Rating: Buy
S&P 500: 1171

Marathon Oil Corporation
Raise Net Present Value to $42 a Share

Symbol	MRO	*Ebitda Next Twelve Months ending 3/31/06 (US$mm)*	3,800
Rating	Buy	*North American Natural Gas/Ebitda (%)*	18
Price (US$/sh)	38.36	*Natural Gas and Oil Production/Ebitda (%)*	63
Pricing Date	1/28/05	*Adjusted Reserves/Production NTM*	7.9
Shares (mm)	347	*EV/Ebitda*	5.2
Market Capitalization (US$mm)	13,300	*PV/Ebitda*	5.5
Debt (US$mm)	6,300	*Undeveloped Reserves (%)*	36
Enterprise Value (EV) (US$mm)	19,600	*Natural Gas and Oil Ebitda (US$/boe)*	20.00
Present Value (PV) (US$mm)	20,800	*Present Value Proven Reserves(US$/boe)*	11.50
Net Present Value (US$/share)	42	*Present Value Proven Reserves(US$/mcfe)*	1.92
Debt/Present Value	0.30	*Earnings Next Twelve Months (US$/sh)*	4.14
McDep Ratio - EV/PV	0.94	*Price/Earnings Next Twelve Months*	9
Dividend Yield (%/year)	2.9	*Indicated Annual Dividend (US$/sh)*	1.12

Note: Estimated cash flow and earnings tied to one-year futures prices for oil and natural gas.
Reported results may vary widely from estimates. Estimated present value per share revised only infrequently.

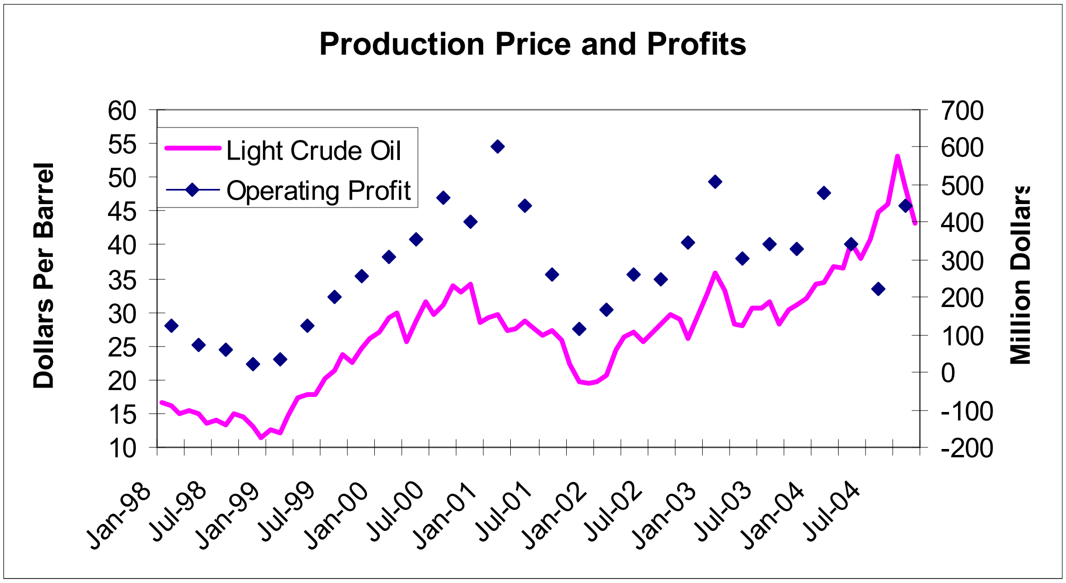
Summary and Recommendation

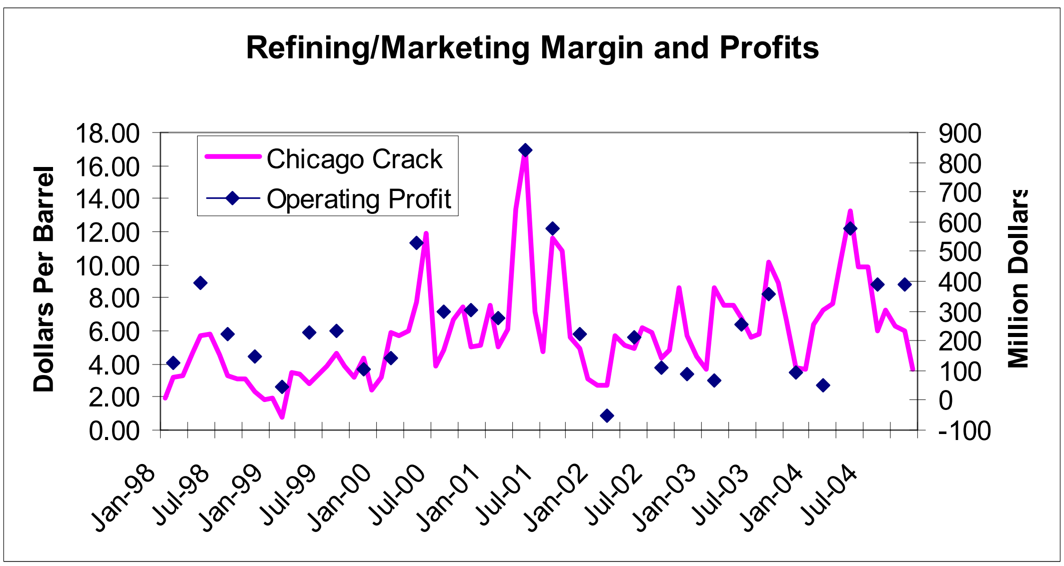
We continue a Buy rating on the common shares of **Marathon Oil (MRO)** as we raise our estimate of net present value for the producer/refiner to $42 a share from $40. Present value is up less than expected considering we revised our estimate of long-term oil price on January 26, 2005 to $40 a barrel constant real, up from $35. New estimates for Marathon appear to be supported by preliminary disclosures of year-end natural gas and oil reserves compared to projected annual cash flow. The proposed acquisition of the 38% minority interest in the Midwest refining/marketing operation has been delayed for lack of a requested tax ruling. Reported fourth quarter financial results appeared to be on track more than previous recent quarters. We see 9% stock price appreciation potential to net present value where the stock would then offer a continuing return of some 12% per year at normal risk.

Earnings Back on Track

Marathon's operating profit from production rebounded in the latest quarter (see chart Production Price and Profits). A low-price natural gas contract involving North Sea production contributes wide positive and negative fluctuations as accounting rules require it to be "marked to market". Apparently the magnitude of potential future losses diminished in the last quarter. Yet it is also clear from the chart that production earnings have not kept up with oil price. The company has taken some earnings hits as it repositions for more growth, albeit from a lower base.

Refining/marketing profits in the latest quarter were better than the trend in "Chicago crack" might have indicated (see chart Refining/Marketing Margin and Profits). The company's 62% owned downstream system may be its most desirable asset. Not only is the business efficiently operated, it is well-positioned for the increased processing demand accompanying rising heavy oil production in Canada.





Management remains optimistic about resolving tax issues that delayed the proposed buyout of its partner, Ashland. The risk is that no deal can be reached and that Marathon invokes its right to force the sale by Ashland at a premium price. Meanwhile the lack of a deal may frustrate expansion plans.

Low Cash Flow Multiples

Multiples of cash flow by line of business helps us estimate present value for Marathon consistent with that for peer companies. While we focus on small differences we keep in mind that the absolute levels are low (see table Functional Cash Flow and Present Value). The company generates a lot of cash that could readily be worth more with small changes in expectations.

Marathon Oil Corporation
Functional Cash Flow and Present Value

	NTM Ebitda	Adjusted R/P	PV/ Ebitda	Present Value	
North American Natural Gas	670	5.9	5.5	3,700	18%
Overseas Natural Gas	340	9.3	4.4	1,500	7%
Oil	1,380	8.4	6.0	8,300	40%
Downstream	1,400		5.3	7,400	35%
	3,790	7.9	5.5	20,900	100%
Debt					6,300
Net Present Value ($mm)					14,600
Shares					347
Net Present Value ($/sh)					42

Downstream Hedge Worked Recently

The quarterly operating and cost details give us a basis for anticipating future performance (see table Next Twelve Months Operating and Financial Estimates). Volumes might be slightly better than projected. Prices depend on the futures market.

Results for the latest quarter demonstrated the value of the downstream refining/marketing business as a natural hedge. The theory is that when oil price is low and economic activity strong, the downstream business does well. When oil price is too high (not yet), and economic activity is weak the downstream might not do well. In a subtler, different sense the natural hedge helped late last year. Though the benchmark Light, Sweet Crude Oil price advanced in the quarter, the gains were less for the heavier, sour grades that Marathon produces primarily. Moreover Hurricane Ivan knocked out light quality oil produced from the company's Petronius platform in the Gulf of Mexico. In contrast, the wider price differential between sweet and sour made Marathon's ability to refine sour oil into clean products more valuable. As a result the weak production response to higher oil price was offset by the strong refining response.

Libya Reopening

Marathon was part of the Oasis group, an important oil producer in Libya in the 1960s. Libya expropriated the assets in the 1970s. Then the U.S. had sanctions against doing business with Libya through the 1990s. Now, Libya and American oil companies are negotiating a reentry. It is unlikely that Libya will be giving anything away, but Marathon may have a chance to reapply its technological skill to create value. If a deal is concluded, possibly in 2005, it may be positive for Marathon stock though we put no explicit value on such a development.

Buy Oil and Gas Producers at Mid Decade

MRO stock appears to have positive appeal in an attractive group for investment (see table Rank by McDep Ratio). Three to five-fold gain potential for oil and gas price over the next 5 to 13 years justifies investment in recommended oil and gas producers, in our opinion. Supporting improving prospects, the average futures price of oil for continuous delivery over the next six years is in a multi-year uptrend as defined by the current quotes above the 40-week average. The current benchmark oil average futures price for the next six years is about $42 a barrel.

Kurt H. Wulff, CFA

Marathon Oil Corporation
Next Twelve Months Operating and Financial Estimates

	Q3 *9/30/04*	*Q4* *12/31/04*	***Year*** ***2004***	*Q1E* *3/31/05*	*Q2E* *6/30/05*	*Q3E* *9/30/05*	*Q4E* *12/31/05*	***Year*** ***2005E***	*Q1E* *3/31/06*	***Next Twelve Months*** ***3/31/06***
Volume										
Natural Gas (mmcfd)										
U.S. (or North America)	598	585	**633**	585	573	562	590	**578**	590	**579**
Overseas (or Int'l)	303	411	**369**	411	353	346	400	**377**	400	**375**
Total	901	996	**1,002**	996	926	908	990	**955**	990	**953**
Oil (mbd)	157	173	**173**	173	170	166	166	**169**	166	**167**
Total gas & oil (bcf)	170	187	**746**	183	177	175	183	**718**	179	**714**
Total gas & oil (mbd))	307	339	**340**	339	324	317	331	**328**	331	**326**
Price										
Natural gas ($/mcf)										
Henry Hub ($/mmbtu)	5.75	7.10	**6.15**	6.28	6.33	6.44	6.77	**6.46**	7.24	**6.70**
U.S. (or North America)	4.76	5.09	**4.89**	4.50	4.54	4.62	4.86	**4.63**	5.19	**4.80**
Overseas (or Int'l)	2.79	3.79	**3.33**	3.77	3.84	3.77	3.69	**3.77**	3.60	**3.72**
Total	4.10	4.55	**4.31**	4.20	4.28	4.30	4.39	**4.29**	4.55	**4.38**
Oil ($/bbl)										
WTI Cushing	43.89	48.30	**41.44**	48.02	48.95	48.09	47.00	**48.02**	45.93	**47.49**
Worldwide	36.29	34.80	**32.24**	34.60	35.27	34.65	33.87	**34.60**	33.10	**34.23**
Total gas & oil ($/mcf)	5.09	5.19	**4.85**	5.00	5.11	5.07	5.02	**5.05**	5.03	**5.06**
NY Harbor 3-2-1 ($/bbl)	7.83	5.44	**8.31**	7.89	9.40	8.46	7.36	**8.28**	9.60	**8.71**
Revenue ($mm)										
Natural Gas										
U.S. (or North America)	262	274	**1,129**	237	237	239	264	**976**	276	**1,015**
Overseas (or Int'l)	78	143	**449**	139	123	120	136	**518**	130	**509**
Total	340	417	**1,578**	376	360	359	399	**1,495**	405	**1,524**
Oil	524	554	**2,041**	539	544	530	518	**2,130**	495	**2,086**
Other	11,452	13,335	**46,289**	13,335	13,335	13,335	13,335	**53,339**	13,335	**53,339**
Total	12,316	14,306	**49,907**	14,250	14,239	14,223	14,252	**56,965**	14,235	**56,950**
Expense										
Fixed	182	171	**649**	171	171	141	141	**622**	141	**592**
Variable	182	171	**649**	161	159	156	161	**637**	158	**634**
Other	11,016	12,895	**44,727**	12,965	12,963	13,000	13,043	**51,970**	12,938	**51,944**
Ebitda ($mm)										
Exploration and Production	500	630	**2,320**	584	575	592	615	**2,366**	602	**2,384**
Other	436	440	**1,561**	370	372	335	292	**1,369**	397	**1,396**
Total Ebitda	936	1,070	**3,881**	954	947	927	907	**3,735**	999	**3,780**
Exploration	43	94	**189**	60	60	60	60	**240**	40	**220**
Deprec., Deplet., & Amort.	299	308	**1,217**	308	320	320	320	**1,268**	320	**1,280**
Other non cash	100		**200**					**-**		**-**
Ebit	494	668	**2,275**	586	567	547	527	**2,227**	639	**2,280**
Interest	40	32	**161**	32	32	32	32	**128**	32	**128**
Ebt	454	636	**2,114**	554	535	515	495	**2,099**	607	**2,152**
Income Tax	159	223	**740**	194	187	180	173	**735**	212	**753**
Net Income ($mm)										
Exploration and Production	244	443	**1,508**							
Other	261	265	**947**							
Unallocated	(210)	(295)	**(1,081)**							
Total	295	413	**1,374**	360	348	335	322	**1,365**	394	**1,399**
Shares (millions)	347	347	**339**	347	347	347	347	**347**	347	**347**
Per share ($)	0.85	1.19	**4.05**	1.04	1.00	0.96	0.93	**3.93**	1.13	**4.03**
Ebitda Margin (E&P)	58%	65%	**64%**	64%	64%	67%	67%	**65%**	67%	**66%**
Tax Rate	35%	35%	**35%**	35%	35%	35%	35%	**35%**	35%	**35%**

Rank by McDep Ratio: Market Cap and Debt to Present Value

	Symbol/	Rating	Price ($/sh) 28-Jan 2005	Shares (mm)	Market Cap ($mm)	Net Present Value ($/sh)	Debt/ Present Value	McDep Ratio
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	73.75	125	9,220	20.00	0.74	1.71
Marathon Oil Corporation	MRO	B3	38.36	347	13,330	42.00	0.30	0.94
Imperial Oil Limited (30%)	IMO	B3	60.32	105	6,360	64.00	0.11	0.95
Norsk Hydro ASA	NHY	B1	77.01	254	19,570	101.00	0.16	0.80
Petro-Canada	PCZ	B3	50.91	264	13,450	70.00	0.17	0.78
ConocoPhillips	COP	B1	90.99	706	64,200	128.00	0.22	0.77
Suncor Energy	SU	B3	31.90	460	14,670	54.00	0.10	0.63
PetroChina Company Ltd (10%)	PTR	B2	55.18	176	9,700	94.00	0.05	0.61
Lukoil Oil Company	LUKOY	B2	121.25	209	25,000	208.00	0.03	0.60
Total or Median					*176,000*		*0.16*	*0.78*

B1 = Buy full unlevered position, B2 = Buy half unlevered position, B3 = Alternative buy, H = Hold
S2 = Short half unlevered position, S3 = Short quarter unlevered position
McDep Ratio = **M**arket **c**ap and **De**bt to **p**resent value of oil and gas and other businesses

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