

Rating: Buy
 S&P 500: 1228

Marathon Oil Corporation

Raise Net Present Value to \$45 a Share

<i>Symbol</i>	MRO	<i>Ebitda Next Twelve Months ending 6/30/06 (US\$mm)</i>	5,400
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	16
<i>Price (US\$/sh)</i>	56.61	<i>Natural Gas and Oil Production/Ebitda (%)</i>	62
<i>Pricing Date</i>	7/22/05	<i>Adjusted Reserves/Production NTM</i>	7.2
<i>Shares (mm)</i>	367	<i>EV/Ebitda</i>	5.3
<i>Market Capitalization (US\$mm)</i>	20,800	<i>PV/Ebitda</i>	4.5
<i>Debt (US\$mm)</i>	8,000	<i>Undeveloped Reserves (%)</i>	38
<i>Enterprise Value (EV) (US\$mm)</i>	28,800	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	26.20
<i>Present Value (PV) (US\$mm)</i>	24,500	<i>Present Value Proven Reserves(US\$/boe)</i>	13.40
<i>Net Present Value (US\$/share)</i>	45	<i>Present Value Proven Reserves(US\$/mcf)</i>	2.23
<i>Debt/Present Value</i>	0.33	<i>Earnings Next Twelve Months (US\$/sh)</i>	6.51
<i>McDep Ratio - EV/PV</i>	1.17	<i>Price/Earnings Next Twelve Months</i>	9
<i>Dividend Yield (%/year)</i>	2.0	<i>Indicated Annual Dividend (US\$/sh)</i>	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

Buy-rated **Marathon Oil (MRO)** boosts refining/marketing concentration to 47% of present value from 35% with the June 30 closing of the revised deal to buy the 38% interest of its minority partner, Ashland Inc. The favorable terms to Marathon contribute to an increase in estimated net present value to \$45 a share from \$42. Despite the increase in the denominator, Marathon's McDep Ratio has reached the high end of the range for buy recommendations. Yet present value may be low for producing operations because it is tied to \$40 oil when the futures market is at more than \$56 for the next six years. The refining business has strategic value to a producer expanding in heavy oil production in Canada. 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.

Long Awaited Refining Deal Completed

Marathon transferred stock now worth about a billion dollars to Ashland shareholders and paid Ashland cash and securities worth about \$2.8 billion. In return Marathon has full ownership and control of what was previously a joint venture.

The transaction appears accretive as Marathon gained value that now looks to be more than it paid (see table Functional Cash Flow and Present Value). Financial statements reflecting the new conditions will not mirror steady state until results are reported for the third quarter three months from now.

Refining may be what Marathon does best today. Most of the company's value remains in oil and gas production.

Offsetting what appears to be a smart refining deal, the company is suffering from an ill-timed forward sale of natural gas to the U.K. market. The U.K. natural gas market has been practically the strongest in the world for the past several months. We have reduced our present value of Rest of World natural gas as it seems clear that the company has given away much of the upside.

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Marathon Oil Corporation
Functional Cash Flow and Present Value

	<i>NTM</i>	<i>Adjusted</i>	<i>PV/</i>	<i>Present</i>	
	<u><i>Ebitda</i></u>	<u><i>R/P</i></u>	<u><i>Ebitda</i></u>	<u><i>Value</i></u>	
North American Natural Gas	850	5.7	4.4	3,700	15%
Rest of World Natural Gas	370	11.3	5.4	2,000	8%
Oil	2,140	6.6	3.5	7,400	30%
Downstream	2,050		5.6	11,400	47%
	5,410	7.2	4.5	24,500	100%
Debt					8,000
Net Present Value (\$mm)					16,500
Shares					367
Net Present Value (\$/sh)					45

Oil Volumes Gaining

Oil volumes are likely to show gains when second quarter results are reported on July 28 (see table [Next Twelve Months Operating and Financial Estimates](#)). We also project a rising trend for “Other” cash flow (Ebitda) on the basis of refining crack futures.

Buy Natural Gas and Oil Producer/Refiners

Peer stocks appear priced at a median McDep Ratio of 0.91 (see table [Rank by McDep Ratio](#)). Since a McDep Ratio of 1.00 represents present value assuming a long-term oil price of US\$40 a barrel, the group appears to be valued at \$36 a barrel, or less. The long-term commodity price in the futures market is currently about \$56 a barrel.

More undervalued stocks have lower McDep Ratios. The rank with lowest on the bottom suggests buy low and sell high. Any temptation to think that Marathon’s McDep Ratio is high is quickly dispelled considering the least undervalued peer has a McDep Ratio half again as high as Marathon.

Kurt H. Wulff, CFA

Marathon Oil Corporation
Next Twelve Months Operating and Financial Estimates

	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Next Twelve Months</i>
	<i>12/31/04</i>	<i>2004</i>	<i>3/31/05</i>	<i>6/30/05</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005E</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>6/30/06</i>
Volume										
Natural Gas (mmcf)										
U.S. (or North America)	585	633	570	580	568	557	569	557	580	566
Overseas (or Int'l)	411	369	455	300	318	432	376	432	300	370
Total	996	1,002	1,025	880	887	989	945	989	880	936
Oil (mbd)	173	173	163	200	200	200	191	200	180	195
Total gas & oil (bcf)	187	746	180	189	192	201	763	197	178	769
Total gas & oil (mbd))	339	340	334	347	348	365	348	365	327	351
Price										
Natural gas (\$/mcf)										
Henry Hub (\$/mmbtu)	7.10	6.15	6.27	6.76	7.21	7.99	7.05	8.82	7.62	7.91
U.S. (or North America)	5.09	4.89	4.95	5.34	5.69	6.31	5.57	6.96	6.02	6.24
Overseas (or Int'l)	3.79	3.33	4.17	4.17	4.17	4.17	4.17	4.17	4.17	4.17
Total	4.55	4.31	4.60	4.94	5.15	5.38	5.01	5.74	5.39	5.42
Oil (\$/bbl)										
WTI Cushing	48.31	41.44	49.65	53.05	56.73	58.35	54.45	58.97	59.28	58.33
Worldwide	34.80	32.24	38.82	41.48	44.36	45.62	42.78	46.11	46.35	45.59
Total gas & oil (\$/mcf)	5.19	4.85	5.52	6.08	6.44	6.60	6.17	6.81	6.68	6.63
NY Harbor 3-2-1 (\$/bbl)	5.72	7.74	6.17	10.59	12.43	7.81	9.25	9.12	11.49	10.21
Revenue (\$mm)										
Natural Gas										
U.S. (or North America)	274	1,129	254	282	298	323	1,157	349	318	1,288
Overseas (or Int'l)	143	449	171	114	122	166	572	162	114	563
Total	417	1,578	425	396	420	489	1,729	511	432	1,851
Oil	554	2,041	570	755	816	839	2,980	830	759	3,245
Other	13,335	46,289	12,016	12,016	12,016	12,016	48,063	12,016	12,016	48,063
Total	14,306	49,907	13,010	13,166	13,252	13,344	52,772	13,357	13,207	53,159
Expense										
Fixed	171	649	90	90	90	90	358	90	90	358
Variable	171	649	269	311	334	359	1,272	362	322	1,377
Other	12,895	44,727	11,716	11,482	11,389	11,622	46,209	11,559	11,440	46,011
Ebitda (\$mm)										
Exploration and Production	630	2,320	636	750	813	880	3,079	889	779	3,361
Other	440	1,561	300	534	626	394	1,854	457	576	2,053
Total Ebitda	1,070	3,881	936	1,284	1,439	1,274	4,932	1,346	1,355	5,414
Exploration	94	189	34	60	60	60	214	60	60	240
Deprec., Deplet., & Amort.	308	1,217	323	320	340	340	1,323	340	320	1,340
Other non cash		200					-			-
Ebit	668	2,275	579	904	1,039	874	3,395	946	975	3,834
Interest	32	161	32	32	40	40	144	40	40	160
Ebt	636	2,114	547	872	999	834	3,251	906	935	3,674
Income Tax	223	740	191	305	350	292	1,138	317	327	1,286
Net Income (\$mm)										
Exploration and Production	443	1,508	555							
Other	265	947	217							
Unallocated	(295)	(1,081)	(416)							
Total	413	1,374	356	567	649	542	2,113	589	608	2,388
Shares (millions)	347	339	349	349	367	367	359	367	367	367
Per share (\$)	1.19	4.05	1.02	1.63	1.77	1.48	5.89	1.60	1.66	6.51
Ebitda Margin (E&P)	65%	64%	64%	65%	66%	66%	65%	66%	65%	66%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%

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

	<i>Symbol/</i>		<i>Price</i>		<i>Market</i>	<i>Net</i>	<i>Debt/</i>	
	<i>Rating</i>		<i>(\$/sh)</i>	<i>Shares</i>	<i>Cap</i>	<i>Present</i>	<i>Present</i>	<i>McDep</i>
			<i>22-Jul</i>	<i>(mm)</i>	<i>(\$mm)</i>	<i>Value</i>	<i>Value</i>	<i>Ratio</i>
			<i>2005</i>			<i>(\$/sh)</i>		
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	88.63	123	10,910	20.00	0.76	1.83
Imperial Oil Limited (30%)	IMO	B	82.87	104	8,580	64.00	0.11	1.26
Marathon Oil Corporation	MRO	B	56.61	367	20,780	45.00	0.33	1.17
Petro-Canada	PCZ	B	68.83	263	18,130	70.00	0.20	0.99
Suncor Energy	SU	B	48.31	461	22,280	54.00	0.11	0.91
ConocoPhillips	COP	B	61.01	1,420	86,600	70.00	0.21	0.90
Norsk Hydro ASA	NHY	B	95.95	251	24,070	110.00	0.13	0.89
PetroChina Company Ltd (10%)	PTR	B	82.90	176	14,570	94.00	0.05	0.89
Lukoil Oil Company	LUKOY	B	39.55	830	33,000	52.00	0.02	0.77
<i>Total or Median</i>					<i>239,000</i>		<i>0.13</i>	<i>0.91</i>

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