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SLB.N - Q2 2020 Schlumberger NV Earnings Call

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OVERVIEW:

Co. reported 2Q20 revenues of $5.4b and EPS, excluding charges and credits, of $0.05.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and 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 the Vice President of Investor Relations, Simon Farrant. Please go ahead.

Simon Farrant - *Schlumberger Limited - VP of IR*

Good morning, good afternoon, and 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 details on our financial results. Then we'll open up to your questions.

As always, before we begin, I'd 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 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 second-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, and good morning, ladies and gentlemen. Thank you all for joining us on the call.

Today, in my prepared remarks, I would like first 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 in 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 community where we work and live.

Reflecting on the quarter's performance, I would like to comment on 4 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 integrated 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 organization structure of 4 divisions, aligned with our customers' key workflows and 5 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 margin of our international franchise remain 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 3 out of 4 business segments either expanded or maintained margin 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-light business model, with significant permanent reduction to fixed and infrastructure costs. At this point, we have shut down about 150 of our facilities and continue 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'm 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 performance of -- factor of performance and was very impactful during the second quarter, operationally and financially. Internally, we made significant improvement in the deployment of digital operations—particularly remote operation and digital inspections—as the COVID-19 pandemic restrictions created the catalyst for further adoptions.

Our drilling remote operations expanded over 25% during the quarter to exceed 2/3 of our drilling activity. We have drilled 1,250 wells in Q2 using our remote operations capability, supported by more than 250 remote operations engineers. In addition, we are now performing over 1,000 digital inspection per week applied to maintenance, manufacturing or integration applications across more than 40 countries, leveraging our digital backbone infrastructure. Therefore, during the quarter, digital operation had a magnifying impact, lowering the cost of service delivery, the size of operating crews, and increasing efficiency across operation 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 digital solution 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 platform. We are extremely proud to be associated with ExxonMobil for the deployment of DrillPlan and DrillOps digital solutions to transform drilling planning and operation, 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 action 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 DUC completion activity in the U.S., 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 the seasonal effect across the different basins. However, it's still indicative of slight sequential contraction from -- for drilling activity during Q3, particularly for deepwater and exploration.

While this -- with this combined North America and 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 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's 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, focused 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 2 or 3 quarters, our ambition is to execute on a path of visible margin recovering and robust free cash flow generation as we transition into 2021.

We embarked on a new strategy less than 1 year ago, but market conditions created a catalyst to accelerate the restructuring of the company to align with our performance vision. The early results of this strategic 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 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 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 and 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 7.6% (sic) [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 will still be 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 4 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 4 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, ECA, and the Middle East.

Going forward, once a year and 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 & Director*

Yes. Thank you. Thank you, Stephane. So I think we are ready to take your questions.

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*

Olivier, so clearly, digital technologies are gaining a lot of traction as the industry accelerates, intensifies its digital journey, and you guys are, of course, leading this charge here. Could you perhaps break out how much of your revenue and earnings comes from digital today? And what the -- what your plans are for that percentage in the future?

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

Thank you, James. So I think as we commented before, I think we are not ready to disclose the detail of our revenue and margin contribution -- net contribution from the digital business. Suffice to say that I think it has been accretive from the growth. It has been the segment of our business that has been declining the least in the last quarter. It has been the one that has seen the most expansion of margin as well during the quarter. So I think it is material to our business.

Our ambition remains the same. We want to double this business in the midterm, in -- double its size. And I think we will use for that 2 avenue -- 3 avenues, the avenues of our subsurface digital platform, where we are doing this transition to cloud-based DELFI solution with our customers, and I think we are already seeing a lot of traction into that space. And I think this will give us new revenue stream of IT infrastructure cloud operation in addition to transformation services for every customer that we transition.

Secondly, we want to open a new business around data and be it on the analytics or be it on the subsurface operational data that we start to offer a platform for data exchange or for trading those data. So we have introduced GAIA as a platform, and I think we are seeing success through national data rooms, as you have seen in Egypt, and other place in the world. So I think that's the second new revenue stream that we are developing.

And finally, digital operation. I think you have seen recent announcement of the partnership we have with -- we have developed with Exxon, and you are about to hear more in the future. We'll continue to lead in this drilling operation as well as production operation with Sensia, our partner, our JV.

And I think these are the 3 revenue stream that we are developing compared to one we had before. So this will give us the opportunity to expand in multiple facets and not only into the license for subsurface application.

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

Okay. Great. That's very helpful. Maybe just a quick follow-up. As we transition to digital, understanding that your costs are lower, but also the customer fees are lower cost, is the ultimate EBITDA dollars, the absolute dollars, are they higher or lower?

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

I think, no doubt, I think with this growth and accretive margin, it would be higher. I think using -- the benefits from digital will also benefit our customer. That's the reason why we are seeing this adoption, because they realize that they extract efficiency, they transform their own operational workflow and, as such, reduce the total cost of the -- in the life cycle of the operation. So we will benefit, they will benefit. We believe we are at the edge. We are ahead of our competitors. And we own the platform that the industry is adopting. So that will give us a sustainable differentiation.

Operator

And our next question is from Sean Meakim with JPMORGAN.

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

Olivier, yes, the cost reduction plan is robust. No one doubts Schlumberger's ability to execute, as we saw in the second quarter. As we've discussed in the past, the medium term, you can't really cut your way to prosperity. So it will be great if we could maybe learn more about how you plan to approach the next cycle. Last cycle, the service sector led with discounts to customers, and that was not least the large-cap diversifieds. I'm sure you received the same request this time around. As you're going to execute well on the cost-out program, looking beyond that, how do we defend the top line trajectory of the coming cycle?

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

Yes, Sean, I think you have to realize that the -- compared to the last cycle, I think things have changed. And first and foremost, I think the margins have been reset for the whole industry. The pricing concession have been steep, and we have not recovered from this pricing from the last cycle.

So I think, first, there is not much that we can give and share. And I think the approach that we are taking with our customers, actually engage collaboratively across the full life cycle of their operation and eliminate waste and focus on engaging to reduce cost of service delivery jointly. And I think we are seeing success in this approach. We are being awarded an expanded scope when we succeed into eliminating costs and eliminating waste across the value chain.

So you will see more of this approach and less of a pricing because the industry doesn't have much to give. And I think our customers realize this. And I think we are working more collaboratively than we had in the last 5 years on this. And I believe that the margin expansion that we are realizing or the resilience of the margin we are realizing today will be something that we'll be able to keep and build upon as the recovery will start to happen.

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

I think that makes sense. Then I guess, as we look out what may be a couple of years away, but at some point, there will be another large tender that will hit the market, and I think that's probably where the rubber meets the road to some degree. How do you think about the competitive dynamics for those large, multiyear tenders that have always been kind of the thorn in the side of this sector?

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

I think the lesson learned from this, I think, is the industry has learned to be capital disciplined. And I think we have learned, all of us. And I think we have suffered from some of the steps we took as an industry. And I think the capital discipline that I have seen and that we are using today, I think is very prominent in many place. And I think we have been having a very strict capital stewardship program, where we make a clear choice on the, I would say, allocating capital where we see returns. And as such, we are grading the opportunity that comes our way, and I believe some of our competitors are applying the same approach as the return are not acceptable the way they were and the way they have been at the trough. So I think the capital discipline is something that has changed. And I think expect that the capital discipline will be an element of success in the future.

Now this being said, very large tender, very large scope that have a runway for multiyears will be competitive. But I think we'll demonstrate we have the most competitive-cost platform to operate those large contracts, and we'll be able to retain margins in those conditions.

Operator

And next, we have a question from Angie Sedita with Goldman Sachs.

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

So around your Q3 guidance for EBITDA and operating income to be up, can you share any additional thoughts around magnitude as far as margins and the bottom line? And then the levers within those numbers, how does Ecuador factor into these numbers as it comes back as well as the furloughed employees coming back? And any additional thoughts around the APS tariffs in Ecuador given oil prices?

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

Let me -- Angie, let me offer some very qualitative comments, and I will let Stephane add, if he believes that we need to add.

So first, I don't think we are in a position where we would like to give quantitative guidance on these. I think considering the level of uncertainty and the mix that could, as we have seen in the second quarter, change dramatically particularly internationally, I don't think I will go further on a quantitative guidance going forward.

But I think we are seeing positive and negative. Obviously, on the positive side, we are seeing the fall through, the incremental impact of our restructuring costs that will continue to fall into a tailwind for our margins. We'll also see, obviously, the return of our Ecuador activity, as you have heard, $100 million impact on the top line. That will come back, both EBITDA and margins, in the -- and operating margins, in the third quarter. And at the same time, I think the -- our execution that we have seen happening on capital stewardship and success of technology, including digital, will also be an uplift.

Now this would be partially offset. And one of them will be the top line measure that we took. Exceptional measure we took during the second quarter will not be there again. But I think as a mix, you understand that this will lift our margin despite a top line flat.

Stephane Biguet - *Schlumberger Limited - Executive VP & CFO*

Just to add, Olivier. Maybe one additional factor on top of incremental fixed cost savings is also the full quarter effect of the large headcount reductions we executed in Q2. The exit rates of those headcount reduction was much larger than the average. So we'll have that tailwind as well.

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

Okay. Okay. Fair enough. And then I mean you really had impressive results in Reservoir Characterization as far as margins. Can you talk a little bit around how much of that was driven by cost cutting versus the impact of digital and maybe even Wireline? And when could we start to see the similar transformation across your other businesses?

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

No, very good question. I think the -- first, I think Reservoir Characterization is certainly the one that is the least -- having the least exposure to North America as a benefit -- had a benefit on international. As I did mention, 3 of the 4 business groups has flat or expanding margin internationally, and that was the case for Reservoir Characterization.

Now to be specific, I will say that a little bit more than half, I will say, came from this aggressive action we take on the structure and cost reduction. But I think the other half came from technology adoption. And technology adoption, otherwise reservoir evaluation from Wireline with Ora as the platform of choice, continue to be very, very successful in the campaign of the -- even if we have less exploration activity, we are able to deploy this new technology with much success, and it was the highest quarter in terms of revenue for that new technology, Ora.

And digital, so I will say that it's a technology success as much a technology adoption success as much as a cost structure. So the other segment have technology (inaudible), and we'll continue to succeed as well. So I'm not worried about our ability to grow margin in every business group. But obviously, we benefited more from the differentiation of our technology in Reservoir Characterization.

Operator

Very good. And our next question is from the line of Scott Gruber with Citigroup.

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

Stephane, can you walk through a few of the major cash items over the next few quarters, specifically with regard to working cap? What are your expectations for the size of the traditional second half release? And then what are your expectations for cash severance in the second half? And how does that split between 3Q and 4Q?

Stephane Biguet - *Schlumberger Limited - Executive VP & CFO*

Sure, sure. Look, for the second half, we actually expect our cash flow from operations to remain very strong, even if, indeed, you're right, the working capital release will not be as large as it was in Q2 because activity -- if we assume activity stabilizing, as we said, in the second half.

However, again, with our additional fixed cost cash savings materializing in the -- in the rest of the year and the reduced intensity of our capital spend, we think we can still generate positive free cash flow in the second half despite the additional severance payments that we will incur. And to your question, we think we will incur most of the remaining severance payments in the second half of the year.

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

And we should think about -- is the $1 billion less the $370 million paid in the second quarter in terms of what's remaining for cash severance? Is that the way to think about it?

Stephane Biguet - *Schlumberger Limited - Executive VP & CFO*

Yes. You can put a little bit more because we had $200 million of provisions at the end of March as well.

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

Okay. And then just on the cost-out program. You mentioned realizing about 40% of the $1.5 billion during the second quarter. Is that a full quarter impact? Or was that realized by quarter end? And then just some color on realizing the majority of the remainder in the second half. Is that fairly linear? Or is it more weighted towards 3Q or 4Q?

Stephane Biguet - *Schlumberger Limited - Executive VP & CFO*

So it is a full quarter impact, meaning that the Q2 results include the 40%, and we exited the quarter actually at a much higher rate. So this is why we have a nice tailwind starting into Q3 and going into Q4 with the remaining 60%. Most of it is -- a lot of it is already realized at the end of -- or triggered at the end of the quarter.

Operator

Next, we go to the line of Bill Herbert with Simmons Energy.

William Andrew Herbert - *Simmons & Company International, Research Division - MD, Head of Energy Research & Senior Research Analyst of Oil Service*

Yes. Olivier, so in a world of record OPEC spare capacity and inventory, which can largely meet the rising call on OPEC output over the next 2 years, how should we think about the uptake for RCG services given the low-hanging fruit with regard to monetizing production?

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

Yes, you're -- I think the RCG, the Reservoir Characterization Group, I think has multiple aspects to it. I think one is the digital. And I think this one, independently of the trajectory of the recovery of the supply-demand balance, will continue to benefit from the digital transformation that is happening in our industry.

When it comes to the Wireline, the testing, the reservoir evaluation aspect, I think you have to look at 2 aspects. One is, first, exploration still is happening and will continue to happen. There were more than 100 wells explored during the offshore during the second quarter, and there will be more than 100 wells, exploration wells in the first quarter. And hence, the ability we have, the differentiation and technology with platforms such as Ora, will continue to be providing us support and sustain margin in this environment.

Secondly, Reservoir Characterization also does characterization for producing reservoir, so that when there is a short-cycle upside of trying to extract more from existing reservoir without exploring, we are applying technology for intervention, we are applying technology for testing of the reservoir so that we can optimize. And I think we have seen actually more resilience of that Wireline intervention production services during the quarter than on the evaluation services during the last quarter.

So I'm reading this. I'm optimistic and quite reassured that the portfolio we have is well balanced and include for Reservoir Characterization production-related technology that will make a difference as our customer will go back into extracting more from the reservoir and the producing field they have.

William Andrew Herbert - *Simmons & Company International, Research Division - MD, Head of Energy Research & Senior Research Analyst of Oil Service*

Okay. And then Stephane, with regard to, I guess, depreciation, did you say that Q3, that total depreciation will be down $80 million quarter-on-quarter?

Stephane Biguet - *Schlumberger Limited - Executive VP & CFO*

Yes, it will be from the impairment effect. However, you will also see a reversal coming from the Ecuador landslide incident that will partially offset this effect. But from impairment totally -- yes, go ahead. Go ahead.

William Andrew Herbert - *Simmons & Company International, Research Division - MD, Head of Energy Research & Senior Research Analyst of Oil Service*

Got it. So the net impact, we had $604 million in Q2. Approximately, what do you think the number and the guidance is for Q3?

Stephane Biguet - *Schlumberger Limited - Executive VP & CFO*

It is not going to be so far from Q2, if you assume the same revenue levels we have.

Operator

And our next question is from Kurt Hallead with RBC.

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

So Olivier, I was wondering if you can potentially give us a little bit more color around what may be -- what you may see happening in terms of business dynamics in the Middle East. There's been a couple of other earnings reports from some of your competitors this week. It seems like there's some mixed messages in terms of overall level of activity and, I guess, still some discussion around some pricing concession dynamics. So you gave us some good color on Latin America and kind of what to expect in Ecuador. So just hoping you can give us some of that same kind of color and context on the Middle East.

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

Yes, thank you. So I think the Middle East activities is seeing indeed a unique mix. The reason for this is that, as part of the OPEC+ commitment and compliance, there were decision made during the second quarter for several of the national company operating in Middle East to contain their activity and to reduce activity, including rig activity or rigless activity during the third quarter.

So this is impacting several countries and, in particular, Saudi. So the number of rigs that Saudi was operating at the beginning of the year compared to where it is operating now, they will be more than 40 rigs down from January to June, and another 9 or 12 rig possibly will go down in the third quarter. So no doubt, that there is a decline by the effect of the transition exit rate from Q2 as well as some further contraction of activity in the third quarter. That's true for that country.

So depending on the exposure you have in Middle East, it can be significant or it can be offset. In our case, we are offsetting this by gain of activity or share in specifically Qatar and Kuwait. And as such, the overall outlook for us on Middle East is relatively flat on a sequential basis where, indeed, the underlying rig activity sequentially will go down 6% to 7% across the region. But depending on the -- so yes, the activity is going down sequentially, no doubt. And it will not be corrected because of the decision of last week OPEC+ agreement to reinstall -- restore the 1.9 million barrel cut. This was already factored those activity cuts were decided. And hence, I'm not expecting any impact on this. So yes, mix down. However, depending on the market exposure, we, in our case, are able to hold our top line relatively flat in that context.

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

That's great. And then my follow-up is you made a reference that given the cost-out dynamics execution and so on that you would expect your operating income margins and EBITDA to improve, obviously, in the third quarter. But it seems like there's going to be some built-in momentum in the system that could carry you over into the fourth quarter even if there is some seasonal decline in revenue. So just wanted to kind of test my theory on that to see if that's true. And then as part of that, I was also curious as to what business segment do you think has the best -- will show the best improvement in EBITDA and margins as you get through the second half of the year?

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

Good question. I think the first, we do confirm that our ambition is to indeed, on a flat outlook, absent of a significant setback that would come from a reversal of the pandemic situation. But -- and considering the forward looking, there will be some seasonal effects, so it's very early to give a perspective on the top line evolution from third to fourth quarter. But assuming that the current directional soft landing of activity continues well into the fourth quarter, we will expect indeed this benefit to carry through and this margin expansion to be consistent and to still hold both from EBITDA and from the operating margin in the fourth quarter. So that's correct, and I think we are supporting this.

I don't think we are in a position where we can project, and we want to detail and give guidance on the business segment outlook beyond next quarter. We expect them to indeed solidify and expand margin next quarter. But I think to go beyond that, there will be some end-of-year effect that could twist some of the fall through. But overall, on a global basis, at the company level, this is what we're expecting.

Operator

And next we have a question from the line of David Anderson with Barclays.

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

I have bigger-picture question for you. But I want to ask a quick question first on the near term, particularly on the Middle East.

You talked about mix being an issue there, but in terms of the rigs going down, is it mostly oil? I'm just curious if you can just talk about the mix between oil and gas. Is gas still kind of largely maintained there?

And secondarily, is there much impact on this on your LSTK contracts at all? You didn't really get into that at all. I'm just wondering if that has any impact there.

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

So the first measure during the third -- the second quarter have been obviously on oil. However, there have been some side effects on gas because of budget reductions. So budget constraints have led to reduction of activity in gas as well. And for what specific, I'm sorry.

The gas LSTK contract indeed have reduced significantly. I'm not talking about the unconventional. I'm talking about the conventional gas operation frac, coiled tubing rigless operation. And this has reduced to a new floor, and this will possibly rebound. But yes, gas was affected for us.

The drilling, LSTK, by contrast was unaffected, probably because the performance of those LSTK contract is differentiated. And there is a mix of oil or gas LSTK drilling contract, and both were actually sustained and have not been impacted at this point. We don't expect to be the case. So that's -- just to give you a little bit of the -- more color.

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

That's great. So my bigger-picture question is sort of going -- looking back in history here a bit. When we talk about the cycles, it seems to me 1986 is kind of the clear parallel to kind of what we're going through now, not only in terms of magnitude, but kind of how we got here in a lot of respects.

Now you started Schlumberger in 1987. And just like now, Schlumberger was going through a pretty major management change at the time. But as that cycle slowly regained its footing, Schlumberger really accelerated out of the downturn, set the company up for another decade of success. So my question is, as you look back at those days in the late '80s and early '90s, and I'm sure you studied your predecessors during those times, I'm just wondering kind of what are some of the big lessons that you learned about how to position the company, what to focus on? And really, I guess, what were the kind of the keys to success back then and that will -- that you're thinking about now as the cycle resets?

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

So first, I'm not old enough to comment on '86, apparently. So no, Dave, I think if we step back, I think the industry has a proportion to go into crisis and rebound. So no doubt that this industry will engineer or innovate its way out of the current crisis, no doubt.

I think the characteristic on the other side of this cycle will be different from what we have known in the last 10 to 15 years. And I think capital efficiency, capital discipline, efficiency, cost of service delivery would be the prime element of differentiation.

So when I'm talking about technology, we'll talk about technology, that impact the performance across the life cycle. That impact efficiency, hence, the fast adoption of digital will be differentiation.

So when you look -- by contrast, okay, the success we had historically was clearly on expanding our international franchise and being the service company that could create value and find hydrocarbon reserve and help develop those reserve everywhere in the world in any condition.

I think the game has changed. This is not about finding new supply. It's produce this supply at a lower cost. And I think on occasion, it would be short-cycle extraction of the next drop. On occasion, it will be finding the next advantage: offshore, deepwater, large basin. Hence technology will always make a difference, but it will be focused on performance, impact efficiency, and this would change the game.

The second aspect, I think -- and digital obviously is part of this, changing cost of sales delivery, changing our efficiency factor. The second aspect is, I believe, I truly believe that the industry is recognizing and we are having better engagement today than maybe we had in the past across the necessity to integrate and partner across the supply chain, and supply chain across on the service side and from supply to operator, to align in partnership that will transcend and create the game change we need. Because we need to transform as an industry, we need to find a way to extract this capital efficiency by standardization, by changing the way we operate, by transforming the way we digitally align with our operators and across the service industry. So partnership across the supply chain to really step change capital efficiency across the life cycle and the technology that are differentiated per basin, focused on performance and focused on lowering the cost of service delivery. This is what I think will be the winning factor in the future.

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

But I would also imagine that R&D spend is critical as well, right? I mean that's one of the things I've noticed over the decades, that R&D spend is critical.

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

Obviously, as I said, I think the industry will innovate its way. And innovation will come from the way we reinvent ourselves, including this partnership, this transformation, operational transformation. But obviously, there will be a very key element of technology. We will have to invent the next and continue to lead on our digital and invent the technology that will transform operationally the performance of the asset of our customer, step change the efficiency of finding oil, and automate the drilling operations. So that will come through technology investment. And no doubt that we continue and we invest into this to make it happen.

Operator

And our next question is from Connor Lynagh with Morgan Stanley.

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

I was wondering if you could sort of frame something for me here. I think the pace of cost reductions, in many cases, structural cost reductions has surprised a lot of observers of the industry. And I guess, what everyone is trying to figure out is how sustainable or how scalable these cost savings are. So if you could characterize the $1.5 billion of cost savings, are you thinking of your business as able to reach the same revenue levels as previously? Are you not interested in reaching the same revenue levels that you had in, say, 2018 or 2019 because some of it was so returns-dilutive? How do you think about the ability of the organization to respond to higher activity levels, if and when we get there?

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

No. First, Connor, I think we had to realize -- and I think this realization has been across the whole industry, that I think we are transitioning into a new normal. And the new normal means that the market for the foreseeable short term will be structurally smaller in size. So I think we have to make that realization. Whether we call it 25%, 30%, 35% smaller in size, it depends on the region and the business, but I think that's a reality that is leading us. So I think that was the first and foremost realization.

The second one, we have realized and, hence, the decision that we have made to restructure the company to adjust and align with this new reality and to rightsize our structure, including our support fixed structure to account for this. This doesn't say that we are not ready for growth. We're absolutely ready for growth. But I think that we believe that the transformation we going through, the capital efficiency, resource efficiency that we have enabled in the last 3 to 4 years, and the digital transformation we are going through in our operation today will create the leverage that we need to add future growth at much limited -- much more limited resource and our capital needs in the future. So I believe that the asset velocity, the capital efficiency will play out.

Now this being said, we'll be very strict on our capital stewardship program, and as such, indeed, made the right choice to not deploy capital and resource when we believe that the return are not in place. And I think we have started to do this. And we are successful in doing this, and we continue to do so. But at the end, we will grow. The recovery is on the horizon. When and as it recovers, we'll be ready with a different shape, a different structure, a new company, be it in the North America market, where we will -- are changing to an asset-light technology access model and scale-to-fit approach; or internationally, where we are more focused on performance, and we are getting success out of this, and we'll accelerate our digital transformation. So yes, we will. And we believe that this structure will be giving us more flexibility as well as we'll have the core digital and transformation capability to flex with an upturn at better incrementals.

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

Got it. That's helpful. I guess I would extend basically the same question to a point you were making, which is a lot of the things you're doing will make the business more capital-light. Is there a way that you can frame for people how the capital intensity or the CapEx needs as a percentage of sales, however you think of it, could look on a go-forward basis relative to what we saw in the previous cycle here?

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

I think we have been in 5% to 7% as a guidance that we have been consistent with. And I think -- we believe that we'll be able, as the market return to -- after completing some of the transformation for asset light and technology access, to continue on this 5% to 7%. We are comfortable on this, and that's the guidance we keep.

Operator

And ladies and gentlemen, we have one final question from the line of Marc Bianchi with Cowen.

Marc Gregory Bianchi - *Cowen and Company, LLC, Research Division - MD & Lead Analyst*

Olivier, you mentioned a soft landing for international in third quarter. I think there's a lot of questions from investors about budget resets and what we've seen so far internationally this year and if there's incremental risk to 2021. Are you comfortable saying that, absent seasonality that we usually see in the first quarter, that international has bottomed in the second quarter of 2020?

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

It's too early to say, Marc. I think what I'm saying is that the -- for this year, the effect of the budget adjustments and the COVID disruption that were -- did create this significant decline, 22% rig decline in the second quarter, this 2 condition are receding and subdued as we go forward. We don't anticipate significant further budget cuts at the current pace.

This, however, it's too early to say what are the consequence on the budget setting in 2021. If the market was indicative of a slow but steady recovery scenario, that will, according to many of the analysts, IEA, and others, to indicate an exit rate at $50 or $60 in '20 for the Brent. In 2021, obviously, this will certainly support a steady 2021 compared to the H2 in light of activity internationally. But this is too early to say, and I think we'll have to wait the budget cycle and also, obviously, 3 to 4 months of more economic recovery of pandemic containment to judge what 2021 demand-supply balance could be and what the condition for the budget will be in 2021.

Marc Gregory Bianchi - *Cowen and Company, LLC, Research Division - MD & Lead Analyst*

Okay. Well, maybe following up on that thought about '21. If I sort of take the run rate level of EBITDA that you have here, it's about $3.3 billion. And we've got another $900 million of cost savings that should be realized. You were kind of on a $4.2 billion annualized rate. As you look to '21, understanding there's a lot of uncertainty, what would you say are the biggest factors that could be driving that higher or lower?

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

I think, obviously, the pace of economic recovery, the anticipated demand-supply balance and the repercussion it will have on the confidence of the operator to invest or reinvest, I think, is the major factor that will shape the turn of 2021.

So again, if it is a run rate of H2 times 2, we expect to sustain whatever we will produce in the second half. And to multiply by 2, that is a correct assumption. But again, the risk, I think, comes down to demand-supply more than anything else. North America is a little bit of a wildcard, and we don't expect this to be a significant year, but it will be up most likely as a slow but steady recovery, but will not come back to the heydays. So I think overall, I think you have the guidance, but the factor is predominantly the pandemic outlook and the demand-supply, the impact on the demand-supply prediction. And we cannot comment more on at this point.

So I believe we are at the -- it's time to close. So to close, let me leave you with 3 points: Firstly, our Q2 performance reflects the decisiveness and depth of our cost adjustments and cash preservation actions. I'm 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's 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.

So with this, and now before I close the call, I wish everyone -- and I 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 very 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 contribution 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.

Simon Farrant - *Schlumberger Limited - VP of IR*

Thank you, Olivier.

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

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.

ND Maduemezia

Thank you, Olivier. I'm excited and truly honored to take on this role, and I look forward to working very closely with all of you. I turn the call over to Simon.

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

Simon?

Simon Farrant - *Schlumberger Limited - VP of IR*

Well, thank you very much, Olivier. It's been an honor to serve as the Head of Investor Relations, as you say, for the last 26 quarters. And I wish my good friend, ND, all the best in taking over this role.

Thank you, operator, you may close the call.

Operator

Thank you. Ladies and gentlemen, that does conclude your conference for today. Thank you for your participation and for using AT&T Teleconference Service. You may now disconnect.
