Buy/Sell Rating: 1 - Strong Buy

USX - Marathon Group
Energy Investment at a Discounted Stock Price

	Symbol	Price ($/sh) 16-Apr 2001	Shares (mm)	Market Cap ($mm)	Net Present Value ($/sh)	Debt/ Present Value	McDep Ratio	EV/ Sales 2001E	EV/ Ebitda NTM	P/E NTM	Div'd NTM (%)	PV/ Ebitda NTM
USX-Marathon Group	MRO	29.54	310	9,200	47.60	0.30	0.73	0.5	4.4	5.9	3.1	6.0
USX-U.S.Steel Group	X	15.75	89	1,400								

McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses
EV = Enterprise Value = Market Cap and Debt (MRO + X): $mm 17,700
Ebitda = Earnings before interest, tax, depreciation and amortization (MRO + X): $mm 4,011
NTM = Next Twelve Months Ended March 31, 2002; P/E = Stock Price to Earnings (MRO)
PV = Present Value of oil and gas and other businesses (MRO + X): $mm 24,100

Summary and Recommendation

We recommend current purchase of the common shares of USX-Marathon Group because we believe energy is an attractive field in which to invest and that Mid Cap stocks like MRO may return more than the Mega Caps that dominate the industry. While crude oil and natural gas production contribute most to cash flow, gasoline sales in the U.S. Midwest in the peak driving season of the summer months may offer the most near-term potential upside for profits. Meanwhile investors pay only about four times cash flow in MRO stock compared to about seven times in Mega Cap Stocks. That relationship has reversed before and may do so again. Also, in our opinion, that discounted price more than makes up for the fact that the energy business appears to subsidize the steel business for USX Corporation. That too, may change as the Board of Directors has brought in a new Chief Executive Officer for Marathon and retained financial, tax and legal advisors to help in determining the future structure of the company that is in the best interests of shareholders.

Energize Your Portfolio

That was our theme recently for our weekly publication, Meter Reader, which ranks more than 25 energy stocks by our proprietary valuation measure, the McDep Ratio. We feel the energy sector offers superior investment potential after a long period of economic and political neglect. EV/Ebitda for non-energy companies is about ten times, twice the median ratio for energy stocks.

The strength in energy stocks has not yet been that great. In fact MRO has yet to respond to the improved industry outlook. Marathon stock was about $33 a share ten years ago. Counting dividends the total return for the past decade was just 4% per year.

Mid Caps Have Valuation Advantage

Mega Cap stocks have done quite a bit better than Non-Mega Cap stocks in the stock market as a whole in recent years. At the same time energy as a group has been neglected. Yet, Mega Cap energy stocks have nearly matched or exceeded the stock market average in providing investors with double-digit total returns the past decade. While Mega Cap energy stocks have outperformed other energy stocks, much of that differential performance has come from stock price reaching a higher multiple of cash flow.

One factor that may have contributed to the greater relative popularity of giant stocks is the reduction in trading cost for individual investors. As direct investment has become more attractive, individuals may have preferentially picked well-known names. In effect, Mega Cap corporate managers now compete with investment fund managers for serving individual investors.

Both manager classes have eyes out for the more attractive investments. Buying the stock of out-of-favor companies of lesser size could satisfy the hunger of both parties.

Futures Price May Understate Oil Value

The futures price of oil five years out has budged little from around $20 a barrel for the past several years. At the same time the current price dropped to near $10 a few years ago and rose to more than $35 last year. You could say the price for five years out has acted in a more sane fashion. While that may be true, our view is that the price five years out understates what is more likely in our opinion to materialize. The futures market has been conditioned by the mini-boom and maxi-bust cycles of the 1980s and 1990s. If instead the 2000s will be more like the 1970s, at least for energy, then the recent gains we have seen in current price are just the beginning of what we will see over several years of a readjustment.

What is different this time is that oil may share the gains more with natural gas, processing and power. That already seems to be happening. Crude oil has remained quite cheap in our opinion. Instead we had a heating oil spike in New England a year ago, a gasoline spike in the Midwest last summer, and a natural gas/power spike in California recently. All of these incidents point to a sustained period of higher energy profitability until we reach excess capacity, if that occurs again.

Price is the most important variable affecting the outlook for all energy producers. Yet we can't control that variable nor does anyone have a record of forecasting it very well. Actually we do not think the futures market can forecast well either, but it does represent a widely available standard that reflects the consensus of many traders betting real money on a potential outcome. Accordingly we use futures market prices for making our projections. As a result, the quarterly pattern of ebitda and operating income that we project for Marathon shows erosion initially in line with the falloff of price in the futures market (see table below). Later in the year the trend turns up again.

Production Volumes May Rise in 2001

While the volume outlook may vary from company to company, there is usually not much change in a single year. Changes over several years are more important, but often there is little basis to project much different results for one company versus another. In Marathon's case there may be somewhat more uncertainty as to the long term trend, but not enough to justify the wide valuation gap in the stock.

Management projects a gain in production volume to 430 thousand barrels equivalent daily split about evenly between oil and natural gas. A newly completed acquisition of Rocky Mountain producer, Pennaco, boosts U.S. natural gas volumes.

The exploration and production business furnishes more than 60% of projected ebitda. It is Marathon's most important business and the source of a majority of the value in the stock.

Clean Gasoline Becoming More Profitable

A joint venture formed a few years ago, Marathon Ashland Petroleum LLC (MAP) holds nearly all of the value in refining/marketing. While we have subtracted Ashland's share of earnings and Ashland's equity investment from our projections, we include Ashland's share of depreciation in ebitda. Thus ebitda may be 10% overstated for that reason. There may be minor additional inconsistencies in applying ebtda analysis to accounting statements that follow full consolidation rather than proportional consolidation of join ventures.

Accounting complications aside, the refining/marketing is doing well currently. Product inventories are low going into the peak gasoline season. More complex environmental standards that vary by metropolitan area further limit supply flexibility and potentially enhance profits. Second quarter results in refining/marketing may be much better than in our model.

Our experience is that most of the profits in refining/marketing are made in a few good years while most years are mediocre. We see some good years in store while valuations may still be influenced by the long dry spell the industry has been through until recently.

Steel Saved, Set It Free

For a non-steel analyst it is hard to be optimistic about an industry that appears to rely on tariff protection for profits. At breakfast at our house when one of us states that a stock in a particular industry looks like it could come back, the other asks, "Are you sure it is not a Bethlehem Steel?"

It is now obvious that the greatest contribution made by the management of USX is not the performance of MRO stock, but the saving of U.S. Steel. Even though the oil company and the steel company have their separately traded stocks, it looks to us like oil subsidizes steel big time.

Suppose that steel can only make ebitda of $400 million that we project for 2001. If that is worth six times as we say Marathon is, the total steel value is $2.4 billion. Meanwhile steel stock has a market cap of $1.4 billion and the steel portion of debt is $3.7 billion. Steel stock appears overpriced and overleveraged by those rough estimates. A $1.00 per share dividend secured by the financial strength of oil appears to keep investors in steel shares.

Those comments may be a little harsh. The USX pension fund is worth more than twice the whole steel company. The fund has a pension benefits surplus almost twice the market value of Steel stock.

The approach we take in our analysis is that oil and steel are intertwined. We combine the market cap and debt of the two and compare it to present value equal to the same six times ebitda as for peer oil and gas companies. That seems to put Marathon stock in line with its peers that we think are also undervalued.

There could be a large extra payoff in Marathon if the steel valuation penalties could be removed. That would be the case if management were sincere about finding a new structure that is in the best interests of shareholders. We recognize that the tax and legal issues are complicated. The businesses should be separated in thoughtful fashion. The heat is on. Management has been paid exceedingly well. It has yet to deliver on the other end of the bargain, that is, a competitive return to shareholders.

Kurt H. Wulff, CFA

Mr. Wulff has a long research association with Marathon stock. He first recommended it in 1973 when he saw an opportunity to increase production in the Yates oil field in Texas. His analysis of Marathon in 1981 indirectly contributed to Mobil's tender offer and the ultimate acquisition of the company by U.S. Steel. In 1990, Mr. Wulff advised investor Carl Icahn in an effort that precipitated the creation of the separate stocks for Marathon and for U.S. Steel.

USX Corporation
Quarterly Results

	Q4 12/31/00	***Year 2000***	*Q1E 3/31/01*	*Q2E 6/30/01*	*Q3E 9/30/01*	*Q4E 12/31/01*	***Year 2001E***	*Q1E 3/31/02*	***Next Twelve Months 3/31/02***
Volume									
Natural Gas (mmcfd)									
U.S.	744	**731**	723	750	750	750	**743**	723	**743**
International	525	**510**	536	510	474	525	**511**	525	**508**
Total	1,269	**1,241**	1,259	1,260	1,224	1,275	**1,255**	1,248	**1,259**
Oil (mbd)	209	**207**	209	210	215	220	**214**	220	**216**
Total gas & oil (mbd)	421	**414**	419	420	419	433	**423**	428	**426**
Price									
Natural gas ($/mcf)									
Henry Hub ($/mmbtu)	6.52	**4.31**	6.31	5.38	5.51	5.66	**5.71**	5.59	**5.54**
U.S.	4.44	**3.30**	5.31	4.38	4.51	4.66	**4.71**	4.59	**4.53**
International	3.58	**2.76**	3.81	3.88	4.01	4.16	**3.96**	4.09	**4.04**
Total	4.08	**3.08**	4.67	4.18	4.32	4.45	**4.40**	4.38	**4.33**
Oil ($/bbl)									
WTI Cushing	32.00	**30.31**	28.81	28.22	28.52	27.53	**28.27**	26.58	**27.71**
Worldwide	25.76	**25.64**	23.81	23.22	23.52	22.53	**23.26**	21.58	**22.70**
Total gas & oil ($/mcf)	4.19	**3.68**	4.32	4.02	4.12	4.10	**4.14**	3.98	**4.05**
Revenue ($mm)									
Natural Gas									
U.S.	304	**883**	345	299	311	321	**1,277**	305	**1,237**
International	173	**515**	184	180	175	201	**740**	198	**753**
Total	477	**1,398**	529	479	486	522	**2,017**	503	**1,990**
Oil	496	**1,943**	448	444	465	456	**1,813**	437	**1,802**
Refining/Marketing	7,087	**30,518**	7,087	7,087	7,087	7,087	**28,347**	7,087	**28,347**
Steel	1,391	**6,055**	1,391	1,391	1,391	1,391	**5,564**	1,391	**5,564**
Total	9,450	**39,914**	9,455	9,400	9,429	9,456	**37,740**	9,417	**37,703**
Cash Operating Cost	8,569	**36,047**	8,417	8,373	8,383	8,417	**33,590**	8,366	**33,540**
Administrative Cost	38	**161**	38	38	38	38	**152**	38	**152**
Ebitda ($mm)									
Exploration and Production	645	**2,344**	645	609	628	646	**2,528**	658	**2,540**
Refining/Marketing	258	**1,073**	255	280	280	255	**1,070**	255	**1,070**
Steel	(60)	**289**	100	100	100	100	**400**	100	**400**
Total	843	**3,706**	1,000	989	1,008	1,001	**3,998**	1,013	**4,011**
Administrative Cost	(38)	**(161)**	(38)	(38)	(38)	(38)	**(152)**	(38)	**(152)**
Non-Cash Operating Cost									
Deprec., Deplet., & Amort.	307	**1,256**	307	307	307	307	**1,228**	307	**1,228**
Exploration	96	**238**	96	96	96	96	**384**	96	**384**
Operating Income									
Exploration and Production	405	**1,535**	405	369	388	406	**1,568**	418	**1,580**
Refining/Marketing	193	**813**	190	215	215	190	**810**	190	**810**
Steel	(120)	**25**	40	40	40	40	**160**	40	**160**
Total	478	**2,373**	635	624	643	636	**2,538**	648	**2,551**
Non-Operating Items	(141)	**(787)**	38	38	38	38	**152**	38	**152**
Ebit	619	**3,160**	597	586	605	598	**2,386**	610	**2,399**
Interest	74	**341**	74	74	74	74	**296**	74	**296**
Ebt	545	**2,819**	523	512	531	524	**2,090**	536	**2,103**
Income Tax	218	**1,442**	209	205	212	209	**836**	214	**841**
Net Income ($mm)	327	**1,377**	314	307	319	314	**1,254**	321	**1,262**
Per share - MRO ($)	1.25	**4.20**	1.24	1.22	1.26	1.25	**4.97**	1.27	**5.00**
Per share - X ($)	(0.67)	**0.78**	(0.81)	(0.80)	(0.81)	(0.81)	**(3.23)**	(0.81)	**(3.23)**