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OVERVIEW:

Co. reported 3Q21 revenue of $5.8b and EPS (excluding charges and credits) of $0.36.

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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, this conference is being recorded. I would now like to turn the conference over to the Vice President of Investor Relations, ND Maduemezia. Please go ahead.

Ndubuisi D. Maduemezia - *Schlumberger Limited - VP of IR*

Thank you, Lea. Good morning, and welcome to the Schlumberger Limited Third Quarter 2021 Earnings Conference Call. Today's call is being hosted from the Schlumberger Doll Research Center in Boston, following the Schlumberger Board meeting held earlier this week. Joining us on the call are Olivier Le Peuch, Chief Executive Officer; and Stephane Biguet, Chief Financial Officer.

Before we begin, I would like to remind all participants that some of the statements we'll be making today are forward-looking. These matters involve risks and uncertainties that could cause our results to differ materially from those projected in these statements. I therefore refer you to our latest 10-K 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 third quarter press release, which is on our website. With that, I'll turn the call over to Olivier.

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

Thank you, ND. Good morning, ladies and gentlemen. Thank you for joining us on the call. In my prepared remarks today, I will cover 3 topics: our third quarter results, our view of the near-term macro and the exceptional growth opportunity ahead of us. I will then share some insights on the Middle East and offshore markets, and finally, a first view of the 2022 growth outlook. Stephane will then give more details on our financial results and we'll open the floor for questions.

The third quarter results further emphasize our returns focus, consistent execution and the advantaged mix of our portfolio. Growth momentum was sustained and we delivered a fifth consecutive quarter of margin expansion, achieving the highest pretax operating margin since 2015 and cash flow from operations in excess of $1 billion.

Let me share with you some performance highlights from the quarter across our core, digital and new energy. In our core, first, margin expansion was led by Well Construction and Reservoir Performance where we fully seized the sequential growth opportunity, driving operating margins in both these divisions above mid-teens, the highest levels in the last 3 years. Revenue quality improved, boosted by favorable activity mix and higher new technology uptake that delivered strong margin expansion.

Second, internationally, we recorded growth in all 3 areas with revenue up 11% year-on-year, consistent with our ambition of double-digit revenue growth compared to the second half of 2020. International margin further expanded, exceeding pre-pandemic levels and are at the highest since 2018. In North America, revenue growth was sustained, albeit impacted by transitory supply and logistics disruption. Margins also continued to expand with operating margins firmly at double digits.

Finally, we are pleased with the very sizable activity pipeline secured during the quarter through competitive tenders, direct awards, and contract extensions, some of which include net pricing improvement, building on our differentiated performance, integration capabilities, and technology. These wins enhance our market position, creating a long tail of activity and a platform to further new technology adoption and digital deployment, strengthening our leadership as we enter an exceptional growth cycle.

We are delivering on the promise of our performance strategy, which is increasingly impacting our top- and bottom-line results, both in North America and internationally. As the cycle accelerates, we will leverage our advantaged platform to capture the exciting growth and outperform the market in our core going forward.

Moving to Digital. We continued to progress our platform strategy this quarter, expanding our offering through the acquisition of Independent Data Services and a strategic investment in DeepIQ to further advance our digital technology offering and the adoption of AI solutions in our industry. In digital production operations, we announced a partnership with AVEVA to expand powerful edge and IoT solutions to the field, complementing our Agora* platform and Sensia solutions.

And in digital drilling, we successfully completed the first fully automated section drilled offshore at the Hebron platform for ExxonMobil in Canada, as you have seen in this morning's earnings release. This achievement is a significant step for our industry, particularly offshore, and signals a momentous opportunity to apply digital technology to create a step change in well construction safety, performance, and carbon footprint.

As shared recently, we are seeing the adoption of digital solutions accelerate in our industry. And whilst we are in the early innings, we are excited about the prospect of transitioning the majority of our software customer base—of over 1,700 companies—to our digital platform during the next few years. This growing adoption will generate an expanding set of digital revenue streams over a long horizon as we transition every customer to new digital solutions for the data, workflows, and operations.

Moving to New Energy, we advanced our portfolio by taking a position in stationary energy storage through our strategic investment in EnerVenue, a company with differentiated metal-hydrogen battery technology. This represents a new opportunity set and an expansion of total addressable market in a sector with significant growth opportunities.

In geoenergy, following the success of the pilot in our technology facility in France, Celsius Energy has secured 5 commercial contracts in Europe. This is a significant achievement in the commercialization road map for Celsius as a low-carbon solution for heating and cooling buildings, contributing to global efforts in reducing emissions.

To conclude on this quarter's performance, we once again demonstrated excellent progress in our strategic execution across our portfolio, supporting outstanding results. And I want to thank the entire Schlumberger team not only for delivering another strong quarter but for their unwavering efforts to create enduring value for our customers and our shareholders.

Now, I would like to turn to the near-term macro and growth opportunity ahead of us. The market fundamentals have improved steadily throughout 2021, especially over the last few weeks with oil and gas price attaining recent highs, inventories at their lowest levels in the recent history, a rebound in demand and encouraging trends in the pandemic containment efforts. This strengthening in industry fundamentals, combined with the action of OPEC+ and continued capital discipline in North America, have firmly established a prospect of an exceptional multiyear growth cycle ahead.

In the international markets, all regions are set to benefit from this highly favorable environment, something not seen internationally since the last supercycle. This expansion will occur at different paces across different basins, operating environments and customer groups, resulting in a sustained multipronged growth cycle. Our broad exposure across these different dimensions put us in an advantaged position to fully seize this growth opportunity.

For example, this growth inflection is already visibly underway in Latin America, sparked by the resumption of exploration and the initiation of long-cycle development campaigns. Activity has strengthened throughout 2021, and revenue in this market is already at 2019 pre-pandemic levels. Year-to-date revenue growth in Latin America is at 30%, with broad activity growth across multiple countries, including Argentina, Brazil, Ecuador and Guyana. This growth is expected to strengthen further in the coming years due to ongoing long-cycle development campaigns.

By contrast, in the Middle East, where activity has been more subdued in 2021, the market conditions are set for a material uptick of activity in the coming quarters. The combination of short-cycle activity to meet supply commitments, strategic oil capacity expansion and the acceleration of gas development projects will result in a significant increase in investment throughout 2022 and beyond. Our recent success in tender awards, as detailed in our earnings release, strengthens our market position, and with our strong presence and commitment, will benefit the most from this exciting outlook in the region.

In the offshore markets, we also set for a strong resurgence this cycle. Rig activity grew for the third sequential quarter internationally and is expected to build on the notable increase in development FIDs in the coming [years]. Advances in new technology, digital and integration are driving performance impact offshore, from discovery to well construction, production and recovery, and are creating the conditions for offshore operators to reinvest with confidence in this cycle.

In North America, the imminent resumption of lease sales in the Gulf of Mexico, where we have significant market presence, will drive additional offshore growth as operators capitalize on the advantage of this prolific basin and its existing takeaway infrastructure and extract more value from the core upstream position through exploration and tiebacks.

Taking these factors together, a broad offshore resurgence will result from IOCs building on their advantaged hubs, independents fast-tracking development on their recently acquired assets and NOCs unlocking their gas and oil reserve recovery potential. Our technology, digital enablement, and integration capability are critical advantages in this market environment and are resulting in significant new contract awards, both internationally and in North America.

Finally, we're extremely pleased with our customer reception of our Transition Technologies* portfolio and the accelerated adoption of these technologies that reduce the carbon impact of oil and gas operations. This portfolio is focused on fugitive emissions, flaring, and electrification and is already helping customers decarbonize operations— advancing our net-zero ambition and strengthening our sustainability leadership in the industry. Some examples of this impact are cited in our highlights.

Turning to the fourth quarter outlook. Directionally, we anticipate another quarter of growth with an ambition for growth across all Divisions. Growth will be led by Production Systems and Digital & Integration, benefiting from a year-end sales uplift tempered by seasonal -- typical seasonality in Reservoir Performance and Well Construction. This should result in an overall sequential growth rate similar to the prior quarter.

With this fourth quarter outlook, we expect to reach our double-digit international growth ambition for the second half of 2021 when compared to the second half of 2020. It will also translate into full year revenue growth both internationally and in North America after adjusting for the effect of divestitures.

Building on third quarter operating margin and recent highs, our ambition is to sustain this level of margin performance in the fourth quarter. Consequently, on a full year basis, we remain confident in attaining the high end of our guidance of 250 to 300 bps EBITDA margin expansion, an excellent foundation for expansion in the year ahead.

Now I would like to close my prepared remarks with our earliest views of 2022. Against the backdrop of the constructive environment I described earlier, our confidence in the onset of an exceptional growth cycle is reinforced. At this early point in the planning cycle, and absent a setback in economic and pandemic recoveries, we anticipate very strong global upstream capital spending growth. This growth will impact all basins, every operating environment, short- and long-cycle activity, and all customer groups.

In North America, we anticipate capital spending growth to increase around 20%, impacting both the onshore and offshore markets. Internationally, growth momentum will strengthen, and early indications point to strong capital spending growth in the low to mid-teens, driven by both short-cycle activity and the onset of multiyear capacity expansion plans.

Through our performance strategy, we have strengthened our position across multiple dimensions. In North America, we have enhanced our market position and are now biased to accretive growth onshore and will benefit from strong growth offshore in the Gulf of Mexico. And in the international markets, we have built a multiyear pipeline of strong activity in the most prolific basins that will lead the supply response both in oil and gas.

More importantly, we have enhanced our earnings growth potential significantly, as demonstrated by multiple quarters of margin expansion. In North America, our operating margins are primed to exit the year at the highest levels since 2015, which combined with the favorable market position I've just described, is an excellent platform for margin expansion. Internationally, we're also set for peer-leading margin expansion as we exit 2021 with margins above prepandemic levels. The combination of strong activity growth and operating leverage will support durable margin expansion.

Additionally, through our fit-for-basin and Transition Technologies and capacity tightening, we see favorable conditions for broader net pricing net gains in the coming years in both North America and the international markets. Finally, as a result of our digital platform strategy and growing customer adoption, we anticipate an acceleration of our digital journey, resulting in accretive revenue and earnings growth.

Consequently, we expect margins to expand further in 2022, supporting material earnings growth potential and are increasingly confident in achieving our mid-cycle adjusted EBITDA margin ambition of 25% or higher and sustaining a double-digit free cash flow margin throughout the cycle. I'll now pass the call to Stephane.

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

Thank you, Olivier, and good morning, ladies and gentlemen. Third quarter earnings per share, excluding charges and credits, was $0.36. This represents an increase of $0.06 compared to the second quarter of this year and an increase of $0.20 when compared to the same period of last year. In addition, we recorded in the third quarter a $0.03 gain relating to a start-up company we had previously invested in. This company was acquired during the quarter and, as a result, our ownership interest was converted into shares of a publicly traded company.

Overall, our third quarter revenue of $5.8 billion increased 4% sequentially. Pretax operating margins improved 120 basis points to 15.5% and have now increased 5 quarters in a row. Margins expanded sequentially in 3 of our 4 Divisions, with very strong incremental margin in both Reservoir Performance and Well Construction. This performance was due to a favorable geographic mix, driven by continued international revenue growth as well as a favorable technology mix with increased exploration and appraisal activity and new technology adoption.

Company-wide adjusted EBITDA margin of 22.2% in the quarter increased 90 basis points sequentially. It is worth noting that this margin expansion was achieved despite the well-documented disruptions in global supply chain systems and inflation in select commodities and materials as well as in logistics. Through our global supply chain organization, we are successfully engaging with our suppliers and customers to jointly navigate inflationary trends.

We are collaborating with our customers to optimize planning and, where applicable, make the necessary adjustments through existing contractual clauses or negotiation. As a result, so far, we have largely been able to shield ourselves from the inflation effects. As the growth cycle accelerates, we will continue to be proactive, dynamically adjusting sourcing strategies and leveraging our diverse global manufacturing footprint and supply network.

Let me now go through the third-quarter results for each Division. Third-quarter Digital & Integration revenue of $812 million was essentially flat sequentially as lower sales of digital solutions were offset by higher APS revenue. Pretax operating margins increased 154 basis points to 35%, largely as a result of improved commodity pricing in our Canada APS project. Reservoir Performance revenue of $1.2 billion increased 7% sequentially. This revenue growth was entirely driven by higher international activity. Margins expanded 202 basis points to 16%, largely due to higher offshore and exploration activity as well as accelerated new technology adoption.

Well Construction revenue of $2.3 billion increased 8% sequentially due to higher land and offshore drilling, both internationally and in North America. Margins increased 230 basis points to 15.2% due to the higher drilling activity and a favorable geographical mix. Finally, Production Systems revenue of $1.7 billion was essentially flat sequentially while margins decreased 27 basis points to 9.9%.

Now turning to our liquidity. Cash flow from operation was once again strong as we generated $1.1 billion of cash flow from operations and free cash flow of $671 million during the quarter. This represented a significant sequential increase when adjusting for last quarter's exceptional tax refund of $477 million. We paid $42 million of severance during the quarter. Excluding these payments, the working capital impact on our cash flow was neutral despite the revenue increase. This was driven by a very strong DSO performance.

We expect the fourth quarter to show another quarter of strong free cash flow generation, which positions us favorably to achieve our ambition of delivering full year double-digit free cash flow margins. As a result of this strong cash flow performance, net debt decreased sequentially by $588 million to $12.5 billion.

During the quarter, we made capital investments of $399 million. This amount includes CapEx, investments in APS projects and multi-client. For the full year 2021, we are now expecting to spend approximately $1.6 billion on capital investments. In total, during the first 9 months of the year, we have generated over $2.7 billion of cash flow from operations and $1.7 billion of free cash flow. As a result, we have been able to progress significantly on our commitment to deleverage the balance sheet. This is evidenced by the fact that gross debt has decreased by almost $1.5 billion since the beginning of the year. Net debt has reduced by $1.4 billion during the same period.

Overall, I am very pleased with our cash flow performance and the progress we are making towards strengthening the balance sheet. This will provide us with greater flexibility in our capital allocation. I will now turn the conference call back to Olivier.

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

Thank you, Stephane. So I think we are ready for the Q&A session at this point.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And our first question is from James West with Evercore ISI.

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

So Olivier, 5 sequential quarters in a row of margin growth and really strong execution. How do you think about or how are you considering or planning for continued strong execution as revenue starts to really accelerate as we go into next year?

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

Thank you, James, for the question. Indeed, we are very, very proud and very satisfied with the last 5 quarters. I think they have demonstrated our ability to leverage restructuring, portfolio high-grading, and the foundation we have put in place during this reset we have operated in the last 18 months. But furthermore, I think the -- looking forward as the cycle will unfold, I think there are 2 or 3 characteristics that are -- that will play favorably and that will help us continue to expand the margin as we have seen in the last quarter.

So first, I believe that the market outlook will create favorable market environment, exposing the basins where we have a strong position internationally and, in particular, Middle East so offshore, as I commented during my prepared remarks. Secondly, I believe that performance still matters and will matter increasingly, Hence, our technology offering, fit-for-basin, Transition Technologies and integration capability will continue to make a huge impact, will create a premium for service in both Well Construction, Reservoir Performance, and Production System.

Digital, we see an acceleration going forward, as you have seen that we have continued to evolve, progress, and mature our digital platform strategy, and we are in the last innings of developing this strategy on the platform, on the foundations. Hence, we are now seeing increased adoption and acceleration. And we expect, as I said earlier, that this will be increasingly accretive to growth and earnings going forward.

And finally, as the revenue -- as the activity both internationally and in North America will increase, this will tighten the market and create a condition for pricing. So when you combine this favorable market exposure, the track record we have, the technology adoption that give us a premium and a performance differentiation, and integrated contract with digital, you have the formula for supporting our ambition for 25% or higher EBITDA margin by mid-cycle.

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

Right. Okay, great. That's very helpful, Olivier. And then maybe a follow-up on that. On the digital side, this will be the first cycle where we'll really see digital as a big part of the business. There's been, as you alluded to, widespread adoption but we haven't yet seen the growth cycle with that adoption. So how do you think that plays out? Is it going to allow you -- I mean, obviously, margins will be part of it, that does allow you to grab more market share? I mean, what are the -- what does digital do in an up-cycle, essentially a strong one like we're projecting?

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

I think I will highlight 3 things that will -- will be a result of our success and our investment and leadership in digital. First, obviously, the acceleration of digital adoption by customers through our workflow, data, and digital operation offering, and you are seeing element of this being announced every quarter. And you will continue to see this unfolding across the different customer groups and across different geographies. So this will mean accretive growth in 2022 to our top line by the digital offering we have.

The second aspect is the long-tail effect beyond the cycle. I believe that the effect is -- certainly will last, considering the very significant size of our customer portfolio, the fact that customers are going into it over the long run. We are seeing multiple effect of revenue stream being deployed across multiple quarters and multiple years across the different customer groups we are addressing. And finally, this is generating margins fall-through that are accretive to earnings and will be and continue to help us operate D&I at or above 30% or mid-30s and also will result into our ability to extract from digital operation and our own operation, particularly integrated performance in Well Construction, Reservoir Performance, the ability to extract more efficiency and hence, to expand and support margin expansion on those divisions.

Operator

Our next question is from David Anderson with Barclays.

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

Want to ask you a couple of questions about the unconventional contracts that you announced in Saudi and Oman. So could you just help us understand the pricing mechanisms there? Are these lump sum? Is there a baseline of stages per day? And also just curious where you're sourcing all this equipment? Do you have all this equipment? Does it require capital? Just a little bit more background on these contracts, please.

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

I think this contract are large integrated contracts that we have been winning on our value proposition based on performance, on demonstrated efficiency and ability to deploy technology that make an impact on execution. So we do have the capacity in place. We have demonstrated to pilots and/or to engagement that we had before that we could deliver the required performance that the customers are expecting. And we have priced it accordingly and we demonstrated during the last few years that we have improved our ability to engage, digitalize our operation, and work with customers to get this integrated contract whether it's LSTK or other to be performing and delivering the margins and earnings we need.

So we will continue to extract value from these contracts over the period of time, so we are very proud of winning those contracts. They are based on performance, they are based on technology and our team on the ground. They have done a great job of demonstrating they could take these contracts and get value for customers and for ourselves.

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

And then in terms of the equipment required, do you need to add equipment? Do you need to build out at all?

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

No, we have started to mobilize this equipment that we have already in place. And obviously, this will pull equipment from other place where we have. But we have the equipment in place and we're able to deliver upon the committed contract we are taking on both Oman and in Saudi.

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

And so my other question is around offshore. You seem to be a bit more optimistic than most on the offshore market. You announced the several awards recently. Are you confident enough to say we're at an inflection point, you think, in offshore spend, which I would think would be quite accretive to your margins with higher utilization OneSubsea? And also all the technology you have in well construction you also mentioned digital as well. Could you just kind of talk a little bit about maybe kind of how you're seeing this unfolding over the next year or so?

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

Yes. I think I remain constructive about the offshore environment for a couple of reasons. First, because this offshore environment has been strengthening steadily for the last few quarters, and that's been the rig activity has been increasing lately. And I think we have, in the offshore international market, been growing in the mid-teens year-on-year in H2-over-H2. So that's proof that this activity translating into revenue opportunity.

And I think the offshore markets, both particularly internationally, have been growing and rebounding in the last 2 to 4 quarters. But now looking ahead and looking at the activity, we see a lot of leading indicator. First, the FIDs. If you look at the actual FID of this year or if you look at the projection of some of the WoodMac projection recently published, showing that there will be in excess of $100 million of offshore FID most likely sanctioned by the end of this year and that will almost double next year. And out of this, 50% of that will be deepwater.

So there is an acceleration of FID back to the 2019 level that is on the horizon. And that is a result of IOCs going to exploit their advantaged basin and focusing on the hubs, the National Oil Company exploiting and unlocking the oil and gas reserve to participate to the supply. And finally, there has been a lot of assets trading hands in the last few quarters. And these international independents are also pursuing accelerated FID in different basins we are exposed.

And the result of that is subsea backlog is growing. We are definitely above 1 book-to-bill ratio. And we will certainly be growing year-on-year in excess of 30% or 40% of booking from 2021 -- 2020 to 2021. So we are indeed quite positive and constructive and this plays very well to our portfolio because this Well Construction, Reservoir Performance in exploration appraisal, in large offshore contract are getting the benefit, and it was very visible during the third quarter. So you could take this as a proxy of the future.

Operator

And our next question is from Chase Mulvehill with Bank of America.

Chase Mulvehill - *BofA Securities, Research Division - Research Analyst*

I guess, first thing, kind of a macro kind of higher-level question about kind of this investment cycle. There seems to be this growing narrative out there that the oil and gas industry is going to continue to under-invest this cycle, given the discipline narrative of the E&P industry and also kind of this energy transition focus. And obviously, you talked to more E&P and oil and gas producers than probably anybody worldwide.

And so given the commentary that you expect exceptional growth in a multiyear cycle in the oil and gas industry, this obviously leads you to believe that there's not going to be this under-investment going forward. So maybe if you can kind of provide some color around this and thoughts around the disconnect between some investor perception that you're not going to see a reinvestment cycle going forward.

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

I think the condition set is a unique combination that we are living with. We are living with -- from the result of under-investment in the last 5 to 7 years, combined with a reset that we have experienced in the industry during 2020 and also an elevated capital discipline, partly in North America. When you combine this and look at the demand outlook that will surpass to the GDP growth expected for the next 2 or 3 years, that will surpass the 2019 level sometime next year, I think the result of which will create a pull on international supply and will create a necessity for reinvestment in our industry.

So the questions are very simple. There is an anticipated deficit of supply if there is no reinvestment into our industry. We have seen that many NOCs have signaled that they are set to reinvest into their capacity going forward. The IOCs are re-concentrating on their advantaged basins. They will not be the one leading the growth in this cycle but they will be the one pursuing still the advantaged basins to generate the cash they need to transition to new energy.

The independents are taking benefit of this position, have inherited some prolific assets and are redeveloping those assets with our support and the support of the entire industry to participate to the supply. So I think the conditions are set, undoubtedly, that this demand will have to be met with supply and this supply cannot come with inventory, cannot come with only releasing the OPEC spare capacity. More will have to be built. Hence, it will create activity growth in the coming years. And it's not only a short in 2022. This FID I talked about, this capacity expansion in Middle East are long-term projects that will have a long-tail effect beyond the '22/'23 horizon.

Chase Mulvehill - *BofA Securities, Research Division - Research Analyst*

Okay, all right. That's perfect. Just 1 quick follow-up. Just some clarification on your guidance. Fourth quarter, I think you said flat margins. Was that flat consolidated margins or was that flat for each segment? In other words, if you run the mix, could actually margins because favorable mix, could margins be up?

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

No, no. Chase, we don't disclose and we don't guide on down to the granular division. I think we are talking about a flattish margin, global margin and, in a sense, maintaining very, very high margin and exiting in the mid-teens globally for the company as operating margins and the same level of EBITDA margin. So that's the -- what matters for us is the exit rate and the implication of this exit rate as we enter 2022 as a platform, as a foundation for margin expansion going forward. So the mix is giving us this result of flat or about mid-teens margin, and that's what the ambition and we are very proud of this -- maintaining this level of margins.

Operator

Our next question is from Arun Jayaram with JPMorgan Chase.

Arun Jayaram - *JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst*

Yes. My first question is, Olivier, there's 3 million to 4 million barrels of productive capacity off-line from OPEC. And as the cartel methodically brings back this output, call it, in [4 KBD] increments, wanted to get your thoughts, is this creating any near-term service opportunities for you? And I was wondering if you could maybe elaborate on any shifts globally in spending from maintenance CapEx-type spending to growth in productive capacity, oil and gas and what this means for Schlumberger.

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

Yes. I think the OPEC+ will continue to release this increment of oil to the market to be behind the supply curve beyond the demand curve. But we are continuing to see an increase of intervention activity, short-cycle activity that is starting to materialize in the OPEC+ countries where we are seeing mobilization of intervention stimulation as we have seen lifting and production maintenance activities. So that's the effect on short cycle.

This will also include a rig remobilization to do some infill drilling to start to support this increment of barrels for the country that have the capacity to expand fast. And this will turn into more long cycle as both the gas development is accelerating, and you have seen the Jafurah announcement from Saudi and the continuation of a large gas in the Middle East and elsewhere, as well as the commitment that 2 or 3 countries have taken in the Middle East particularly around the expansion of production capacity, permanent capacity towards the horizon of '24-2027, depending on the country. So what you talk about has an impact on short cycle but this is an underlying activity growth coming from long cycle as well.

Operator

And our next question is -- Arun, do you have any follow-up? We'll move on and we'll go to the line of Connor Lynagh with Morgan Stanley.

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

Just on the first point here, I just wanted to return to Chase's question and just think through some of the dynamics in the fourth quarter here. So I would think with digital being an area that you called out as particularly strong in the fourth quarter as well as some activity growth that you're expecting, it would seem, assuming that supply chain issues aren't getting worse, that you would naturally have some expansion in the margin in the fourth quarter. So I'm just curious what I'm sort of missing in that framework. What's your -- what type of issues are you seeing or accounting for?

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

No, it's a mix effect. I think you have to account for 2 effects: first, the production system that had some logistics and supply-related delay into delivery will have a sizable catch-up in the fourth quarter. And this segment where we are very happy with the double-digit margin and anticipate for margin expansion, this will be, in a mix, slightly dilutive to our margin overall. And that will offset some of the -- what you could expect from a digital fall through where we expect a strong end-of-year sales.

But also you have to add to the mix the fact that you are, in going into a seasonal effect in Northern Hemisphere and to lower mix of exploration and appraisal, that will have an effect and seasonality of Reservoir Performance. That is something that we -- that happens every year. And where the third quarter is typically the high margin quarter due to this probable offshore exposure operation mix, that decline for 1 or 2 quarters before it rebounds strongly every spring. So that's -- when you put this mix together, you result into maintaining the margin at the level we are putting, which is something remarkable and entering the 2022 on a high ground.

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

That's helpful context. Second 1 is a higher-level question here. So you did have some integrated projects you disclosed in the press release. As we think about this portion of your business, I mean, it certainly has been characterized by yourself and peers as probably the later area where you were going to see pricing improvement. But I guess my question is effectively why?

It seemed to me that the service companies that can really execute that kind of large-scale integrated work is a very short list, and it seems like there's a lot of value to be delivered to the customer from that type of contract. So why isn't this an area that we should be more excited about over the next year or 2 here?

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

Well, I think it has remained competitive due to the sheer size of this contract. But until the capacity in the market is stretched and is tightening, I think you will see that the market remains competitive in large integrated contract. But our capital discipline, the activity growing in all basins is set to create a condition for the tightening and hence, a lifting on the core pricing of our offering.

Now we are still very satisfied with these awards because we have demonstrated that we -- through integration, through performance, through technology, including digital and (inaudible) we have been differentiated in our ability to sustain our performance on those contracts and create the value we need to elevate the margins.

Operator

And next, we have a question from Scott Gruber with Citigroup.

Scott Andrew Gruber - *Citigroup Inc., Research Division - Director, Head of Americas Energy Sector & Senior Analyst*

Olivier, you're feeling better about your mid-cycle 25%-plus EBITDA margin target, which seems warranted, given the backdrop here. But if I just look at consensus estimates, at least the market believes it would take you a while to achieve. So if you kind of extend consensus, assume 10% annual growth in '24, '25, extend the 30%-ish type incrementals, the market is forecasting in '22 and '23, it would actually take about 5 years to get to 25%-plus EBITDA margin. Do you think you can outpace 30% incrementals over the next few years and hit that 25% margin faster than 5 years?

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

I think first, it's not a matter of if but when we'll hit and exceed this 25% EBITDA. We have been doing it. We have been delivering over 30% recently. The market condition, as we foresee for -- going forward, as I've commented earlier, are favorable with the right basin and operating environment mix that is favorable to our margin mix. Our technology adoption, performance through integration and digital operation and our accretive digital mix, I think, are putting the condition before pricing kicks in to give us the outlook, a positive outlook on this so that we will indeed ambition to achieve this before 5 years clearly.

Scott Andrew Gruber - *Citigroup Inc., Research Division - Director, Head of Americas Energy Sector & Senior Analyst*

And do you think you can get there without much pricing? The pricing gains just always take a while to kind of move across discrete products into the bundled contracts and then kind of into your average selling price. Do you think you can get the other drivers and get there faster without much pricing?

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

Some of the performance to date, okay, pulling and elevating the performance of our Divisions to their highest level in 3 years or more and restoring to portfolio high-grading North America, already proved that we can move our margins through execution, through performance through high-grading visibly. So can we move forward? I think pricing will only accelerate the time by which this will be met. But we are still constructive that we will achieve this independently of pricing, and that pricing will come as a bonus to elevate beyond 25%.

Operator

Our next question is we're going back to line of Arun Jayaram.

Arun Jayaram - *JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst*

So Olivier, year-to-date, you've reduced debt by about $1.5 billion. And I wanted to get your thoughts on how you're thinking about the priorities for free cash flow generation between cash return, the dividend, and the balance sheet, and also how you're thinking about Schlumberger's investment in Liberty now that the lockup recently expired.

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

I'll take this, Arun. Look, our immediate priority remains the deleveraging of the balance sheet. And yes, we've progressed quite well and we are very happy with its own. So now we do have a clear line of sight to achieving our 2x net debt-to-EBITDA target leverage, and we said we should do that by the end of 2022.

With the earnings expansion, we are expecting in this growth cycle and our continuous focus on capital stewardship, yes, we will continue to generate significant excess cash in the next few years. So this will allow us to maintain a healthy balance sheet, and it will give us the flexibility to increase returns to shareholders as well as fund new growth opportunities.

As it relates to returns to shareholders, this is something we will continue to review with our Board of Directors as the cycle unfolds and the deleveraging of our balance sheet accelerates. And as it relates to new growth opportunities, we will -- whether it's in digital, New Energy, any new investment, we will continue to look at under the strict lens of our returns-based capital stewardship framework.

Your question on Liberty. Clearly, we are happy with the transaction we made now more than a year ago. We are benefiting from the recovery in North America through the significant appreciation of our equity stake there. And yes, monetization is clearly an option. The timing and the pace and the magnitude of this monetization will be based on the market conditions and the outlook. But we'll make sure we'll optimize it basically.

Operator

Next, we'll go to the line of Roger Read with Wells Fargo.

Roger David Read - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

I guess I'd like to come back to the 25% margin goal for EBITDA but think of it maybe in a slightly different way. You've got obviously the typical cyclical recovery, so utilization, you'll get some pricing. You talked about digital as one of the big separating factors. And I was wondering if -- as you look at the goal of the 25%, maybe a weighting of where you think that could go if you thought what would be normal for utilization, normal for pricing and then digital on top? Is it 1/3, 1/3, 1/3? Is it 50-50? I'm just kind of curious how we should think about that coming through.

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

I think it would be difficult to give you a precise outlook because this will depend on every division and almost on every geography, depending on a mix outlook we foresee. But suffice to say that I think our operating leverage will indeed be a base for margin expansion to the way we execute with efficiency using our own digital transformation to execute and extract performance from our execution. So that's the base.

Above that, I will place the technology first and technology mix adoption from Fit-for-Basin that are highly differentiated and successful in all basins. I will include the Transition Technologies that are starting to emerge as a unique differentiator. And it will include also the integration delivery performance in integration contract.

And then indeed and you are correct, our digital expansion will be favorable on top. So I think you have these 3 things, but I don't want to be starting to be trying to create a boundary between these, I don't think is appropriate. And I think it will depend on every basin and every division will have a different trajectory, but we are confident that across the profile we have, considering the international mix, considering the offshore, considering the technology adoption that is coming back, I think this -- we have the path forward.

Roger David Read - *Wells Fargo Securities, LLC, Research Division - MD & Senior Equity Research Analyst*

Okay, great. And then just an unrelated follow-up. I was curious, you talked about a lot of major projects and so forth globally. We've seen obviously some pretty extreme pricing in LNG and natural gas overall. So if you just kind of looked at natural gas as a driver on the project side or the activity side, anything globally you could say? It looks like it's improved over recent months or recent quarters. Or anything on the sort of larger project side there (inaudible).

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

Gas is there for a long time as a critical supply, as a transition fuel as well. So I think you see that the existing reserves, be it on unconventional or conventional, offshore and onshore will be commercialized by our customers as long as they have a path to market through LNG or they have a path to market to pipeline. So we see this accelerating. You have seen some of the critical announcement we made this morning relating to onshore, offshore, unconventional and conventional gas developments, and we see it as a trend that is not about to stop.

Now, will it accelerate? I think the gas supply/demand is misbalanced this year, will recover a little bit next year but will continue its strong trajectory going forward. And there are few countries that are committed to accelerate their gas transition. India is the most visible one that will step change their consumption of gas and will then participate to fuel the gas demand and will itself expand in gas supply as well domestically.

So Middle East, domestic gas, India as an engine of growth for gas beyond the current mix and some specific security supply that will trigger some gas development from existing gas, the redevelopment or short-cycle activity. So I'm optimistic, hence, very, very pleased with the gas contract we have been winning this quarter.

Operator

And our next question is from Waqar Syed with ATB Capital Markets.

Waqar Mustafa Syed - *ATB Capital Markets Inc., Research Division - MD of North American Energy Services & Head of U.S. Institutional Equity Research*

Olivier, just 1 broader question. You've given us some good guidance on upstream capital spending for international markets and North American markets for next year. Now with respect to exploration budgets in particular, do you see the growth rate of exploration spending in line with otherwise global spending or higher or lower?

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

It's too early to give a specific guidance for exploration. What I will say for exploration is that we are seeing 2 things coming back. We are seeing some seismic activity coming back, including there are some proof that the seismic boat utilization is going. But what is more critical is the near-field exploration is triggering more activity in exploration going forward as everybody wants to get better return on their existing infrastructure to create tieback. And hence, we have seen some licensing rounds as well. So licensing rounds, some seismic survey coming back and exploration, near-field exploration for future infill or tieback is what we see. So to give you a magnitude, directionally, it will increase, but to keep in mind it is too early.

Waqar Mustafa Syed - *ATB Capital Markets Inc., Research Division - MD of North American Energy Services & Head of U.S. Institutional Equity Research*

Okay. And then with respect to the APS business, previously, there were some plans for asset divestitures. Are those plans on hold or are you still pursuing those?

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

Look, Waqar, for APS assets in Canada, which is what we discussed previously, we have received offers with various commercial constructs, and now we are just in the process of evaluating the potential merits and risks associated with those proposals. So this is what we are doing now. In the meantime, we are, of course, managing this asset as to optimize cash flows in the current commodity pricing environment, and it generates quite a lot of cash flow.

Operator

And next, we go to the line of Neil Mehta with Goldman Sachs.

Neil Singhvi Mehta - *Goldman Sachs Group, Inc., Research Division - VP and Integrated Oil & Refining Analyst*

I just want to go back to Arun's question on deleveraging. As you think about the right -- the optimal capital structure, is 2x net debt to EBITDA still the normalized way you would think about the business? And based on the visibility you have on the cash flow, when do you think you'll be in a position to hit that target?

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

It's a good question, Neil. Is 2x the right level? You could argue it's a good level throughout the cycle. Now in an up-cycle with the cash you generate, the excess cash, we would probably be happy to go below 2x, and it will give us the required flexibility, as I said, to look at growth, additional growth opportunities and potential incremental shareholder returns. So we may not stop at 2x. We can take this as an intermediary step, and we -- 2x will just be an average throughout the cycle, I think, is the right level.

Neil Singhvi Mehta - *Goldman Sachs Group, Inc., Research Division - VP and Integrated Oil & Refining Analyst*

Yes. The follow-up is just on the digital business. You spent a lot of time talking about it on this call, but do you think you'll -- the company will ever get credit for the digital business, which is highly valuable, terrific margins, embedded within a more volatile services and technology business? Does the -- does that asset ultimately belong outside of your core business? And I look at Emerson and Aspen, the transaction that they recently did, try to put a better marker on the value of digital. It's a high-level question, but curious on what the optimal way to showcase the value of that business is.

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

So first, we will continue to pursue. We have made investment into a digital platform. We are using it both internally and externally. We have critical customers that depend upon us and will continue to trust us for the future. So we are using it to accelerate our growth, be accretive on our growth and our returns. And whether we are getting the right value, I think it's up to you to review and give us the multiple expansion that we deserve for this.

I think we have been, so far, demonstrating enough margins -- sustained margin. To this, we anticipate the growth to now come to play visibly in the coming years. And I think our leadership in this is recognized. And yes, I would expect that this will be turning into a premium for valuation.

I believe it's time to call. I'm not sure that we have time for another question.

Operator

No further time, you may conclude.

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

So thank you very much. So I would like to conclude the call and I would like to leave you with a few key takeaways. First, during the third quarter, our growth momentum was sustained, both internally, internationally and in North America and drove peer-leading margin expansion, reflecting our operating leverage, advantaged market position, and increased technology adoption. We also generated sizable free cash flow, allowing us to materially reduce our net debt.

Secondly, our performance in execution, our proven integration capabilities, and our differentiated technology and digital portfolio are increasingly resonating with our customers and have resulted in sizable awards in the quarter across Middle East, offshore, and in gas development, in particular, all critical markets as the up-cycle unfolds.

Thirdly, we are confident that the momentum of this up-cycle will continue, allowing us to close this year with another quarter of revenue and earnings growth, resulting in full year sequential growth internationally and pro forma North America and full year margin expansion on the high end of our guidance.

Finally, with the backdrop of strengthening demand in the energy markets, the macro conditions are increasingly set for an exceptional multiyear growth cycle unfolding broadly during 2022, both internationally and North America and resulting in significant earnings growth potential for Schlumberger.

Ladies and gentlemen, I could not be more satisfied with our strategy execution progress to date, the enthusiasm of our entire team, and the elevated trust of our customers. I look forward to the coming quarters with increased confidence. Our returns-focused strategic execution has created the conditions for a unique outperformance in our core and digital offering at the onset of this up-cycle whilst elevating our sustainability commitment and accelerating our new energy strategic initiatives. Thank you very much.

Operator

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.
