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Halliburton Company (HAL) CEO Jeffrey Miller on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-21-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $0.34 misses by $-0.00 | Revenue of $5.55B (-10.08% Y/Y) misses by $-269.22M

Earning Call Audio

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Halliburton Company (NYSE:HAL) Q3 2019 Results Earnings Conference Call October 21, 2019 9:00 AM ET

Company Participants

Abu Zeya - Senior Director, Investor Relations

Jeffrey Miller - Chairman, President and Chief Executive Officer

Lance Loeffler - Executive Vice President and Chief Financial Officer

Conference Call Participants

James West - Evercore ISI

Angeline Sedita - Goldman Sachs

Sean Meakim - JP Morgan

Scott Gruber - Citigroup

Chase Mulvehill - Bank of America Merrill Lynch

Kurt Hallead - RBC Capital Markets

Dan Boyd - BMO Capital Markets

David Anderson - Barclays

Marc Bianchi - Cowen and Company

Operator

Ladies and gentlemen, thank you for standing by and welcome to Halliburton Third Quarter 2019 Earnings Call. At this time, all participants lines are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator instructions]. Please be advised that today's conference is being recorded. [Operator Instructions].

I would now like to hand the conference over to your speaker today, Abu Zeya, Head of Investor Relations. Thank you. Please go ahead, sir.

Abu Zeya

Good morning. And welcome to the Halliburton third quarter 2019 conference call. As a reminder, today's call is being webcast and a replay will be available on Halliburton's website for seven days.

Joining me today are Jeff Miller, Chairman, President, and CEO, and Lance Loeffler, CFO.

Some of our comments today may include forward-looking statements, reflecting Halliburton's views about future events. These matters involve risks and uncertainties that could cause our actual results to materially differ from our forward-looking statements. These risks are discussed in Halliburton's Form 10-K for the year ended December 31st, 2018; Form 10-Q for the quarter ended June 30th, 2019; recent current reports on Form 8-K and other Securities and Exchange Commission filings. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Our comments today also include non-GAAP financial measures that exclude the impact of impairments and other charges taking during the second quarter. Additional details and reconciliation to the most directly comparable GAAP financial measures are included in our third quarter press release and can also be found in the Quarterly Results & Presentation section of our website.

After our prepared remarks, we ask that you please limit yourself to one question and one related follow-up during the Q&A period in order to allow time for others who may be in the queue.

Now, I will turn the call over to Jeff.

Jeffrey Miller

Thank you. Abu, and good morning, everyone. As the second half of 2019 unfolds, US and international markets continue to diverge. International activity growth is gaining momentum across multiple regions. Meanwhile, operators' capital discipline weighs on North American activity levels.

That said, our outstanding employees executed effectively in the third quarter. We managed the market dynamics and delivered on our financial results as per expectations.

Let me cover some headlines. Total company revenue was $5.6 billion and operating income was $536 million, representing decreases of 6% and 3% respectively compared to the second quarter of 2019.

Our Drilling and Evaluation division revenue was down 4% sequentially, but operating income grew 3% quarter-over-quarter. Our international D&E operating margin increased 180 basis points. Overall, D&E margin performance was negatively impacted by weaker demand for our services in North America.

Our Completion and Production division revenue declined 8% sequentially, driven by lower completions activity in North America land. C&P operating margin was essentially flat compared to the second quarter, supported by strong international activity and the execution of our new playbook in North America.

International revenue was flat sequentially, but is up 10% year-to-date. Lower project management and stimulation activity in the Middle East and Asia offset healthy growth in Latin America and Europe/Eurasia in the third quarter.

North America revenue decreased 11% sequentially, primarily driven by customer activity declines.

And finally, we generated approximately $530 million of free cash flow in the third quarter, a significant improvement over the first half of the year.

In the third quarter, supply and demand uncertainties continued to impact commodity prices. On the one hand, Iran sanctions, Venezuela production declines, and political instability in Latin America and North Africa are constraining supply. On the other hand, there is near-term uncertainty in demand due to ongoing US-China trade tensions and negative economic data out of Asia and Europe.

As the US production growth continues to weigh on supply, OPEC+ extended its agreement until March 2020 to manage production and support oil prices.

Even with these crosscurrents, international growth continues at a steady pace. This summer, I spent a month visiting our customers in the Eastern Hemisphere, and I'm excited by what I saw, consistently improving markets across Europe, Asia, and Australia. This confirms my confidence in Halliburton delivering high-single digit international revenue growth this year.

It is important to note that both of our divisions are meaningfully contributing to our international growth. Our Drilling and Evaluation division traditionally had the most exposure to international markets, with about 70% of division revenues coming from outside North America.

The revenue split has generally been the opposite for our Completion and Production division. We're pleased to see the C&P division increasing its participation in the international markets in this cycle. Year-to-date, international C&P revenue has grown 13%, double the international revenue growth rate of D&E.

In today's environment, customers aim to squeeze every available barrel from their existing assets. So, mature fields development is prominent.

We also see increased unconventional activity in several international regions. The technology mix required for development-focused, production-oriented, and unconventional project plays to our C&P portfolio strengths.

With a focus on the international mature fields market, we're growing our production group, part of the C&P division that comprises artificial lift, specialty chemicals, and well intervention solutions.

Historically, Halliburton primarily participated in the drilling and completion stages of a well's lifecycle. With our expansion into production services, we're tapping into a long-term, later cycle market with significant growth potential.

Our well intervention business helps operators diagnose field productivity issues and design and deliver immediate impact solutions leveraging our custom chemistries and tools.

This capability is critical for mature fields. With rig-less intervention and well surveillance activity increasing, especially in the Middle East, Europe and Asia, we've already executed multiple contract startups in 13 different countries this year.

In Latin America, we've recently deployed our SPECTRUM FUSION hybrid coil tubing service for a customer in Colombia. In a single trip, with the well still producing, we provided real-time visualization of the shape and location of old perforations and performed production logging, while maintaining the ability to circulate fluid to clean the well as needed. The customer gathered valuable downhole insights without having to take the well off-production.

In the last couple of years, we've had a significant uptick in unconventional activity in several Middle Eastern countries as well as in Argentina and Australia. Our production enhancement business demonstrated strong international growth year-to-date, benefiting from these developments.

Halliburton leveraged our experience in US shales to provide a customized application of technology, logistics management, and operational excellence to maximize asset value for our international customers.

In Argentina, Halliburton delivered the highest number of frac stages to date in the third quarter as a result of consistent execution and applying service efficiency best practices in the Vaca Muerta shale play.

Our completion tools and cementing businesses also increased international revenue and margins on the back of strong activity recovery in the UK and Norway sectors of the North Sea, IOC activity expansion in Brazil and Mexico, and increased demand from Asia and the Middle East.

We grew cementing services as well as installations of casing equipment and intelligent multi-lateral and core completion solutions for customers in all these markets.

For example, this summer, we installed a multi-lateral completion to increase reservoir exposure and inflow control in an operator's mature field in Norway. This intelligent completion system allowed the operator to manage production from each of the four laterals without impacting production from the others in the event of a gas influx or water breakthrough.

To be clear, our Drilling and Evaluation businesses are also meaningfully contributing to our international growth. As you know, Halliburton entered this international recovery a much stronger competitor due in large part to technology investments we've made in key services like drilling, LWD, open hole wireline, and testing.

Recently, an operator recognized Halliburton wireline as a benchmark for service quality and execution in an ultra-deepwater exploration campaign in West Africa. Open hole wireline data collected at water depth over 10,000 feet helped the customer to confirm significant additional reserves and successfully determine fracture enclosure pressure in sand and shale formations.

In the Norwegian North Sea, an operator has adopted our latest logging-while-drilling innovation, the EarthStar ultra-deep resistivity service as a standard in their exploration wells.

The customer's target formation has exceedingly complex geometry, making it hard to interpret using conventional methods. The unique 3D inversion capability of the EarthStar sensor is the only LWD technology capable of reliably mapping such complex structures.

Looking to 2020, I see more international topline and margin growth opportunities for Halliburton coming from mature fields and shallow water markets. Barring a global economic slowdown, a broader offshore recovery should add momentum to the international growth going forward.

Offshore rig count increased 19% year-on-year and sanctioned FID volumes are up 20% compared to last year, led by Guyana, Brazil and Azerbaijan project sanctions.

Recently, Woodside Energy awarded Halliburton drilling and completion services for its deepwater field development campaign in offshore Senegal. It's due for the final investment decision in December and work is planned to start in late 2020 or early 2021.

The campaign is expected to include 18 wells with up to 8 optional wells over an estimated 3 to 4 year term. Halliburton was awarded the well construction, lower completions, e-line, slick line cold tubing and well testing services. We have also announced several new offshore project wins this year in Latin America and the Middle East.

Our pipeline of projects is strong and I expect Halliburton to outperform the growth in international drilling and completion spending next year. Increasing activity and improving pricing across markets, our ability to compete for a larger share of high-margin services and reallocating assets to the markets where we can earn the highest returns, I believe, will improve our international margins going forward.

In North America, the market is very different. Customer spending has decreased and is largely concentrated in the first half of the year. The US land rig count declined 11% from the second to the third quarter for the first time in 10 years. And while, historically, the third quarter used to be the busiest in terms of hydraulic fracturing activity in the US, stage counts declined every month this quarter.

As a result, the market for both drilling and completion services in North America softened during the third quarter, impacting service company activity, and Halliburton was no exception.

Throughout the third quarter, pricing pressures continued as operators tried to lower overall costs in order to meet their cash flow objectives.

We are the execution company. So, let's talk about how we are proactively executing our North America playbook with a clear purpose to generate returns and free cash flow.

This is what it looks like. We are stacking equipment. In the third quarter, we stacked more equipment than we did in the first six months of the year. While this impacts our revenues, we would rather err on the side of stacking than work for insufficient margins and wear out our equipment.

We're reducing costs. You've seen us do this before. We took out $1 billion in 2016. We reorganized and reduced our fixed costs in North America earlier this year. We continue to evaluate the way we work and we'll keep reducing costs in our North American operations.

We're aligning with the right customers. We are and continue to be aligned with the customer groups that are spending and that value our services.

We're deploying technology that lowers our cost and accrues value to Halliburton. Take integrated well completions, for example. It is a combination of wireline and fracturing services. It is one thing to have both product lines and another thing to integrate them technically and culturally and achieve lower cost on location. It takes R&D effort to develop a host of new proprietary technologies that enable this integration.

Halliburton's integrated well completions offering minimizes non-productive time, improves efficiency, reduces personnel on location and capital costs for Halliburton. This technology integration, which is hard to duplicate, improves customer efficiency, but, more importantly, it improves our margins.

These actions allows us to maximize our active fleet utilization and protect our margins. Our third quarter results demonstrate that our new North America playbook is working and is the right approach for this market.

Looking ahead to the fourth quarter, we see more of the same. We expect customer activity to decline across all basins in North America land, impacting both our drilling and completion businesses.

Feedback from our customers leads us to believe that the rig count and completions activity may be lower than in the fourth quarter of last year. While holidays and potential weather impacts are the usual culprits, other drivers of this continued activity decline are our customers' free cash flow generation commitments, an oversupplied gas market and concerns about oil demand softness in 2020.

Given the reduction and cadence in customer spending that we see, we plan to further change the way we deliver our services in order to improve our margins and maximize returns.

In the fourth quarter, consistent with our playbook, we plan to undertake further cost reductions by streamlining our operations and corporate functions. We're still finalizing our estimates, but expect to capture approximately $300 million in annualized cost savings over the next few quarters.

Importantly, regardless of the cuts and idling of equipment, the size and scale of our business in North America give us the ability to drive a sustainable model without sacrificing our leadership position. I believe that the actions we are taking will enable Halliburton to evolve and emerge stronger in the future.

So, what changes the narrative for North America going forward? While the cadence of activity will likely remain the same over the near term, there are a few other key trends we're watching closely today that should play out over time and alter the market dynamics in US land.

First, attrition. Given demand deceleration, the service industry has adjusted accordingly and cut capital spend this year. There were hardly any new equipment additions and maintenance spending has been severely curtailed. All the while, service intensity showed no signs of slowing down. Multiwell pad penetration continued, lateral length kept growing and proppant loading increased further.

The direct result of higher service intensity, especially in terms of hours pumped per day, is the increase in maintenance frequency. This should accelerate the long-awaited equipment attrition from the market, both voluntary through stacking and involuntary.

As I said at the beginning of the year, there would be less horsepower available in the market at the end of the year than there was in January. We can now see this happening as service companies are cannibalizing stacked equipment for parts rather than paying for replacement components due to budget constraints. We expect attrition to continue into 2020.

At Halliburton, our size and scale allow us to flex down with the market and generate sufficient free cash flow to keep our active fleet healthy. We benefit from in-house manufacturing, digital preventative maintenance protocols, ongoing materials R&D and automation efforts to increase equipment lifespan. These are unique competitive advantages that are hard and expensive to replicate in this market.

Second, some of our customers are changing their buying behavior. They have started contracting for services and integrated packages rather than discreetly. This helps tie up multiple services, compresses the learning curve and drives cost savings and efficiencies for both us and our customers. This is similar to how the North Sea has volved over the last few years.

We're currently working on integrated projects with customers in the Bakken and the Permian. The collaboration has resulted in better performance and helped secure longer-term customer commitment.

Some companies are increasingly centralizing the management of their procurement activities. This should lead to supplier rationalization and concentration of a larger share of the work with a select number of high quality, safe and efficient service companies.

We believe that these new customer-buying behaviors uniquely position Halliburton to get an outsized share of their spend.

Finally, one more trend we are watching is the deceleration of incremental US production growth brought about by capital discipline. The record-breaking 2018 growth will not be replicated in 2019. In fact, current projections for 2020 indicate a further decline in production from the current-year estimates.

To maximize production per every CapEx dollar they spend, operators will require technologies that can improve both efficiencies and well productivity. Instead of counting stages, they will want to make every stage count. For this, I believe, they will turn to Halliburton.

We bring to the table technologies like automated fracturing and distributed fiber optic sensing that are tailor-made for addressing production challenges. While customers are mostly focused on price today, early studies confirm our technologies work. They are hard to replicate and will be more valuable to Halliburton over time.

Also, with declining US incremental contribution to world production, non-US production will be required to fill the gap. This means more growth in international and offshore markets and more opportunities for Halliburton.

As the international recovery continues and the North American market matures, our strategy will allow us to thrive in this dynamic environment. I believe that the actions I have described to you today will ensure that Halliburton continues to improve its earnings power and generate strong free cash flow and industry-leading returns in the future.

With that, I'll turn the call over to Lance for a financial update. Lance?

Lance Loeffler

Thank you, Jeff. And good morning. Let's begin with an overview of our third quarter results compared to the second quarter of 2019.

Total company revenue for the quarter was $5.6 billion and operating income was $536 million, representing decreases of 6% and 3% respectively. North America led the decline as a result of activity and pricing headwinds.

Let me go over the details of our divisional results. In our Completion and Production division, revenue was $3.5 billion, a decrease of $299 million or 8%, while operating income was $446 million, a decrease of $24 million or 5%.

These results were primarily driven by lower pressure pumping activity and pricing in North America land, coupled with decreased completion tool sales in Latin America and reduced simulation activity in the Middle East/Asia.

Partially offsetting these declines were increased cementing activity in the eastern hemisphere, improved completion tool sales in Europe/Africa/CIS, and higher simulation activity in Latin America.

In our Drilling and Evaluation division, revenue was $2 billion, a decrease of $81 million or 4%, while operating income was $150 million, an increase of $5 million or 3%.

These results were driven by reduced drilling and wireline activity in North America and lower project management activity in Middle East/Asia. These declines were partially offset by higher drilling activity in the eastern hemisphere, fluids activity in Latin America and higher testing and software sales globally, resulting in better overall margins.

Moving on to our geographical results. In North America, revenue in the third quarter of 2019 was $2.9 billion, an 11% decrease, primarily associated with lower activity and pricing in pressure pumping and well construction services in North America land.

In Latin America, revenue was $608 million, a 6% increase, resulting primarily from higher activity in multiple product service lines in Argentina, increased testing activity and artificial lift sales across the region, and improved fluids activity in Mexico. These improvements were partially offset by lower completion tool sales in Brazil.

Turning to Europe/Africa/CIS, revenue was $831 million, which was essentially flat with the second quarter. Higher activity across multiple product service lines in Russia, the Caspian and North Sea offset lower activity in West Africa.

In the Middle East/Asia, revenue was $1.2 billion, a 4% decrease, largely resulting from reduced project management and simulation activity across the region. These declines were partially offset by increased activity in multiple product service lines in Indonesia.

In the third quarter, our corporate and other expense totaled $60 million. We estimate that our corporate expenses for the fourth quarter will revert to our average run rate of approximately $65 million.

Our net interest expense for the quarter was $141 million and we expect it to remain approximately the same in the fourth quarter.

Our effective tax rate for the third quarter was approximately 20%, coming in slightly lower than anticipated due to certain discrete tax benefits. We expect our fourth quarter tax rate to be 23% based on the market environment and our expected geographic earnings mix. Our full-year effective tax rate should be approximately 22%.

We generated $871 million of cash from operations in the third quarter. Our free cash flow generation for the quarter was approximately $530 million and we reached positive free cash flow on a year-to-date basis.

We believe further improvement in receivables and a drawdown and inventory in the fourth quarter will allow us to generate approximately $1 billion of free cash flow for the full year.

Capital expenditures during the quarter were $345 million and our 2019 full-year CapEx guidance remains unchanged. We told you last quarter that our capital spend in 2020 would be significantly less than $1.6 billion.

We are carefully monitoring the market dynamics in North America and will exercise prudent judgment to make further adjustments according to the anticipated activity levels in 2020.

Finally, let me provide you with some comments on our operations outlook for the fourth quarter. For our Drilling and Evaluation division, we expect sequential revenue to be flat to up low single-digits, with margin improvement in the range of 425 basis points to 475 basis points.

This is driven by year-end software and product sales combined with activity increases across our international markets, offset by lower demand in North America land.

In our Completion and Production division, we believe our sequential revenue will be down low-double digits, with margins expected to decline 125 basis points to 175 basis points.

As Jeff stated, in North America, we have continued to stack equipment that does not meet our returns threshold and we will be proactive in reducing costs.

We anticipate that higher activity in Asia and the Middle East will be offset by activity declines in North America land, Latin America, and Europe and Eurasia.

Now, I'll turn the call back over to Jeff for closing comments. Jeff?

Jeffrey Miller

Thanks, Lance. In summary, international growth continues at a steady pace across multiple regions, benefiting both our D&E and C&P divisions. Increased activity, pricing improvements, our ability to compete for a larger share of high-margin services and reallocation of our assets should lead to higher international margins as we look past this year.

In North America, we expect activity reductions to continue into the fourth quarter. Halliburton is successfully executing our new North America playbook to maximize returns and free cash flow.

We stacked additional equipment throughout the quarter and will continue managing utilization with a focus on returns. We're aligning with the right customers. We're introducing new technologies to improve margins. And we will continue to take actions that lower the overall service delivery cost.

I want to close by thanking our employees for their outstanding focus and dedication to our company and our customers. Your resiliency and hard work are the foundation of our company's strength and why together we can continue delivering on our promise to our shareholders.

And now, let's open it up for questions.

Question-and-Answer Session

Operator

[Operator Instructions]. Our first question comes from James West with Evercore ISI. Your line is open.

James West

Good morning, Jeff. Good morning, Lance.

Jeffrey Miller

Good morning, James.

Lance Loeffler

Good morning, James.

James West

So, Jeff, obviously, [technical difficulty] third quarter. Fourth quarter, as Lance described is just going to be fairly tough. What does this mean for the exit rate and how are we going to 2020 and how the outlook there starts to shape up?

Jeffrey Miller

Yeah. Thanks, James. You're a little crackly there at the beginning, but as we look at the Q4 activity, obviously, we think budget exhaustion, et cetera, starts to bring that down. I expect we'll see an uptick as we go into Q1 of 2020, and I think that's a little bit getting to that cadence of spend. So, I think that we'll be increasing activity certainly in the first half – first quarter and then really first half of 2020, and our playbook will have us ready to take advantage of that.

James West

Okay, great. That's very helpful. And then, as we talk about the playbook or think about the playbook, what are you seeing from your competition? Clearly, some of these guys can't actually perform at the same levels or will not perform at the same levels, but also some may follow you on your returns-focused strategy. What have you seen so far from you showing leadership here with your willingness to walk away from the underperforming contracts or low return [ph] contracts versus your peers?

Jeffrey Miller

James, we're early in that process now. And, I guess, my view is we know we are extremely competitive. We have very good margins and returns in that business relative to anyone in that marketplace. And so, when we see an opportunity where it transacts well below cost, we're pretty comfortable stepping back from that just because we don't want to burn up our equipment without making the kind of returns and cash flow that we want to make. So, to be seen, I fully expect we'll see the – we see it actually some today, the flight to quality. Our service delivery is very, very good; our safety performance is very, very good. And so, I think this unfolds as equipment just gets tighter. And I think we're well-positioned in this market.

James West

Got it. Thanks, guys.

Jeffrey Miller

Thank you.

Lance Loeffler

Thanks, James.

Operator

Our next question comes from Angie Sedita with Goldman Sachs. Your line is open.

Angeline Sedita

Good morning, guys.

Jeffrey Miller

Good morning, Angie.

Lance Loeffler

Good morning, Angie.

Angeline Sedita

Good morning. So, Jeff, maybe a little bit more color on the international markets and the visibility there, I think there's some debate about the pace of growth for 2020. So, I'd love to hear what you're seeing out there and the prospects for having similar growth rates in 2020 as you did in 2019, and maybe you could also touch on the growth you saw in C&P versus D&E?

Jeffrey Miller

Yeah. Thanks, Angie. Less clear on – we just don't have the visibility on 2020 at this point because it's still early. That said, I believe Halliburton outgrows the increase in drilling and completion spend, whatever that is internationally. And as I described, I think we've got a good set of contracts set up for 2020. And, technically, we're very well-positioned for 2020. And so, without trying to put a number on that today, I feel Halliburton will be very competitive in that space, anyway. Yeah.

Angeline Sedita

Okay. Okay. So, maybe on your remarks on the attrition, it'd be great to hear any additional color on attrition and retirements for Halliburton and what you're hearing for the industry as a whole for even this year and next year, and how much supply you think could be pulled out of the market?

Jeffrey Miller

Yeah. As I've always said, it's hard to see attrition until there's a call on the equipment, but it's pretty clear there's less equipment in the market today than there was at the beginning of the year, and that amount varies in terms of how people call it. We think it's 15% to 20%

easily in the marketplace. But then, we watch equipment adds, of which there really aren't any, and we know how hard equipment is working. And so, I really believe we will continue to see that as we go into even 2020 in terms of the attrition happening. And our view of the market is we want to be super careful with our equipment. We want to work it for returns and when we don't see those returns, we want to set it to the side.

Angeline Sedita

Great. Thanks. I'll turn it over.

Jeffrey Miller

Thanks, Angie.

Operator

Our next question comes from Sean Meakim with JP Morgan. Your line is open.

Sean Meakim

Thank you. Good morning.

Jeffrey Miller

Good morning, Sean.

Sean Meakim

So, on free cash flow, I was hoping we could get a little bit more granular on the quarter and the guide. So, collections improved, I think, as we expected, but payables also fell a good amount. Inventory is still growing. CapEx is unchanged for the year. Sounds like earnings power is going to be challenged in the fourth quarter. So the $900 million of free cash that you're effectively guiding for this quarter is dependent upon working capital to a large degree. Could you maybe just walk us through those pieces?

Lance Loeffler

Yeah, Sean. Let me take a stab at that. So, look, we did make considerable improvements in 3Q. I think that that momentum clearly has to continue into 4Q, and it's really done – as you talk about the working capital movements, we continue to believe that we're going to progress on the way that we're collecting our receivables expect inventory will draw down as we deliver on our completion tools orders for the fourth quarter. And my belief is that working capital on a year-on-year basis is still relatively flat in 2019.

Sean Meakim

Okay.

Lance Loeffler

I'd also say, in addition to the working capital goals that we have in the fourth quarter, we're also going to be down on CapEx as well. The rate of spend of CapEx that will contribute to that free cash flow number.

Sean Meakim

Got it. Thank you for that.

Jeffrey Miller

And then, maybe just on the D&E margin ramp, some moving pieces there too. In the third quarter, top line fell, but margins expanded. So, you had got North America. It's challenging on the top line, but you're getting some progress where you're trying to go on the international side. For the fourth quarter, it seems like similar dynamics, but a little bit different. The international is helping you more given the year-end product sales, et cetera. Are we getting those moving parts correctly and then, can we just get a little bit more of an update on how iCruise is fitting into that relatively? What your expectations would have been, say, 9, 12 months ago?

Jeffrey Miller

Yeah. thanks, Sean. I'll start with the second part of that question. The iCruise is really delivering what we had expected though it is obviously – some of the contracts we were targeting or have been won, but are moving a bit to the right. That said, the performance of the tool, very good, very excited about what it can do, and coupled with EarthStar, for example, really is delivering on the technical promise that we had hoped. So, I expect, as I look through Q4 and into 2020 and beyond that the value of this suite of technology is going to be very impactful. In fact, I'll just comment here, at the World Oil Awards this week, actually the best drilling technology was the EarthStar 3D Inversion which is fantastic technology.

So, to get back to progression, we kind of see a longer ramp on the recovery of that business, but all of the building blocks are in place and the technical approach is working, and I see us winning the kind of contracts that I think are required to earn higher margins.

Sean Meakim

Great. Thank you very much.

Operator

Our next question comes from Scott Gruber with Citigroup. Your line is open.

Scott Gruber

Yes. Good morning.

Jeffrey Miller

Good morning.

Scott Gruber

Good morning. Staying on D&E margins, I know you guys typically forecast just one quarter ahead, but I was curious about a bit of color on 1Q. How should we think about margins going into next year? You have a bit more North Sea exposure at this point. Has that changed the seasonality? Are we going to see a little more seasonal impact on D&E margins or is there still sufficient underlying profit improvement that you can offset and have more normal seasonal margin performance in 1Q?

Lance Loeffler

Scott, this is Lance. Appreciate the question. I think looking ahead, I think there's still going to be some seasonality in 1Q. We're still dealing with weather in the Northern Hemisphere as we traditionally see it. But I think, overall, as you think about where international margins can go, based on some of the comments Jeff made prior, I think not only are you seeing the investment in technology come to fruition and what we expect, but also just generally more activity in the international markets help improve – also seeing better pricing in certain regions around the world. That comes because of the tightness of tools, et cetera, that will drive that. So, I think that there is, obviously, continued progression on where we see international margins going, not just in the fourth quarter, but into next year.

Scott Gruber

Got it. And then, on the $300 million of cost savings, obviously, you'll get a bit in 4Q. Can you just provide a bit more color on how that phases in over the next few quarters and whether there's any offset in terms of severance or facility closure cost and how large those could be?

Lance Loeffler

Yeah. Scott, I'm not going get into the details today on that. I think the point is is that we're focused on lowering our service delivery costs. And I think probably the most important point is is that we're being decisive, right? We're looking to move quickly around cost reductions in North America. We've seen some of those actions – seen some of the benefit of those actions that we took in 2Q. I'd just say stay tuned over the course of the next couple of quarters.

Jeffrey Miller

I think just to add to that, when we think about our North America playbook which is driving specifically towards utilization and efficiency and cost, I think this playbook is right squarely in the middle of the types of decisive actions we're taking around taking out costs.

Scott Gruber

Got it. Appreciate it. Thank you.

Jeffrey Miller

Thanks.

Operator

Our next question comes from Chase Mulvehill with Bank of America Merrill Lynch. Your line is open.

Chase Mulvehill

Hey. Good morning, fellas. I guess I just want to follow-up on Scott's question here. So, maybe on 4Q for D&E, I don't know if you can maybe help us kind of understand how much of the improvement in margin on the revenue side is attributed to kind of the software sales that you typically get in the fourth quarter? And then, along those lines, how much of the $300 million of cost savings are included in your 4Q guide?

Lance Loeffler

Yeah. Appreciate the question, Chase. Look, I think in terms of the impact on software and product sales for the fourth quarter, it's relatively the same as we saw last year. So, not above or below what we experienced last year.

On the cost-cutting side, look, again, I'm not going to get into the details today on the call on how that transforms over the next couple of quarters, but we will keep you posted as that continues to develop.

Chase Mulvehill

Okay, all right. Follow-up. Listening to the prepared remarks, Jeff, you talked about your more integrated packages that you're seeing in US onshore. Maybe could you expand a little bit, what kind of customers you're seeing kind of push more towards integrated packages? And is this more on the drilling side, the completion side or both?

Jeffrey Miller

I'd really say it's both. And it's customers of all sizes quite frankly, but probably more to the – larger into that. And I think some of that's just reflect – look, this is the early days, but it's encouraging because I know the type of safety and service quality performance that we have in the market and the ability to put more things together, I think, drives better performance over time. It's really a collective investment and a learning curve that drives that kind of efficiency. And we've seen that actually evolve in the North Sea. So, while early days North America, very early days, I think there's an analog which was the North Sea, which was obviously a very disintermediated market probably just five or six years ago and we've seen roughly 90% of our work today in the North Sea is in some form or fashion of integrated or bundled or in some form or fashion a more stable set of work that is more outcome-based that then allows us to, over time, demonstrate really some of the things that make Halliburton so reliable and so efficient over the long term.

Chase Mulvehill

Okay, all right. That's helpful. Thanks, Jeff. I'll turn it back over.

Jeffrey Miller

Thanks.

Operator

Our next question comes from Kurt Hallead with RBC. Your line is open.

Kurt Hallead

Hey, good morning.

Jeffrey Miller

Good morning.

Lance Loeffler

Good morning, Kurt.

Kurt Hallead

Appreciate all that color so far. Good stuff. The question I had for you initially here is on the US/North American frac, Completion and Production side of the business, right? You guys talked about a cost reduction effort that's underway, focus on the right players, et cetera. However, it looks like the market is still going to be kind of devoid of pricing, right? So, when we think about the – or when you guys think about your business in US, and US frac, in particular, beyond your cost reductions and pricing, do you think there is other ways you can drive margin improvement, Jeff?

Jeffrey Miller

Yes, I do. I think, strategically – technology is always an important part of this business and we continue to invest in technology. And some of that technology allows us to lower our cost. And we don't necessarily spend a lot of time talking about that simply because it's not for sale. I want to keep it and have that benefit accrue to Halliburton.

I talked about one just this quarter on the call with integrated completions, but that's more complicated to do than meets the eye and it actually drives a lot of cost savings for Halliburton.

When we direct our efforts that way, that is part of the sustainable competitive advantage we have around not just cost cutting – actually, I don't see it as cost cutting. I see the playbook actually is strategically driving better efficiency and better margins sort of in the face of where the market is today.

And I say all of that – and I want to pivot to what I really think the future looks like, which, over the next few years, the dialogue I believe will be more around recovery factors in unconventionals and less about just pure speed. And I think, in that market, some of the things we're doing with Prodigi and a host of things that I think will be quite impactful in that future scenario, which the future – what, a couple years out, but I'm really excited about that also. And nothing we're doing today gets in the way of delivering on that future set of technologies.

Kurt Hallead

Okay. That's great color. Then you indicated – you gave us some sense on attrition. Say, on a general basis, it runs maybe 15% to 20% per year. And then, given the dynamics at play in the marketplace with companies not generating enough free cash to put into the maintenance, what would be your assessment above and beyond that 15% to 20%? I know you didn't really – maybe not want to comment on it, but maybe pressing a little bit here, kind of give us your best guess as to what you think it could be given the underinvestment in the business?

Jeffrey Miller

Look, I think this is something that accelerates, particularly as we get into 2020. We'll see an uptick in the first half of the year, first quarter, and I think there will be stress in the system at that point. The extent to which there isn't new investment in this business, that just continues to wear on equipment. So, it has to accelerate over time.

Kurt Hallead

All right. Jeff, I'll leave it there. Thanks, guys.

Jeffrey Miller

Thank you.

Operator

Our next question comes from Dan Boyd with BMO Capital Markets. Your line is open.

Dan Boyd

Hi, thanks. Good morning, guys.

Jeffrey Miller

Good morning, Dan.

Lance Loeffler

Good morning, Dan.

Dan Boyd

So, thinking about the 300 million in cost savings over the next three quarters, can you give us an idea on how much that is fixed versus variable?

Jeffrey Miller

I think most of that would be more in the fixed category, not the variable. The variable costs, we're managing all of the time. And, in fact, our ability to flex up and down on variable cost allows us to be, I think, hyper responsive to moves in the marketplace. But when we attack – the type of fixed cost things are the parts that – that's the removal of the waste that is permanent when we think about continuous improvement and driving there. And that's what you saw in the second quarter as well. It was a move around taking out waste. And so, that tends to come in steps as we sort of evaluate how best to get that efficiency and then we're able to move on the cost.

Dan Boyd

Okay, great. And then, Lance, just going back to the D&E margins, I think what we're all trying to figure out is just what the go-forward run rate is, exit any kind of 4Q seasonality. So, earlier this year, we talked about flat margins year-on-year. Looks like they're maybe going to come in a little bit below, closer to 8%. But should we be thinking about the new run rate being in the double-digit range on an annual basis or is it just too early to say?

Lance Loeffler

I think to try to call 2020, it's probably a little early, but we firmly believe that margins in D&E and the international markets are higher than where they are today. Obviously, we've got room to run. I think as the markets continue to improve and for the things that I sort of talked about maybe on an earlier question around activity, leads to tool tightness, more constructive pricing discussions and further implementation of our technology, particularly on the drilling side, we're encouraged by what we see. So, yes, the goal is to be higher than where we are today, clearly, but little too early to call on what would be our expectations for a 2020 market.

Jeffrey Miller

Maybe just to add to that if I could. The other important part of this is, as we manage capital, we are reallocating assets where we believe we need to in order to drive those margins up. So, we see tool tightness in the marketplace broadly. And, clearly, we're going to move those assets to where they make the best returns. And so, I think that, in and of itself, drives better margins over time. And at the same time, we do have the ability to meet and exceed growth rates, I believe, internationally.

Dan Boyd

Maybe just kind of sneak one more in on that. When you look at the margin improvement then in D&E, Lance, how much of it would you just – if you had to put it in two buckets of – one self-help and then the other one just being external market growth and pricing. How should we think about that?

Lance Loeffler

I would weight that to the latter…

Dan Boyd

Okay.

Lance Loeffler

…in terms of activity and pricing.

Dan Boyd

Okay. Thanks, guys.

Jeffrey Miller

Thanks, Dan.

Operator

Our next question comes from David Anderson with Barclays. Your line is open.

David Anderson

Hey. Good morning, gentlemen. So, aside from the pressure pumping aspect, I was wondering about what other parts of your North American business have been impacted by the new playbook? I know part of this is you're looking at every business in terms of its returns. I was just kind of curious, how many of those product lines are kind of underwater in terms of returns? I just wonder if you can just kind of help us understand how this new playbook is impacting the other parts of your business.

Jeffrey Miller

I think it has an impact on all parts of our business. I think our view to, obviously, improving returns will get to other parts of the business. And I think that anything we do, in some cases, to take out fixed costs also have an impact on other parts of the business. So, can't do one really without the other. We like all of our businesses in North America. And I think they all benefit a degree from the approach we're taking with frac. So, it's probably more pronounced with frac.

David Anderson

Okay. I was just curious, there's been a lot of talk about the digital space over the past quarter. You announced 10 new applications on your DecisionSpace 365 digital platform. But as we kind of look out there and we see a lot of promise out there. I was just curious how you're thinking about the investment required. A bit of an arms race going on it seems like out there. But can you give us a sense as to how much your R&D spending is today dedicated towards digital and how are you thinking about spending kind of going forward over the next few years in that space?

Jeffrey Miller

Yeah. I think the capital and R&D spend around that is included in sort of our run rate. So, I don't think it's going to be outsized to what you've seen us do in the past. I think the – we really like our landmark business. We are a leading software provider in the industry. We hosted an important event in Houston. We had 1,300 customers at our event in Houston to look at sort of the future of digital and had thought leaders who are also our clients present at that event.

But I think the key focus and where we will spend more time talking to you, it will be around how it's monetized because I think that's really the important component of all things digital, which is – in my view, it's internal efficiency, enhanced tools that we charge more for and then software sales and consulting that we sell directly to clients. And you hear me talk about those at different times. I'll try to frame them better, but if I think our enhanced tools, 3D inversion is a good example of that with EarthStar, that has a lot of digital involved in making it work. Internal efficiencies look like things like our maintenance, it's automated, and digital planning and manufacturing. And then, 365 being one of the products that we actually sell, both in the cloud and the subscription model.

So, I'm comfortable with where we are. In fact, I really like where we are digitally and I think the digital principles that we laid out early around being open architecture, evolving with partners, and then clearly making returns for Halliburton are the right – that is absolutely the right strategy.

David Anderson

Great. Thanks, Jeff.

Jeffrey Miller

Thank you.

Operator

Our next question comes from Marc Bianchi with Cowen. Your line is open.

Marc Bianchi

Thank you. I wanted to ask – first on CapEx, I suspect you guys aren't looking to get into what you expect to spend in 2020. But just looking where the run rate is here in third quarter and then saying it's going to be again lower in fourth, is that the right way to think about the CapEx that you think the business needs on a go-forward basis?

Jeffrey Miller

Yeah. I think the timing of the spend is more weighted, obviously, towards the first part of the year just because that's when tools are actually going to work and a lot of the planning goes on as we look to next year. We have a view of where we want things to be and when we want them to be there.

Marc Bianchi

Okay. Thanks for that, Jeff. And back on the $300 million of cost save, is that the right amount of cost save for this level of revenue or how are you thinking about what level of revenue the business will be sized for once you complete that program?

Jeffrey Miller

Look, I think that we continuously take waste out of the business and look for ways to operate it at a lower cost point. So, that's kind of the step that we see right now that is effective. But at the same time, we're always looking for ways to make the business more and more efficient and we'll continue to do that almost irrespective of what we think the revenues are or will be.

Marc Bianchi

Okay. Thanks for that. I'll turn it back.

Operator

Thank you. This concludes the question-and-answer session. I would now like to turn the call back over to Jeff Miller for closing remarks.

Jeffrey Miller

Yeah. Thank you, Shannon. Look in closing, I'm excited about the international outlook and how Halliburton is positioned to benefit from these improving conditions.

The combination of increased activity, pricing improvements, ability to compete for a larger share of high-margin services and reallocation of our assets should lead to higher international margins as I look towards the future.

Our North America playbook is working. We're driving lower costs, better asset utilization and market-leading returns in the near term, while concurrently developing technology that lowers our cost or is essential to our customers over the longer-term, principally unconventional resource recovery, drilling and digital and all technologies where Halliburton is uniquely positioned to win.

So, thank you. I look forward to talking to you again next quarter. Shannon, you can close out the call.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.