Rating: Buy
S&P 500: 1146

Marathon Oil Corporation
Between China and Canada

Symbol	MRO	*Ebitda Next Twelve Months ending 3/31/06 (US$mm)*	4,900
Rating	Buy	*North American Natural Gas/Ebitda (%)*	16
Price (US$/sh)	47.06	*Natural Gas and Oil Production/Ebitda (%)*	62
Pricing Date	4/29/05	*Adjusted Reserves/Production NTM*	7.5
Shares (mm)	349	*EV/Ebitda*	4.7
Market Capitalization (US$mm)	16,400	*PV/Ebitda*	4.3
Debt (US$mm)	6,400	*Undeveloped Reserves (%)*	38
Enterprise Value (EV) (US$mm)	22,800	*Natural Gas and Oil Ebitda (US$/boe)*	24.90
Present Value (PV) (US$mm)	21,100	*Present Value Proven Reserves(US$/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$/sh)*	6.06
McDep Ratio - EV/PV	1.08	*Price/Earnings Next Twelve Months*	8
Dividend Yield (%/year)	2.4	*Indicated Annual Dividend (US$/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

The hidden value in Buy-rated **Marathon Oil (MRO)** may be its strategically positioned refining business. A revised deal to buy the 38% minority interest may be completed by mid-year at a higher price than previously announced. The soon-to-be wholly owned system is close to large supplies of heavy oil in Canada likely to be available at a discounted price. Refined products are priced in a world market where China appears to be scooping up all available incremental supply. Estimated present value of $42 a share, near, but somewhat below, current stock price is likely to continue in a rising trend along with that of peer companies. The main risk is that natural gas, oil and oil product prices can be volatile even if the long-term trend, we believe, remains up.

Refining Deal Valued at Six Times Cash Flow

Marathon and Ashland have renegotiated the price for the 38% minority interest in Marathon Ashland Petroleum to about $3.9 billion, up from about $3.2 billion. We believe this would be a good deal for Marathon as the increase in value seems justified by improving industry conditions.

We think we heard on the quarterly call that management measured the price at six times 2004 cash flow. That happens to be the median multiple we currently apply to next twelve months cash flow for valuing the downstream businesses of integrated oil companies. We apply a lower multiple to all of Marathon's downstream businesses in part because of consolidated accounting that includes the minority share of depreciation in Marathon's cash flow (see table Functional Cash Flow and Present Value). Yet, the multiple of 4.0 is so low that there may be room for raising it after we see how the wholly-owned business operates.

Marathon Oil Corporation
Functional Cash Flow and Present Value

	NTM Ebitda	*Adjusted R/P*	*PV/ Ebitda*	*Present Value*	
North American Natural Gas	800	5.7	4.6	3,700	18%
Overseas Natural Gas	410	11.3	6.1	2,500	12%
Oil	1,840	7.2	4.0	7,400	35%
Downstream	1,850		4.0	7,400	35%
	4,900	7.5	4.3	21,000	100%
Debt					6,400
Net Present Value ($mm)					14,600
Shares					349
Net Present Value ($/sh)					42

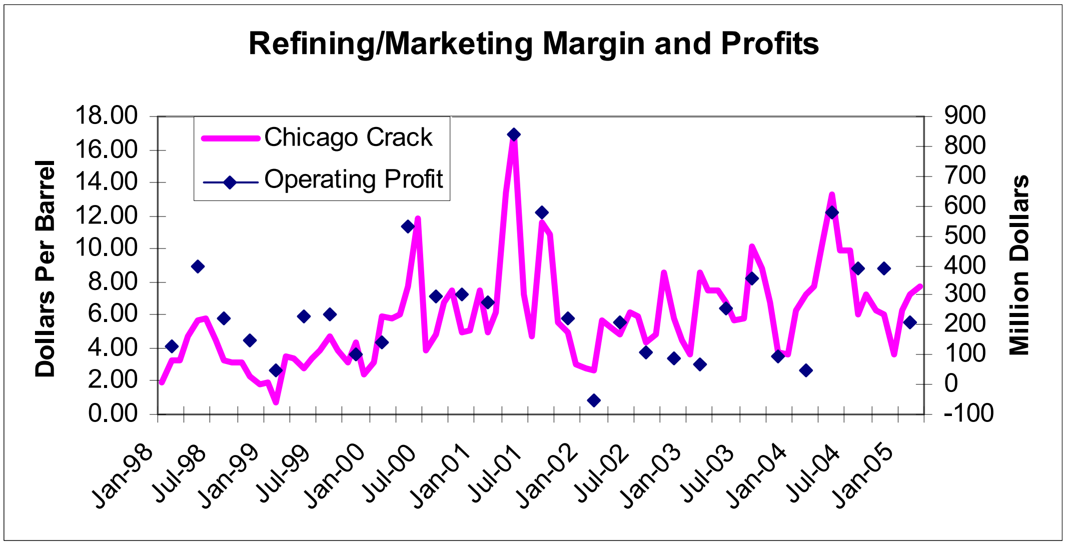
Our long experience with the refining business is that most of the time the profitability is mediocre. That is part of the reason why Marathon's Garyville, Louisiana refinery, built in about 1976, may have been the last new refinery built in the U.S. A single good year can make the difference between overall attractive and marginal economics for a project. The signs seem to point increasingly to a "good year" ahead that rewards long-suffering operators.

Canada Supply, China Demand

Our ears perked up when we heard Marathon management explaining how refining margins were improving with the availability of heavy oil from Canada at a "wide price spread" to light, sweet crude oil. Marathon's U.S. Midwest refineries are close enough to the Canadian source to offer an alternative to building upgrading facilities at the production outlet. For the time being production capacity is coming on faster than upgrading capacity in Canada.

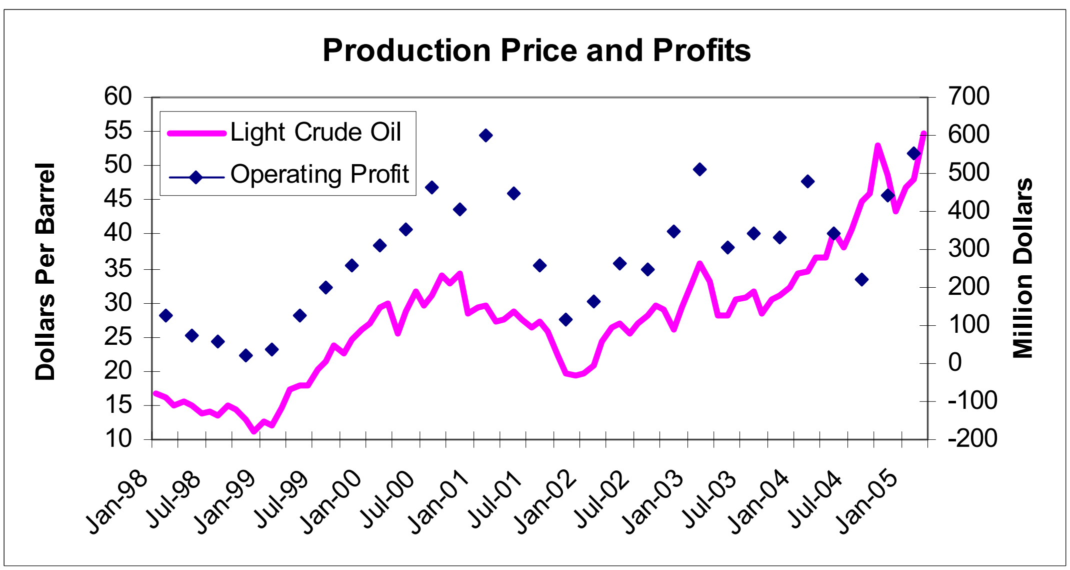
At the same time, the Marathon executive saw "distillate" cargos moving to China, even from Europe. China seems to be little concerned about quality, taking high sulfur supplies as well as low sulfur for diesel fuel and for electrical generation. Marathon's Gulf Coast refineries may sell to China while the Midwest refineries would benefit indirectly from strong world demand for refined products.

Latest quarterly earnings for refining approximated the normal relationship to the Chicago crack spread (see chart Refining/Marketing Margin and Profits). There were negative items like a hedging loss, but otherwise results were better than for the usually seasonally lower winter quarter.



Production Profit Tracking Oil Price

After some erosion of profits with the repositioning of the company's production toward international natural gas, operating profit tracked oil price in the latest quarter (see chart Production Price and Profits). It helped that overseas natural gas price advanced some and that there were no especially large hedging losses on a low-price natural gas contract involving North Sea production.



Hurricane Interrupted Production Restored

Oil volumes are rebounding in part with the restoration in March of production from the company's Petronius platform in the Gulf of Mexico. Hurricane Ivan knocked out that valuable light quality oil supply for a half year. Damage to the facility inspired tales of a 100-foot rogue wave. Meanwhile, current futures prices point to further gains on top of volume (see table Next Twelve Months Operating and Financial Estimates).

Buy Oil and Gas Producers at Mid Decade

Multi-fold gain potential for oil and gas price over the years ahead 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 US$51 a barrel.

A McDep Ratio of 1.0 implies that a stock is valued at present value assuming a constant real oil price of US$40. Though Marathon stock may not be priced at the lowest ratio to present value the company's prospects in an industry with attractive prospects continue to justify a buy recommendation (see table Rank by McDep Ratio).

Kurt H. Wulff, CFA

Marathon Oil Corporation
Next Twelve Months Operating and Financial Estimates

	Q3 *9/30/04*	*Q4* *12/31/04*	***Year*** ***2004***	*Q1* *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**	570	580	568	557	**569**	557	**566**
Overseas (or Int'l)	303	411	**369**	455	300	318	432	**376**	432	**370**
Total	901	996	**1,002**	1,025	880	887	989	**945**	989	**936**
Oil (mbd)	157	173	**173**	163	180	180	180	**176**	180	**180**
Total gas & oil (bcf)	170	187	**746**	180	178	181	190	**730**	186	**736**
Total gas & oil (mbd))	307	339	**340**	334	327	328	345	**333**	345	**336**
Price										
Natural gas ($/mcf)										
Henry Hub ($/mmbtu)	5.75	7.10	**6.15**	6.27	6.99	6.94	7.49	**6.92**	8.13	**7.39**
U.S. (or North America)	4.76	5.09	**4.89**	4.95	5.52	5.48	5.92	**5.47**	6.42	**5.83**
Overseas (or Int'l)	2.79	3.79	**3.33**	4.17	4.40	4.55	4.62	**4.43**	4.58	**4.55**
Total	4.10	4.55	**4.31**	4.60	5.14	5.15	5.35	**5.05**	5.62	**5.32**
Oil ($/bbl)										
WTI Cushing	43.89	48.31	**41.44**	49.65	52.36	54.19	55.00	**52.80**	54.56	**54.03**
Worldwide	36.29	34.80	**32.24**	38.82	40.94	42.37	43.01	**41.36**	42.66	**42.25**
Total gas & oil ($/mcf)	5.09	5.19	**4.85**	5.52	6.07	6.20	6.30	**6.02**	6.40	**6.24**
NY Harbor 3-2-1 ($/bbl)	7.78	5.72	**7.74**	6.17	11.99	10.46	7.76	**9.10**	8.51	**9.68**
Revenue ($mm)										
Natural Gas										
U.S. (or North America)	262	274	**1,129**	254	291	287	303	**1,136**	322	**1,203**
Overseas (or Int'l)	78	143	**449**	171	120	133	183	**607**	178	**615**
Total	340	417	**1,578**	425	412	420	487	**1,743**	500	**1,818**
Oil	524	554	**2,041**	570	671	702	712	**2,654**	691	**2,776**
Other	11,452	13,335	**46,289**	12,016	12,016	12,016	12,016	**48,063**	12,016	**48,063**
Total	12,316	14,306	**49,907**	13,010	13,098	13,137	13,215	**52,460**	13,207	**52,657**
Expense										
Fixed	182	171	**649**	179	179	179	179	**716**	179	**716**
Variable	182	171	**649**	179	195	202	216	**792**	215	**827**
Other	11,016	12,895	**44,727**	11,716	11,536	11,536	11,536	**46,323**	11,609	**46,216**
Ebitda ($mm)										
Exploration and Production	500	630	**2,320**	636	708	741	804	**2,889**	797	**3,050**
Other	436	440	**1,561**	300	480	480	480	**1,740**	407	**1,847**
Total Ebitda	936	1,070	**3,881**	936	1,188	1,221	1,284	**4,629**	1,205	$\boxed{\mathbf{4,897}}$
Exploration	43	94	**189**	34	60	60	60	**214**	60	**240**
Deprec., Deplet., & Amort.	299	308	**1,217**	323	320	320	320	**1,283**	320	**1,280**
Other non cash	100		**200**					**-**		**-**
Ebit	494	668	**2,275**	579	808	841	904	**3,132**	825	**3,377**
Interest	40	32	**161**	32	32	32	32	**128**	32	**128**
Ebt	454	636	**2,114**	547	776	809	872	**3,004**	793	**3,249**
Income Tax	159	223	**740**	191	272	283	305	**1,051**	277	**1,137**
Net Income ($mm)										
Exploration and Production	244	443	**1,508**	555						
Other	261	265	**947**	217						
Unallocated	(210)	(295)	**(1,081)**	(416)						
Total	295	413	**1,374**	356	505	526	567	**1,952**	515	**2,112**
Shares (millions)	347	347	**339**	349	349	349	349	**349**	349	**349**
Per share ($)	0.85	1.19	**4.05**	1.02	1.45	1.51	1.63	**5.60**	1.48	**6.06**

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

	Symbol/	Rating	Price ($/sh) 29-Apr 2005	Shares (mm)	Market Cap ($mm)	Net Present Value ($/sh)	Debt/ Present Value	McDep Ratio
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	76.00	125	9,500	20.00	0.74	1.74
Imperial Oil Limited (30%)	IMO	B	70.25	105	7,370	64.00	0.11	1.09
Marathon Oil Corporation	MRO	B	47.06	349	16,410	42.00	0.30	1.08
ConocoPhillips	COP	B	104.67	706	73,900	128.00	0.23	0.86
Petro-Canada	PCZ	B	56.11	263	14,780	70.00	0.19	0.84
Norsk Hydro ASA	NHY	B	78.69	252	19,850	101.00	0.16	0.81
Suncor Energy	SU	B	37.23	460	17,130	54.00	0.10	0.72
Lukoil Oil Company	LUKOY	B	135.50	209	28,000	208.00	0.03	0.66
PetroChina Company Ltd (10%)	PTR	B	60.01	176	10,550	94.00	0.05	0.66
Total or Median					*197,000*		*0.16*	*0.84*

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