquidity position of the company significantly improved during Q2, while debt was visibly lower year-over-year.

The attention to liquidity and cash preservation has been a very clear focus for the entire management team and finance function during the last several months, and I am quite satisfied to have navigated this very difficult quarter with such a positive outcome.

Finally, the adoption of digital, both internally and externally, is becoming a major factor of performance and was very impactful during the second quarter—operationally and financially.

Internally, we made significant improvements in the deployment of digital operations—particularly remote operations and digital inspections—as the COVID-19 pandemic restrictions created a catalyst for further adoption.

Our drilling remote operations expanded over 25% during the quarter to exceed two-thirds of our drilling activity. We have drilled 1,250 wells in Q2 using our remote operations capabilities, supported by more than 250 remote operation engineers.

In addition, we are now performing over 1,000 digital inspections per week, applied to maintenance, manufacturing, or integration applications across more than 40 countries, leveraging our digital backbone infrastructure.

Therefore, during the quarter, digital operations had a magnifying impact—lowering the cost of service delivery, the size of operating crews, and increasing efficiency across operations life cycle, hence contributing to our operating margins.

Externally, we saw greater adoption of our open digital platform for both subsurface and operations solutions. The diversity and depth of the digital solutions deployed with our customers, as described in several examples in our earnings release, reflects the growing maturity of the digital transformation in our industry and the success of our DELFI* [cognitive E&P] platform.

We are extremely proud to be associated with ExxonMobil for the deployment of DrillPlan* [coherent well construction planning solution] and DrillOps* [on-target well delivery] digital solutions to transform drilling planning and operations, including automation. We share the same vision for the future of our industry, with ambition to deliver faster and lower-cost wells through digital technology.

As digitalization is accelerating, we are also seeing continued progress in technology adoption despite the challenging context, as fit-for-basin and performance-focused technology generate significant efficiency gains for our customers.

All in all, this quarter promised to be messy from an activity outlook, and it certainly was. However, the performance and resilience of our team, our decisive actions to preserve cash and margins, and the continued execution of our strategy, including digital, have delivered a very strong outcome, resetting the company's competitiveness, and enabling us to operate with resilient margins in a structurally smaller market.

Now let me turn to the short-term outlook.

Given the uncertainties regarding the pace of economic and oil demand recovery, the range of activity outcomes for the second half of the year is still wide. However, with what we know and see today, we expect the global activity decline to recede into a soft landing in the coming months, absent further negative impact from COVID-19 on economic recovery or escalating rig activity disruptions.

In the North America market, there is an uptick of [drilled but uncompleted] DUC completions activity in the US, contrasted by the slow but continued decline of both land and offshore rig activity. The frac rebound is expected to last until the seasonal decline at year-end, provided commodity pricing remains stable.

International activity outlook appears mixed due to seasonal effect across the different basins, however, is still indicative of slight sequential contraction for drilling activity during Q3, particularly for deepwater and exploration.

With this combined North America & International activity outlook, and based on our position in the respective markets, we anticipate revenue to remain essentially flat sequentially on a global basis, with a slight positive uptick internationally, offset by flat- to low-single-digit decline in North America.

In this context, and absent of any new setback due to COVID-19, we expect EBITDA and operating income to grow and the respective margins to expand during Q3, above and beyond the positive impact of impairment charges.

These margins will benefit from the combination of incremental restructuring cost savings during the second half of the year, tailwind from the recovery of activity in Ecuador, and continued execution of our capital stewardship strategy.

While we continue to navigate the trough of this cycle, we are actually setting an inflection point in our margin performance, ahead of the recovery and despite the backdrop of a significantly smaller market size.

Cash flow performance in the coming quarter will continue to benefit from the tailwind of our aggressive capital spend adjustment, focus on working capital efficiency, and incremental cash savings from our restructuring program. Our ambition in the second half remains positive free cash flow—despite anticipated severance payments.

Put another way, in a flattening activity outlook for the next two or three quarters, our ambition is to execute on a path of visible margins recovery and robust free cash flow generation as we transition into 2021.

We embarked on a new strategy less than one year ago, but market conditions created the catalyst to accelerate the restructuring of the company to align with our performance vision. The early results of this strategy execution are already visible in our operational performance, our financial results, and in the alignment with the new industry landscape.

Our mid- to long-term financial targets remain intact and clearly focused on returns. I believe that the steps accomplished during the quarter not only solidify our vision, but also have created a clear path to restore margins and returns performance despite a structurally smaller market.

And now I will hand the call to Stephane, who will discuss Q2 financials and the impact of our cost-out program in a bit more detail.

Stephane Biguet *Schlumberger Limited – Executive VP & CFO*

Thank you, Olivier.

Good morning ladies and gentlemen and thank you for participating in this conference call.

Second-quarter earnings per share, excluding charges and credits, was $0.05. This represents a decrease of $0.20 sequentially and $0.30 when compared to the same quarter of last year.

During the quarter, we recorded $3.7 billion of pretax charges. These charges primarily relate to workforce reductions, the impairment of an APS investment, and excess assets. You can find details of the components in the FAQs at the end of our earnings press release.

Other than the $1 billion of severance, the rest of the charges are largely non-cash. The charge relating to severance covers both the permanent fixed-cost reductions we are implementing as part of the Company restructuring as well as the variable headcount reductions we are executing to adjust to the reduced level of activity.

It is important to note that these impairments were all recorded as of the end of June. Therefore, our second quarter results did not include any benefit from reduced expenses as a result of these charges.

However, going forward, the impact of the Q2 charges will result in reduced depreciation and amortization expense of approximately $80 million on a quarterly basis, while lease expense will be reduced by $25 million.

Approximately $70 million of this quarterly pretax reduction will be reflected in the Production segment. The remaining $35 million will be reflected amongst the Characterization, Drilling, and Cameron segments.

The quarterly after-tax impact of these reductions is approximately $0.07 in EPS terms.

I will now summarize the main drivers of our second-quarter results.

Overall, our second-quarter revenue of $5.4 billion decreased 28% sequentially. Pretax segment operating margins decreased 303 basis points to 7.4%.

The swift actions we have taken to reduce variable costs—combined with the early results of our restructuring and structural cost reduction efforts—resulted in decremental margins of less than 20% both sequentially and year-over-year. As a reminder, our restructuring program will permanently remove $1.5 billion of fixed costs, with more than half relating to our international businesses.

For the sake of clarity, let me highlight that these are true cash savings. They do not take into account the reduction in Depreciation & Amortization expense as a result of impairment charges.

We have achieved approximately 40% of this $1.5 billion target in the second quarter and we aim to complete the large majority of the remainder before the end of the year. This will provide a strong tailwind to our margins in the second half of the year and into 2021.

Now looking at our results by business segment, second-quarter Reservoir Characterization revenue of $1.1 billion decreased 20% sequentially, while margins increased 357 basis points to [17.6%†]. The revenue decrease was due to customers curtailing discretionary exploration-related expenditures. However, margins expanded as a result of the implementation of prompt cost reduction measures and the resilience of our digital businesses. The adoption of new Wireline technology also contributed to the margin increase.

Drilling revenue of $1.7 billion decreased 24% while margins fell by 289 basis points to 9.6%. These decreases were primarily driven by a sharp decline in the North America land rig count and COVID-related restrictions in Latin America, Africa, and Europe.

Production revenue of $1.6 billion decreased 40% sequentially and margins fell 630 basis points to 1.5%. These declines were largely a result of a sharp drop in pressure pumping activity in North America land.

Additionally, a production interruption in Ecuador, that was caused by a major landslide, resulted in a revenue reduction this quarter of approximately $100 million in our Asset Performance Solutions or APS business. This had a significant—albeit temporary—impact on our decremental margins.

Largely as a result of this production interruption, partially offset by the effects of the Q2 impairment, we anticipate APS amortization expense will increase by approximately $40 million next quarter.

Finally, Cameron revenue of $1 billion decreased 19% while margins decreased by 180 basis points to 7.9% as international margin expansion partially offset the impact of the severe activity decline in North America land.

Let me now turn to our liquidity.

I was very pleased with our cash flow generation during the second quarter, given the environment we were operating in. We generated $803 million of cash flow from operations and $465 million of free cash flow. Both of these amounts are higher than last quarter, despite making $370 million of severance payments during the second quarter.

As a result, we ended the quarter with total cash and investments of $3.6 billion. Our net debt at the end of the quarter was $13.8 billion, an increase of $479 million compared to last quarter, but down almost $1 billion when compared to the same time last year.

During the quarter, we spent $251 million on capex and invested $61 million in APS projects.

Our total capital spend for 2020, including APS and multiclient, will now be approximately $1.5 billion. This represents a 45% decrease as compared to 2019, mostly coming from lower capex in North America and reduced investments in APS projects. Our total APS investments for 2020 was revised down to about $300 million.

Despite the second quarter being the most challenging quarter in our modern history, we were still able to take steps to further strengthen the balance sheet.

We issued EUR 1 billion of 1.375% Notes due 2026, $900 million of 2.65% Notes due 2030, and EUR 1 billion of 2% Notes due 2032.

By issuing these notes at attractive rates, we were able to retire approximately $1.5 billion of bonds that were coming due in the next four quarters. It also allowed us to pay down existing commercial paper, providing us with additional flexibility.

We ended the quarter with $1.8 billion of commercial paper borrowings outstanding. Therefore, after considering the $3.6 billion of cash on hand, as well as $6.2 billion of undrawn credit facilities, we had approximately $9.8 billion of liquidity available to us at the end of the quarter. This represents an increase of $3 billion from where we ended last quarter.

In light of this available liquidity and the various actions we have taken during the quarter, our debt maturity profile over the next 24 months is quite manageable. We only have $500 million of bonds coming due in the fourth quarter of this year and another $665 million coming due in the third quarter of 2021. The next maturity after that will only come in August 2022.

Before I conclude, let me say a quick word about our financial reporting going forward. The corporate reorganization we are undertaking is a significant exercise that will take some time to fully implement. Therefore, we will continue to report our results for the third quarter consistent with our historical practices.

Starting with the fourth quarter, we will report our results on the basis of the four new divisions. We will continue to disclose revenue on a geographic basis quarterly in line with our historical format—in other words, split between North America, Latin America, [Europe/CIS/Africa] ECA, and the Middle East.

Going forward, once a year, in connection with our fourth quarter and full-year earnings release, we will disclose pretax operating income split between North America and the rest of the world. These margins will include the results of the Cameron businesses.

Shortly after we issue our third quarter earnings release, we will provide historical pro forma financial information based upon the new division structure as well as the annual geographic margins to assist you with your modeling.

I will now turn the conference call back to Olivier.

Olivier Le Peuch *Schlumberger Limited – CEO*

To close, let me leave you with three points:

Firstly, our Q2 performance reflects the decisiveness and depth of our cost adjustment and cash preservation actions. I am very pleased with the operational performance, international margins resilience, cash flow results, and uptake in digital during the quarter.

Secondly, we are resetting the company structure to support our performance vision and to align with the new market reality, and as such, we have initiated a clear path to restore margins and returns performance with the backdrop of a structurally smaller market. We expect this to show visibly during the second half, absent of a setback in economic recovery.

Finally, our performance strategy—with digital and sustainability as imperatives—and capital stewardship and fit-for-basin technology as performance factors, will create differentiation in this new industry landscape and will support our returns ambition, particularly as the future recovery pivots towards international markets.

Now, before I close the call and wish everyone a safe and happy summer, I would like to thank Simon Farrant for nearly 33 years of service, as he has elected to take an early retirement from Schlumberger. Simon has been a familiar voice and face throughout the last 6 years—26 quarters—in his role as Vice President of Investor Relations, and I trust that his unique contributions to both Schlumberger and the investor community will be greatly missed. Simon, we wish you and your family all the best. Enjoy the new chapter!

ND Maduemezia, who most recently was the Sub-Sahara Africa GeoMarket manager, will take over from Simon effective at the end of this month. I ask that you all welcome ND and extend to him the same, high level of support and professional engagement as shared with Simon. Welcome, ND.

*Mark of Schlumberger.

†On the conference call, the speaker unintentionally stated 7.6%. The intent was for the statement to refer to 17.6%.