

---

---

# THE SPIN-OFF REPORT

---

April 21, 2011

---

## Marathon Oil Corporation (Pre-Spin)

---

**Current Share Price (4/11/11): \$50.18**  
**Fair Value Estimate: \$60**  
**Shares Outstanding: 710 million**  
**Market Capitalization: \$35.6 billion**

**Ticker: MRO**  
**Dividend: \$1.00**  
**Yield: 2.0%**

## Marathon Oil Corporation (Post-Spin)

---

**Fair Value Estimate: \$44 per share**  
**Shares Outstanding\*: 710 million**  
**Market Capitalization: \$31.2 billion**

**Ticker: MRO**  
**Dividend: \$0.60**  
**Yield: 1.4%**

## Marathon Petroleum Corporation

---

**Fair Value Estimate: \$32 per share**  
**Shares Outstanding\*: 355 million**  
**Market Capitalization: \$11.4 billion**

**Ticker: MPC**  
**Dividend: \$0.80**  
**Yield: 2.5%**

\*Assumes an exchange ratio of 1:2.

Note: Market capitalization is based on fair value estimate for post-spin entities and current market cap for pre-spin Marathon Oil.



*Exclusive Marketers of  
The Spin-Off Report*

PCS Research Services  
125 Maiden Lane, 6<sup>th</sup> Floor  
New York, NY 10038  
(212) 233-0100  
[www.pcsresearchservices.com](http://www.pcsresearchservices.com)



**Horizon Research Group**

<b>Murray Stahl</b>	<b>Steven Bregman</b>
Thérèse Byars	Derek Devens
Peter Doyle	Steve Ferazani
Michael Gallant	Matthew Houk
David Leibowitz	Eric Sites
Fredrik Tjernstrom	Steven Tuen

---

This report is based on information available to the public; no representation is made with regard to its accuracy or completeness. This document is neither an offer nor a solicitation to buy or sell securities. All expressions of opinion reflect judgment at this date and are subject to change. Horizon Research Group and others associated with it may have positions in securities of companies mentioned. Mr. Ferazani is employed by Institutional Research Group, LLC. Reproduction of this report is strictly prohibited. © Horizon Asset Management, Inc. 2011.

---

# THE SPIN-OFF REPORT

---

## Investment Thesis

On January 13, 2011, Marathon Oil Corporation (NYSE: MRO) announced that its Board of Directors had approved the spin-off of its refining, marketing, and transportation business via a tax-free distribution to shareholders, which is expected to be completed on June 30, 2011. The spin-off company, which will be named Marathon Petroleum, is expected to trade on the NYSE under the ticker symbol “MPC,” while Marathon Oil, which will become a pure-play global exploration and production company, will continue to trade under the ticker symbol “MRO.”

Marathon Oil (“MRO”) had originally intended to spin off the downstream business in early 2009, but management eventually cancelled the transaction due to uncertainty in the financial markets. The decision to move forward with the spin-off will permit both companies to focus their operations and implement strategic objectives without internal competition for capital and resources. Management also expects to unlock shareholder value by making the investment profiles of each business more transparent to the market.

Marathon Petroleum (“MPC”), the spin-off company, will operate within three segments: Refining & Marketing, which will comprise a six-plant refining network with 1,142,000 barrels per day of crude oil refining capacity located primarily in the Midwest, as well as wholesale marketing, transportation, and retail operations; Speedway, a convenience store chain with approximately 1,350 locations in the Midwest; and Pipeline Transportation, comprising ownership interests in 9,700 miles of crude oil pipelines. Marathon Petroleum will target investment-grade status and is expected to pay yearly dividends of \$0.80 per share.

Following the completion of the spin-off, Marathon Oil will become a geographically diverse upstream company with a portfolio primarily comprising liquids. Exploration and production assets include its core areas in the US, Equatorial Guinea (where LNG operations are also undertaken), Libya, and the North Sea, while its growth assets that are yet to be developed include resource plays in the US, Gulf of Mexico, Angola, and Canada, and exploration plays in the Gulf of Mexico, Iraq, Poland, and Indonesia. Post-spin-off Marathon Oil will also own a 20% interest in an oil-sands mining business in Canada.

Shareholders of record will receive one share of MPC for every two shares owned of MRO. The transaction is expected to be completed in late June 2011. A sum-of-the-parts valuation of MRO shows modest upside for the stock on a comparison of proved reserves, daily production, and refinery capacity to similar companies in the exploration and production and US refinery sectors. Investors may also see opportunities in post-spin MRO as management focuses on expanding its reserve base and investing in drilling programs as opposed to the heavy capital investment required in the competitive refinery space. Alternatively, MPC investors may see opportunities in a refiner that just completed upgrades to two large plants, a step that could boost operating margins compared to competitors.

MRO appears to be trading at a slight discount to peers due to its integrated model, although the discount partially evaporated following the announced plans to separate. From the January announcement date through April 12, 2011, MRO is up approximately 23%, compared to a rise of only about 6.5% for the AMEX Oil Index (AMEX: XOJ), a price-weighted index of leading

---

# THE SPIN-OFF REPORT

---

E&Ps. Still, given the investment in the refinery system prior to the spin-off and the ability of the E&P to invest more heavily in drilling programs and reserve growth post-spin-off, the upside to our sum-of-the-parts fair value estimate of \$60 per share is enough to warrant a cautious buy recommendation. Of note, the probable reserves of MRO's stake in its Canadian oil sands operations maybe under-reflected in this valuation based on recent acquisition premiums paid for assets in this region, including Sinopec's purchase of ConocoPhillips' (NYSE: COP) interest in Syncrude last year. If one applies recent purchase prices to MRO's Canadian oil sands 2P (probable and proved reserves), an \$80 target could be considered. Thus if MRO were to consider an asset sale, one might find an extra 33% upside to the current price target. As a result shares are recommended for purchase prior to the spin-off.

---

# THE SPIN-OFF REPORT

---

## Company Description

Marathon Oil Corporation (NYSE: MRO) is an integrated oil company created in 1887 by Henry M. Ernst as The Ohio Oil Company. Two years later, it was acquired by John D. Rockefeller's Standard Oil Trust. It was reestablished as an independent entity when the Standard Oil monopoly was unwound. The Ohio grew through oil discoveries in West Texas, Alaska, and Mexico, as well as through acquisitions. In 1962 the company's name was changed to Marathon Oil Company in honor of its well-established motor fuel brand. Twenty years later Marathon became a subsidiary of United States Steel Corporation. In 1991 separate classes of common stock were issued: USX-U.S. Steel Group (NYSE: X) to track the performance of the steel operations and USX-Marathon Group (NYSE: MRO) to track the energy business. Ten years later the steel-related segment was spun off to shareholders as a separate free-standing publicly traded company – United States Steel Corporation. The remaining energy business became Marathon Oil Corporation. MRO began independent operations on January 1, 2002.

Over the years, MRO expanded its exploration, refining, marketing, retail, and pipeline operations. Through the planned spin-off, MRO will become a pure-play E&P business, while the refining, marketing, retail, and pipeline operations will become a separate stand-alone publicly traded company, Marathon Petroleum Corporation (NYSE: MPC). E&P operations have been the largest contributor to MRO segment income for the last three years (see Exhibit 1).

### **Exhibit 1 MRO: Operating Results by Segment, 2008 – 2010**

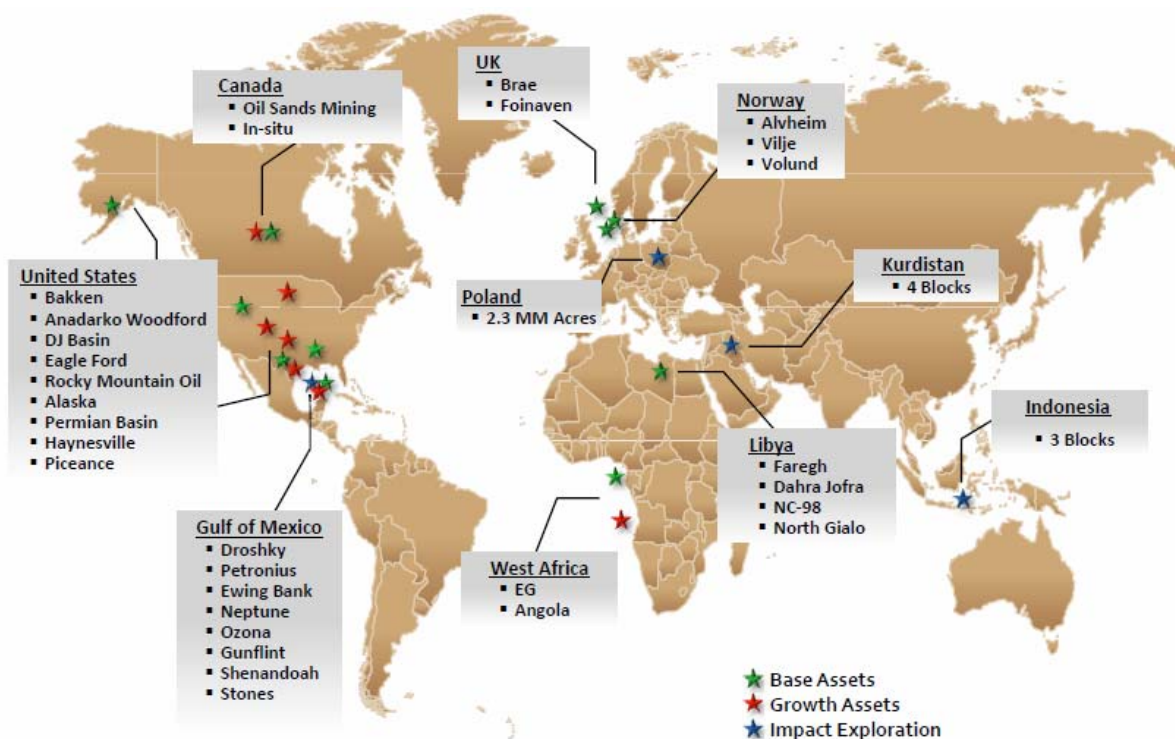
<i>(millions of \$)</i>	<b>2008</b>	<b>2009</b>	<b>2010</b>
<b>Pre-tax income</b>			
US E&P	1,397	37	387
International E&P	3,986	2,747	3,819
<b>Total E&amp;P</b>	<b>5,383</b>	<b>2,784</b>	<b>4,206</b>
Income taxes	2,827	1,563	2,266
<b>E&amp;P Segment Income</b>	<b>2,556</b>	<b>1,221</b>	<b>1,940</b>
<b>Oil Sands Mining</b>	<b>351</b>	<b>50</b>	<b>(62)</b>
Income taxes	93	6	(12)
<b>Segment Income</b>	<b>258</b>	<b>44</b>	<b>(50)</b>
<b>Integrated Gas</b>	<b>433</b>	<b>129</b>	<b>215</b>
Income taxes	131	39	73
<b>Segment Income</b>	<b>302</b>	<b>90</b>	<b>142</b>
<b>RM&amp;T</b>	<b>1,863</b>	<b>698</b>	<b>1,128</b>
Income taxes	684	234	446
<b>Segment Income</b>	<b>1,179</b>	<b>464</b>	<b>682</b>
<b>TOTAL</b>	<b>8,030</b>	<b>3,661</b>	<b>5,487</b>
Income taxes	3,735	1,842	2,773
<b>Segment Income</b>	<b>4,295</b>	<b>1,819</b>	<b>2,714</b>
Effective tax rate	47%	50%	51%
Other costs	767	356	146
<b>Net Income</b>	<b>3,528</b>	<b>1,463</b>	<b>2,568</b>
Special items	(1,085)	307	(30)
<b>Adjusted net income</b>	<b>4,613</b>	<b>1,156</b>	<b>2,598</b>

Source: Company reports

# THE SPIN-OFF REPORT

MRO has assets in most of the leading hydrocarbon-producing US basins, including the fast-developing Bakken and Niobrara oil-shale plays, the liquids-rich Eagle Ford Shale in South Texas, the gassy Haynesville Shale, and the Permian Basin in West Texas. MRO also has operations in the Gulf of Mexico and Alaska (see Exhibit 2). In 2010 MRO's US operations produced 131 million barrels of oil equivalent per day (mboed) compared to 126 mboed in 2009 and 138 mboed in 2008.

**Exhibit 2 MRO: Asset Map**



Source: Company reports.

MRO's international E&P assets are located in offshore Norway, the United Kingdom, Indonesia, and West Africa as well as in onshore Poland, Libya, and the Iraqi Kurdistan region in addition to assorted other locations. International production in 2010 totaled 260 mboed compared to 282 mboed in 2009 and 243 in 2008.

US operations generated 29% of total liquids sales and 41% of natural gas sales in 2010, while Equatorial Guinea accounted for 15% of liquids sales and 46% of gas sales. MRO holds a 16% stake in a Libyan concession, which encompasses about 13 million acres. In 2010 the company drilled 28 exploration wells on these properties. MRO entered the offshore Norway market in 2002, with production beginning in 2008. MRO also holds interests in offshore UK-based North Sea properties and holds licenses to develop shale gas plays in Poland. In October 2010 MRO acquired a position in several exploration blocks in the Kurdistan region of Iraq. The company is committed to a seismic study and drilling of multiple wells during the three-year exploration phase. Of 126 wells drilled in 2010, MRO drilled 116 in the US, six in Africa, two in Europe, and two in other regions.

---

# THE SPIN-OFF REPORT

---

MRO holds a 20% stake in the Royal Dutch Shell (NYSE-RDS/A)-operated Athabasca Oil Sands Project (AOSP) in Alberta, Canada. Marathon's 2010 AOSP production was 24,000 barrels per day (bpd) compared to 27,000 bpd in 2009. The production decline was the result of a turnaround (maintenance) in the middle of the year. Production rose late in the year, however, with completion of the turnaround and the start-up of a new mine. Increased costs related to the turnaround and new mine start-up resulted in an operating loss compared to modest profitability in 2009. MRO operates liquefied natural gas (LNG) facilities in Equatorial Guinea. Natural gas is liquefied for transport to international markets. LNG sales were up more than 3% in 2010 to 6,859 metric tonnes per day despite a mid-year turnaround.

## **Marathon Petroleum**

MRO intends to spin off its refining, marketing, and transportation (RM&T) segment into a separately traded public entity in late June 2011. That entity, Marathon Petroleum, is the fifth largest US refiner, with six plants and daily processing capacity in excess of 1.1 million barrels. The facilities are located in Garyville, LA; Detroit, MI; Canton, OH; Robinson, IL; Catlettsburg, KY; and Texas City, TX. MRO sold its 74,000 barrel-per-day (bpd) St. Paul Park, MN refinery, associated pipeline assets, and Minnesota-based convenience stores to a private equity group for \$935 million, including \$300 million for inventories. A subsidiary of MPC owns and operates about 1,350 Safeway retail outlets. MPC also distributes fuel through third-party operated Marathon-branded stations. The company owns and operates a fleet of barges, trucks, and terminals to distribute fuel.

Refining and marketing accounted for about 78% of MPC's segment revenue (total revenue minus intersegment revenue) in 2009 and 82% in 2010. Speedway accounted for 21% and 18% of total revenue in 2009 and 2010, respectively, and the remaining revenue was generated from pipeline transportation.

Refinery profitability is generally influenced by demand for gasoline, diesel fuel, heating oil, and other refined products, the spread between refined products and crude oil, and the differential between sweet and sour crude. In 2010 MPC's refining and marketing segment revenue rose almost 41% to \$57.3 million. MPC benefited from 15% improvement in daily sales volume, in part due to upgrade and expansion of its Garyville refinery. Gross margin rose 17%, or one cent per gallon, on an increased sweet-to-sour differential offsetting a weaker crack spread. Refined product demand grows during periods of economic expansion, and the sweet-to-sour differential may also increase during periods of rising demand. The wider the difference, the lower the price MPC will pay for feedstock at certain facilities. The crack spread may improve during periods of rising demand, but significantly elevated crude prices may not be entirely passed onto end users, particularly if price hikes are accentuated by geopolitical concerns rather than strict supply-demand issues.

In 2010, MPC's refining and marketing segment operating margin rose 30 basis points to 1.4%, well below the 6.0% achieved in 2007 (see Exhibit 3). Industry-wide refiner overcapacity has continued to plague US refiners and has pressured gross spreads. Improving demand, however, has alleviated some of the pressure.

---

# THE SPIN-OFF REPORT

---

## Exhibit 3 MPC: Refining and Marketing Operating Performance

	2007	2008	2009	2010
Gross margin (dollars per gallon)	\$0.1804	\$0.1114	\$0.0577	\$0.0677
Sales volume (thousands of bbls/day)	1,399	1,339	1,365	1,573
Revenue (millions)	\$50,379	\$60,000	\$40,665	\$57,333
Operating income (millions)	\$2,998	\$1,377	\$452	\$800
<b>Operating margin</b>	<b>6.0%</b>	<b>2.3%</b>	<b>1.1%</b>	<b>1.4%</b>

Source: Company reports

The wide variance in spreads can have a large effect on profitability. Given the high-fixed-cost nature of the business, margins vary significantly each year. In particular, the economic recession massively cut into spreads in 2008, with only modest recovery in 2009. Through 2010 spreads remained more than 50% below 2007 levels (see Exhibit 4). To maintain positive spreads, refiners must continue to invest in plant technology to keep an efficiency edge over competitors. In addition, maintenance (turnaround) costs are high due to a strict regulatory environment and safety concerns. Refiners also must spend to meet changing environmental legislation.

## Exhibit 4 Annual Crack Spreads

	2007	2008	2009	2010
Crack spreads				
Chicago LLS 6-3-2-1	\$8.87	\$3.27	\$3.52	\$3.04
US Gulf Coast LLS 6-3-2-1	\$6.42	\$2.45	\$2.54	\$2.14
Sweet/sour differential	\$11.59	\$11.99	\$5.82	\$7.71

(6-3-2-1 = ratio of 6 barrels of crude oil producing 3 barrels of gasoline, 2 barrels of distillate and 1 barrel of residual fuel)

Source: Company reports

MPC's Garyville refinery, located in Louisiana on the Mississippi River, was built in 1976 and has the distinction of being the last refinery constructed in the US. Environmental and regulatory issues and costs have kept any new entrants from moving forward with constructing plants. Nevertheless, overcapacity is a significant industry concern. While no new plants have been built, existing refineries have been upgraded and expanded. For instance, MPC upgraded and expanded Garyville in 2009. The expansion nearly doubled capacity to 436,000 bpd. US refiners must also contend with more refined product entering the country from international markets.

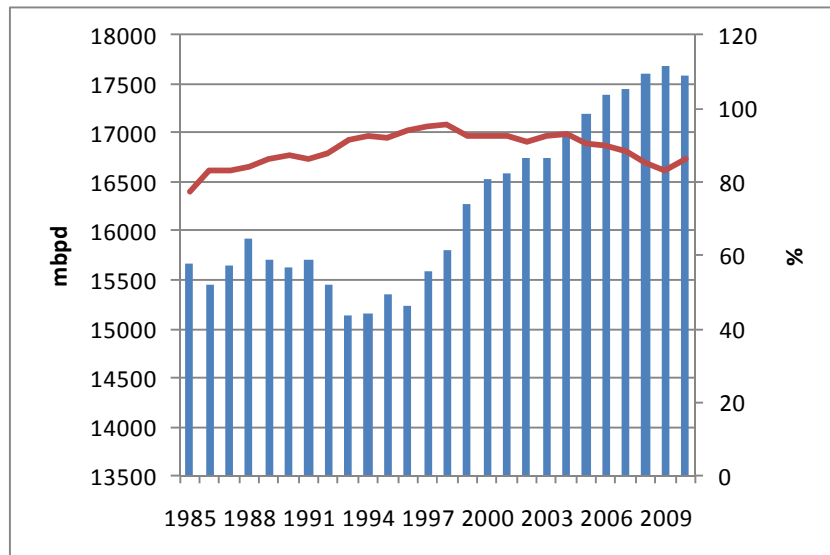
From 1985 through 2009, US refinery capacity expanded almost 13% (0.5% annually), according to the US Energy Information Administration (see Exhibit 5). From 1993 through 2005, annual plant utilization topped 90%, averaging in the mid-90% level through the mid- and late 1990s. But from 2005 through 2009, utilization declined every year before finally rebounding modestly in 2010. While annual capacity growth since the mid 1980s has been modest, the impact of increased refined product imports coupled with the recessionary pullback in demand created significant problems industry-wide. Weaker utilization has negatively affected refiner economics and pressured profitability. The industry may require a reduction in capacity in

# THE SPIN-OFF REPORT

order to improve earnings. Older East Coast refineries could be mothballed. Some capacity temporarily exited the market during the recent downturn, but private equity companies have stepped in to acquire older refineries in some cases.

## Exhibit 5 US Refinery Capacity and Utilization

(Refinery capacity, bar charts on left scale; utilization rate, line graph on right scale)



Source: Energy Information Administration.

Marathon has invested in its refinery network to increase efficiency and raise margins. Expansion of the Garyville plant cost about \$3.9 billion. In addition, Marathon is spending about \$2.2 billion at its Detroit facility to increase heavy oil processing by about 80,000 bpd and crude refining capacity by 15,000 bpd. The upgrade is expected to be completed in mid-2012. The ability to process greater amounts of heavy crude could improve margins, but the heavy investment in the refinery network arguably took funding away from E&P drilling programs and reserve replacement strategies. The spin-off will enable each business to make separate decisions about spending priorities moving forward. In 2008 and 2009, MRO's RM&T segment accounted for more than 40% of total capital expenditures, largely due to the Garyville upgrade and expansion costs (see Exhibit 6). Efforts to meet stricter environmental standards also increased costs. By spinning off the lower-margin, capital-intensive refining and marketing businesses, MRO will be able to focus spending on reserve expansion.

---

# THE SPIN-OFF REPORT

---

## Exhibit 6 MRO: Capital Expenditures by Segment

in millions of \$	2008	2009	2010
<b>E&amp;P</b>	2,971	2,162	2,474
<b>OSM</b>	1,038	1,115	874
<b>IG</b>	4	2	2
<b>Oil Total</b>	<b>4,013</b>	<b>3,279</b>	<b>3,350</b>
% of total	57.6%	56.1%	74.0%
<b>RM&amp;T</b>	<b>2,954</b>	<b>2,570</b>	<b>1,175</b>
% of total	42.4%	43.9%	26.0%
<b>MRO Total</b>	<b>6,968</b>	<b>5,850</b>	<b>4,526</b>

Note: excludes discontinued operations and corporate expenses

Source: Company reports

Speedway stores are located in seven states across the Midwest (Illinois, Indiana, Kentucky, Michigan, Ohio, West Virginia, and Wisconsin). Revenue for MPC's Speedway segment increased 15% in 2010 to \$12.5 billion, while segment operating income improved 38% to \$293 million. Sales increased, largely due to higher gasoline prices. Segment income benefited from a retail spread improvement to 12.07 cents per gallon from 10.30 cents per gallon in 2009. Same-store gasoline sales rose 3.0%, while merchandise sales increased 4.4%. Retail spreads vary by region and locality and may be affected by economic activity in the region as well as the competitive landscape in the locale.

Stations can offset declines in gasoline spreads by attempting to boost merchandise margins. In 2008 Speedway revenue declined 19% to \$10.8 billion as retail gasoline spreads decreased from 13.5 cents per gallon to 10.3 cents. However, segment operating margin fell less than 20 basis points to a little under 2.0% as merchandise sales increased \$59 million to \$775 million. Many Speedway locations offer pizza, hot dogs, hamburgers, and hot and cold sandwiches as well as traditional convenience store items. Retail gasoline pricing tends to lag crude oil price swings, so retail spreads can often improve when oil prices pull back and vice versa, particularly if pricing is not a direct reflection of US retail demand.

According to MPC's most recently issued Form 10, the spin-off is expected to have a balance sheet with about \$3.3 billion in debt and \$750 million in cash, or \$2.5 billion in net debt. MPC issued \$3.3 billion in senior notes in February 2011 in order to repay \$3.6 billion in MRO outstanding debt and make a \$1.1 billion cash distribution to the parent prior to the spin-off. MPC also intends to redeem its preferred stock of PFD, a Marathon subsidiary. Cash flow from operations totaled nearly \$2.5 billion in 2009 and but fell to about \$2.2 billion in 2010, the decline coming largely as a result of higher oil prices on working capital. Capital expenditures were \$2.9 billion in 2009 and \$1.2 billion in 2010. The decline in 2010 resulted from completion of the Garyville upgrade in the previous year.

### Outlook: Post-Spin MRO and Marathon Petroleum

MRO has projected 2011 hydrocarbon production relatively flat at 380,000-400,000 boepd, compared to 391,000 boepd in 2010. Growth in production from US resource plays is expected to offset international declines, notably in the North Sea. Athabasca Oil Sands Project production is expected to rise to 36,000-45,000 bpd in 2011 from 24,000 in 2010 owing to a full year of

---

# THE SPIN-OFF REPORT

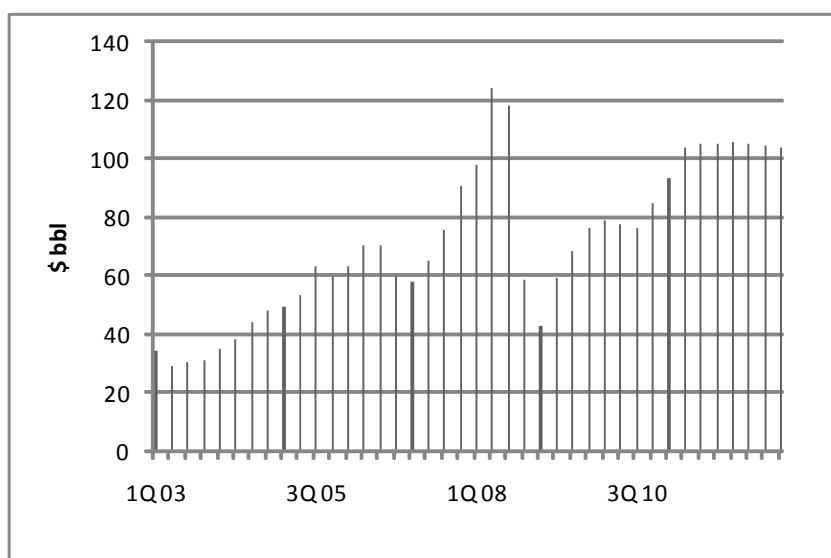
---

improvements from the recently started mine and the turnaround that slowed production last year.

MRO set a nearly \$5.3 billion capital and exploration budget for 2011, up 9% from 2010. Management targeted \$3.7 billion for upstream assets (or 71% of total spending), including \$1 billion for base E&P projects, \$300 million for oil-sands mining and integrated gas, \$1.9 billion for new development and exploration projects, including oily US resource plays and exploration in Indonesia, Iraq, Poland, and the Gulf of Mexico. Refinery and marketing spending was set at about \$1.2 billion, with the biggest funding being for the Detroit upgrade project.

West Texas Intermediate (WTI) prices are projected to average nearly \$102 per barrel in 2011 and \$105 in 2012 compared to \$79.40 in 2010, according to the Energy Information Administration (EIA) (see Exhibit 7).

## Exhibit 7 WTI Prices, 2003-2012E



Source: Energy Information Administration.

Higher oil prices are likely to benefit MRO's E&P operations. Increasing cash flows should allow MRO to pursue new asset purchases and fund expanded drilling programs, particularly in liquid-rich US shale plays. However, high prices may pressure refiner spreads if overcapacity issues are not addressed. The EIA projects US liquid fuels demand growing by 0.7% in 2011 and 1.0% in 2012, compared to 2.0% growth in 2010. As a result, retail gasoline prices are forecast to average \$3.56 per gallon in 2011 and \$3.57 in 2012, up from \$2.78 in 2010. Higher retail demand should help refiners. The upgrades at Garyville, in 2009, and Detroit, to be completed in the second half of 2012, should also help MPC's spreads. MPC could also benefit from increased higher-margin merchandise sales at Speedway, notably its hot foods.

---

# THE SPIN-OFF REPORT

---

## Valuation Analysis

Despite the run-up in MRO's share price following the spin-off announcement, modest upside remains in the stock when valued on a sum-of-the-parts basis. Marathon announced its intention to separate the refining and marketing operations on January 13, 2011. From that date through April 12, 2011, MRO is up approximately 23%, compared to a rise of only about 6.5% for the AMEX Oil Index (AMEX: XOI), a price-weighted index of leading E&Ps. While MRO appeared to be trading at a discount to peers due to its integrated model, the discount partially evaporated following the announced plans to separate. Still, given the investment in the refinery system prior to the spin-off and the ability of the E&P to invest more heavily in drilling programs and reserve growth post-spin-off, the upside to our fair value estimate is enough to warrant a cautious buy recommendation.

### **MPC Valuation**

Following the spin-off from MRO, Marathon Petroleum will be the fifth largest US refiner. Competitors include Valero Energy (NYSE: VLO), Tesoro Corp. (NYSE: TSO), Holly Corp. (NYSE: HOC), and Western Refining (NYSE: WNR). One could value MPC utilizing refining capacity and/or EBITDA compared to leading US refiners. As a group, refiners are trading at their EV/trailing EBITDA multiples of the last five years, largely due to recovering crack spreads and expectations of improving customer demand for refined product. EBITDA is expected to grow considerably in 2011 based on Thomson ONE consensus estimates.

As a result, this methodology accounts for only 25% of our fair value estimate given the volatility in multiples and spreads. Currently, four leading refiners are trading at about 8.5x 2010 EBITDA. Applying that EV/EBITDA multiple to MPC's 2010 pro forma EBITDA of \$1.952 billion generates a \$40 target (see Exhibit 8).

### **Exhibit 8 Refiner Comparable Fair Value Calculation**

<b>Average EV/2010 EBITDA</b>	<b>8.5</b>
Marathon Petroleum 2010 EBITDA	\$1,952
Calculation	\$16,592
Net debt	\$2,524
<b>Market capitalization</b>	<b>\$14,068</b>
Share count	355
<b>Fair value estimate</b>	<b>\$39.63</b>

Source: Company reports, *The Spin-Off Report* estimates, Thomson ONE.

One could also consider EV/refining capacity. The drawback is that this methodology would heavily ignore the retail operations and also not reflect variations in refining operating efficiency. To help offset these weaknesses, one could utilize the EV/refining capacity for only Holly and Western Refining, which generate more than 90% of sales from refining, and add a fair value estimate for Speedway (MPC's retail operations) separately. WNR and HOC are trading at about \$11.26 per daily barrel of refining capacity. Multiplying \$11.26 by MPC's daily refining capacity of 1,157 mbpd (post Detroit upgrade) generates a refining enterprise value of \$13.0 billion (see Exhibit 9).

# THE SPIN-OFF REPORT

## Exhibit 9 US Refiners

	<b>Valero Energy Corp. (NYSE: VLO)</b>	<b>Tesoro Corp. (NYSE: TSO)</b>	<b>Holly Corp. (NYSE: HOC)</b>	<b>Western Refining Inc. (NYSE: WNR)</b>
<i>(stock prices as of 4/11/11)</i>				
Share Price	\$27.56	\$25.65	\$60.04	\$17.15
FD Shares Out. (mn.)	568.97	143.17	53.30	88.30
Market Capitalization	15,680.8	3,672.3	3,200.1	1,514.3
Net Debt	5,010	1,352	590	1,013
Enterprise Value	20,690.8	5,024.3	3,790.1	2,527.3
2010 Adjusted EBITDA	3,281	616	354	288
EV/EBITDA	6.3x	8.2x	10.7x	8.8x
<i>Average</i>	8.5x			
2011E EBITDA	4,615	1,038	617	552
EV/EBITDA	4.5x	4.8x	6.1x	4.6x
<i>Average</i>	5.0x			
Capacity (mbpd)	2,200	665	256	151
EV/capacity	7.13x	5.52x	12.50x	10.03x
<i>Average</i>	8.79x			
<i>Average (HOC, WNR)</i>	11.26x			

mbpd = thousands of barrels per day

Source: Company reports, *The Spin-Off Report* estimates, Thomson ONE

Convenience store chains comparable to MPC's Speedway include The Pantry Inc. (NASDAQ: PTRY), Susser Holdings Corporation (NASDAQ: SUSS), and Casey's General Stores Inc. (NASDAQ: CASY). On average, the group trades at about 6.5x 2010 EBITDA (see Exhibit 10).

## Exhibit 10 Convenience Store Comparables

	<b>The Pantry Inc. (NASDAQ: PTRY)</b>	<b>Susser Holdings Corporation (NASDAQ: SUSS)</b>	<b>Casey's General Stores Inc. (NASDAQ: CASY)</b>
<i>(stock prices as of 4/11/11)</i>			
Share Price	\$15.39	\$13.30	\$39.09
FD Shares Out. (mn.)	22.94	17.04	37.95
Market Capitalization	353.0	226.6	1,483.5
Net Debt	1,088	383	625
Enterprise Value	1,441.0	609.6	2,108.5
2010 EBITDA	229	117	261
EV/EBITDA	6.3x	5.2x	8.1x
<i>Average</i>	6.5x		
2011E EBITDA	234	112	289
EV/EBITDA	6.2x	5.4x	7.3x
<i>Average</i>	6.3x		

Source: Company reports, *The Spin-Off Report* estimates, Thomson ONE.

---

# THE SPIN-OFF REPORT

---

Speedway generated pro forma operating income of \$293 million in 2010 with depreciation and amortization of \$131 million, according to MPC's most recent Form 10, for EBITDA of about \$424 million. Applying a 6.5x multiple generates an EV for the Speedway operations of nearly \$2.8 billion. A fair value estimate of \$37 is reached using this approach (see Exhibit 11).

## Exhibit 11 Refiner Capacity Fair Value Calculation

<b>Average EV/daily capacity (mbpd)</b>	<b>\$11.26</b>
Marathon Petroleum Daily capacity (mbpd)	1,157
	13,028
<b>Speedway valuation</b>	<b>\$2,756</b>
Calculation	\$15,784
Net debt	\$2,524
<b>Market capitalization</b>	<b>\$13,260</b>
Share count	355
<b>Fair value estimate</b>	<b>\$37.35</b>

Source: Company reports, *The Spin-Off Report* estimates, Thomson ONE.

An alternative valuation methodology for MPC would be to consider recent acquisition prices of US refineries (based on capacity) and again add the fair value estimate for the retail network. PBF Energy Company LLC, backed by private equity firms The Blackstone Group (NYSE: BX) and First Reserve Corp., has made three US refinery acquisitions over the last two years (see Exhibit 12).

## Exhibit 12 PBF Energy Acquisitions

Refinery	Seller	Price (millions)	Refinery capacity (bbl/day)	Price per daily capacity
Delaware City	Valero	\$220	190,000	\$1,158
Paulsboro, NJ	Valero	\$707	180,000	\$3,928
Toledo, OH	Sunoco	\$400	170,000	\$2,353
<b>Average</b>				<b>\$2,480</b>

Source: Company reports.

Notably, Delaware City had been idled prior to its acquisition and required more than \$100 million in additional investments before a restart. As a result, it seems prudent to add the \$6.1 billion invested in the two MPC refinery upgrades over the last five years to the valuation. If one adds the \$2.8 billion fair value estimate for Speedway, the total fair value estimate using this approach is \$26 per share (see Exhibit 13).

---

# THE SPIN-OFF REPORT

---

## Exhibit 13 Asset Sale Fair Value Calculation

<b>Average sale price per daily capacity (mbpd)</b>	<b>\$2.48</b>
Marathon Petroleum Daily capacity (mbpd)	1,157
	\$2,869
Garyville/Detroit upgrade costs	\$6,100
Refinery valuation	\$8,969
Speedway valuation	\$2,756
<b>Total valuation</b>	<b>\$11,725</b>
Net debt	\$2,524
<b>Market capitalization</b>	<b>\$9,201</b>
Share count	355
<b>Fair value estimate</b>	<b>\$25.92</b>

Source: Company reports, *The Spin-Off Report* estimates, Thomson ONE.

Averaging the valuations for MPC derived based on these methodologies (50% for the comparables methodology, generating a \$38.50 valuation, 50% for the refinery asset sale methodology, generating a \$26 valuation) results in a fair value estimate of \$32 per share, assuming 355 million shares are issued to MRO holders.

### MRO Post-Spin Valuation

Following the spin-off of its refining assets, MRO will be a pure-play E&P with a portfolio of assets in most of the large US hydrocarbon basins, Poland, Equatorial Guinea, Libya, and the Canadian oil sands. Although one might, ideally, value these assets basin by basin, that methodology goes beyond the scope of this report. Rather, one may take a simpler approach and compare MRO's proved reserves and daily production with those of other leading US-based E&Ps. Comparables to be considered using this method include Apache Corp. (NYSE: APA), Anadarko Petroleum Corp. (NYSE: APC), and Hess Corp. (NYSE: HES) (see Exhibit 14).

# THE SPIN-OFF REPORT

## Exhibit 14 E&P Comparables

	Apache Corp. (NYSE: APA)	Anadarko Petroleum Corp. (NYSE: APC)	Hess Corp. (NYSE: HES)	Average
<i>(stock prices as of 4/11/11)</i>				
Share Price	\$126.25	\$81.11	\$81.78	
FD Shares Out. (mn.)	382.75	496.26	334.84	
Market Capitalization	48,322.2	40,251.6	27,383.2	
Net Debt	8,006	9,670	3,970	
Enterprise Value	56,328.2	49,921.6	31,353.2	
Proved reserves (mmboe)	2,953	2,422	1,537	
EV/proved reserves	19.1	20.6	20.4	<b>20.0</b>
Daily production (boepd)	728,657	608,000	420,000	
Price/production (mboe/d)	66.3	66.2	65.2	<b>65.9</b>
Proved reserve replacement 2011	102%*	153%	176%	<b>144%</b>

\*344% including acquisitions

Source: Company reports, *The Spin-Off Report* estimates, Thomson ONE.

It is worth noting that the group averaged a reserve replacement ratio (RRR) of 144% in 2010, compared to only 95% for MRO. Post-spin-off, however, capital will no longer be divided between E&P and the capital-intensive refinery business. One might expect an improving RRR for MRO post-spin-off as more funds are devoted to drilling programs and asset acquisitions, which could benefit the company's prospects and valuation. For now, applying the peer averages for EV/proved reserves and price/daily production produces a fair value estimate for MRO post-spin of \$44 per share (see Exhibit 15).

## Exhibit 15 MRO: Post-Spin Fair Value Calculation

<b>Proved reserves (mmboe)</b>	<b>1,638</b>
Comparables EV/proved reserves	20.0
EV	\$32,760
Pro forma net debt	\$431
Market capitalization	\$32,329
Share count	710
<b>Share price</b>	<b>\$45.53</b>
<b>Daily production (mboe, 4Q 10)</b>	<b>451</b>
Comparables market cap./daily prod.	65.9
Market capitalization	\$29,721
Share count	710
<b>Share price</b>	<b>\$41.86</b>
<b>Average</b>	<b>\$43.70</b>

Source: Company reports, *The Spin-Off Report* estimates

---

# THE SPIN-OFF REPORT

---

A higher target could be attained if MRO's stake in the Canadian oil sands were considered on a 2P basis. MRO's proved reserves in the Canadian oil sands at the end of 2010 totaled 572 million barrels, but the 2P (proved and probable) totaled around 2.6 billion barrels. While not quantified in this report's valuation, upside to the target could be generated if oil sands production costs decline and more probable reserves are eventually categorized as proved reserves.

Even applying a 50% discount to the \$20 per barrel proved reserve multiple would generate an oil sands enterprise value (EV) of about \$36 per share (using only proved reserves in the current valuation generates an oil sands EV of \$16) (see Exhibit 16).

## Exhibit 16 MRO: Canadian Oil Sands EV Calculation

<b>Proved reserves (mmboe)</b>	<b>572</b>
Comparables EV/proved reserves	20.0
EV	\$11,440
Share count	710
<b>Share price</b>	<b>\$15.51</b>
<b>Proved and probable reserves (mmboe)</b>	<b>2,600</b>
Comparables EV/proved reserves	10.0
EV	\$26,000
Share count	710
<b>Share price</b>	<b>\$36.01</b>

Source: Company reports, *The Spin-Off Report* estimates

Notably the higher costs of oil sands production are also not reflected in the valuation. The \$36 per share EV for the Canadian oil sands stake would be supported by last year's sale by ConocoPhillips (NYSE: COP) of its 9.03% stake in the Canadian Syncrude oil sands venture to China's Sinopec International Petroleum Exploration and Production Company for \$4.65 billion. If one assumes its portion of the 5.1 billion proved and probable (2P) reserve base was about 474 million then Sinopec paid almost \$10 per proved or probable barrel, in line with the multiple used to generate the \$36 per share EV.

The sum-of-the-parts calculation for pre-spin Marathon Oil yields a fair value estimate of \$60 per share (\$44 for post-spin MRO and \$16 for the refining business based on 710 million shares). That valuation leaves modest upside to the current stock price. Given the limited time prior to the spin, however, the stock price is likely to be closely correlated with changes in crude oil prices. As a result, shares of MRO are modestly recommended for purchase, with the caution that a pullback in oil prices pre-spin is likely to present a more compelling buying opportunity for either piece after the late June 2011 separation.

# THE SPIN-OFF REPORT

## Conclusion

The separation of MRO's refining and marketing businesses from its core E&P operations will provide investors with clear options based on their commodity price assumptions. MRO will be able to focus capital budgets on drilling programs and asset acquisitions to build out its proved reserve base in the US and internationally. MPC will look for ways to improve refiner operating efficiency as US refinery overcapacity remains an industry-wide issue. In a long-term elevated oil price environment, MRO will benefit from higher returns on investment without grappling with volatile crack spreads in its refinery operations. MPC is well positioned as a stand-alone entity despite industry capacity concerns, given the heavy investment in its refinery network over the last five years, including the upgrading of its Garyville and Detroit plants. Improving US economic activity should drive higher plant utilization, provided the recovery remains on track and higher oil prices do not result in falling demand.

Our sum-of-the-parts fair value estimate for MRO pre-spin is \$60 per share, offering modest upside to the current stock price. If one assumes a potential sale of MRO's Canadian oil sands stake, a target close to \$80 could be considered. As a result, MRO shares are recommended for purchase prior to the spin-off, provided one has a relatively bullish near-term view of commodity prices. A significant pullback in oil prices before the separation may offer a better entry point for either entity post-spin. Oil prices are likely to be the biggest driver for the stock in the next three months. Post-spin, investor decisions should be based on a \$44 fair value estimate for MRO and \$32 for MPC (based on a 355 million share count). Notably, based on a fair value estimate of \$32 per share, MPC would have the highest dividend yield (2.5%) of its peer group (see Exhibit 17).

### **Exhibit 17 MPC: Fair Value Estimate and Comparables**

	<b>Marathon Petroleum Inc. pro forma (NYSE: MPC)</b>	<b>Valero Energy Corp. (NYSE: VLO)</b>	<b>Tesoro Corp. (NYSE: TSO)</b>	<b>Holly Corp. (NYSE: HOC)</b>	<b>Western Refining Inc. (NYSE: WNR)</b>
<i>(stock prices as of 4/11/11)</i>					
Share Price*	\$32.00	\$27.56	\$25.65	\$60.04	\$17.15
FD Shares Out. (mn.)	355	569	143	53	88
Market Capitalization	11,360	15,681	3,672	3,200	1,514
Net Debt	2,524	5,010	1,352	590	1,013
Enterprise Value	13,884	20,691	5,024	3,790	2,527
2010 Net Income	545	923	(29)	104	(17)
Shareholders' equity	7,144	15,025	3,215	697	676
ROE	7.6%	6.1%	N/A	14.9%	N/A
Price/book	1.6x	1.0x	1.1x	4.6x	2.2x
Dividend	\$0.80	\$0.20	N/A	\$0.60	N/A
Dividend yield	2.5%	0.7%	N/A	1.0%	N/A

\*The Spin-Off Report fair value estimate for MPC is utilized for share price

Source: Thomson, company reports, The Spin-Off Report estimates

---

# THE SPIN-OFF REPORT

---

With the completion of the Garyville refinery upgrade and expansion, and the scheduled completion of the Detroit upgrade in mid-2012, MPC's large-scale spending programs should be wrapped up. As a result, cash flow generation could be utilized to raise the dividend, buy back shares, or seek out undervalued assets for acquisition. Post-upgrade spending, annual capital expenditures should fall below \$1.0 billion. Average cash flow from operations over the last three years equaled about \$1.8 billion (see Exhibit 18). Without significant new investment requirements on the horizon, MPC should be positioned to generate nearly \$1 billion per year in normalized free cash flow. Of course, given spread volatility, cash flow will likely fluctuate significantly year to year. The nearly \$1 billion in free cash provides a dividend coverage ratio of around 3.5x.

## Exhibit 18 Marathon RM&T Free Cash Flow

	2010	2009	2008
Cash flow from operations	\$2,217	\$2,455	\$684
Capital expenditures	\$1,217	\$2,891	\$2,787
Free cash flow	\$1,000	(\$436)	(\$2,103)

Source: Company reports.

The risk is volatile crack spreads, as geopolitical risks can cause oil prices to spike. Those higher costs cannot necessarily be passed onto consumers, resulting in narrowing spreads. Such risks could contain significant spending programs by MPC in the near term. Nevertheless, if the stock trades below \$32 per share post-spin-off, the stock would be recommended for purchase.

# THE SPIN-OFF REPORT

## Exhibit 19 MPC: Pro Forma Income Statement

	Pro forma	as reported		
in millions	2010	2010	2009	2008
<b>Revenue</b>	<b>\$62,605</b>	<b>\$62,605</b>	<b>\$45,639</b>	<b>\$65,258</b>
Cost of revenue	\$54,278	\$54,278	\$38,320	\$56,527
Gross profit	\$8,327	\$8,327	\$7,319	\$8,731
Consumer excise taxes	\$5,208	\$5,208	\$4,924	\$5,065
SG&A	\$920	\$920	\$842	\$961
Other taxes	\$247	\$247	\$229	\$244
<b>EBITDA</b>	<b>\$1,952</b>	<b>\$1,952</b>	<b>\$1,324</b>	<b>\$2,461</b>
Depreciation and amortization	\$941	\$941	\$670	\$606
<b>Operating income</b>	<b>\$1,011</b>	<b>\$1,011</b>	<b>\$654</b>	<b>\$1,855</b>
Related party net interest		\$24	\$45	\$26
Net interest and other	(\$103)	(\$12)	(\$14)	\$4
Pre-tax income	\$908	\$1,023	\$685	\$1,885
Income tax	\$363	\$400	\$236	\$670
Effective tax rate	40.0%	39.1%	34.5%	35.5%
<b>Net income</b>	<b>\$545</b>	<b>\$623</b>	<b>\$449</b>	<b>\$1,215</b>
Gross margin	13.3%	13.3%	16.0%	13.4%
EBITDA margin	3.1%	3.1%	2.9%	3.8%
Operating margin	1.6%	1.6%	1.4%	2.8%
Net margin	0.9%	1.0%	1.0%	1.9%

Source: Company reports

# THE SPIN-OFF REPORT

## Exhibit 20 MPC: Pro Forma Balance Sheet

in millions		Pro forma 2010	as reported 2010	2009
ASSETS	<b>Cash and equivalents</b>	<b>\$750</b>	<b>\$118</b>	<b>\$128</b>
	Related party debt	\$0	\$2,404	\$864
	Receivables, net	\$4,397	\$4,393	\$3,526
	Related party receivables	\$1	\$5	\$17
	Inventories	\$3,071	\$3,071	\$3,324
	Other current assets	\$65	\$65	\$41
	<b>Total current assets</b>	<b>\$8,284</b>	<b>\$10,056</b>	<b>\$7,900</b>
	Equity method investments	\$312	\$312	\$365
	PP&E, net	\$11,724	\$11,724	\$11,897
	Goodwill	\$837	\$837	\$872
	Other noncurrent assets	\$366	\$303	\$220
	<b>Total assets</b>	<b>\$21,523</b>	<b>\$23,232</b>	<b>\$21,254</b>
	LIABILITIES	Accounts payable	\$6,782	\$6,453
Related party payables		\$12	\$341	\$190
Payroll and benefits payable		\$266	\$266	\$243
Consumer excise tax payable		\$286	\$286	\$292
Deferred income taxes		\$440	\$440	\$265
Current portion of debt to parent			\$655	
Current portion of l-t debt		\$11	\$11	\$11
Other current liabilities		\$168	\$168	\$129
<b>Total current liabilities</b>		<b>\$7,965</b>	<b>\$8,620</b>	<b>\$6,637</b>
L-t debt payable to parent			\$2,963	\$2,358
Long-term debt		\$3,257	\$268	\$243
Deferred income taxes		\$1,367	\$1,367	\$1,251
Postretirement plan obligations		\$1,493	\$1,493	\$1,361
Deferred credits and other		\$297	\$277	\$232
<b>Total liabilities</b>		<b>\$14,379</b>	<b>\$14,988</b>	<b>\$12,082</b>
<b>Stockholders' equity</b>	<b>\$7,144</b>	<b>\$8,244</b>	<b>\$9,172</b>	
<b>Liabilities and equity</b>	<b>\$21,523</b>	<b>\$23,232</b>	<b>\$21,254</b>	
<b>Working capital</b>	<b>\$319</b>	<b>\$1,436</b>	<b>\$1,263</b>	
<b>Debt to total capital</b>	<b>31.4%</b>	<b>32.1%</b>	<b>22.2%</b>	
<b>Book value per share*</b>	<b>\$20.12</b>	<b>\$23.22</b>	<b>\$25.84</b>	
<b>Tangible book*</b>	<b>\$17.77</b>	<b>\$20.86</b>	<b>\$23.38</b>	
<b>ROE</b>	<b>7.6%</b>	<b>7.6%</b>	<b>4.9%</b>	
<b>ROA</b>	<b>2.5%</b>	<b>2.7%</b>	<b>2.1%</b>	

\*based on 355 million shares  
Source: Company reports.