

Rating: Buy
S&P 500: 1210

Marathon Oil Corporation Hurricane Watch

<i>Symbol</i>	MRO	<i>Ebitda Next Twelve Months ending 9/30/06 (US\$mm)</i>	7,400
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	18
<i>Price (US\$/sh)</i>	70.83	<i>Natural Gas and Oil Production/Ebitda (%)</i>	55
<i>Pricing Date</i>	9/21/05	<i>Adjusted Reserves/Production NTM</i>	7.1
<i>Shares (mm)</i>	367	<i>EV/Ebitda</i>	4.7
<i>Market Capitalization (US\$mm)</i>	26,000	<i>PV/Ebitda</i>	4.4
<i>Debt (US\$mm)</i>	9,000	<i>Undeveloped Reserves (%)</i>	38
<i>Enterprise Value (EV) (US\$mm)</i>	35,000	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	31.50
<i>Present Value (PV) (US\$mm)</i>	32,900	<i>Present Value Proven Reserves(US\$/boe)</i>	16.00
<i>Net Present Value (US\$/share)</i>	65	<i>Present Value Proven Reserves(US\$/mcf)</i>	2.67
<i>Debt/Present Value</i>	0.27	<i>Earnings Next Twelve Months (US\$/sh)</i>	9.54
<i>McDep Ratio - EV/PV</i>	1.07	<i>Price/Earnings Next Twelve Months</i>	7
<i>Dividend Yield (%/year)</i>	1.6	<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

The full measure of long-term opportunity in the oil refining business may not yet be reflected in stock price or estimated present value of buy-recommended **Marathon Oil Corporation (MRO)**. An active hurricane season is boosting refining profits today. Increasing demand for cleaner fuels may sustain better profits after the hurricane effect subsides. We are beginning to see a basis for raising present value to \$75 a share and next twelve months earnings to \$12 a share, but we would like to see the results of the current quarter, the first that reflects full ownership of refining operations previously 62% owned. Though the stock is priced above our current estimate of present value, industry conditions are also stronger currently. The main risk may be a potential reversal of the favorable energy investment trend that continues intact for now.

Immediate Hurricane Concern

Marathon has shut down its 72,000 barrels daily Texas City refinery as Hurricane Rita aims for a direct hit. We expect a few days of lost operations and hope that no one in the hurricane's path suffers unduly.

The tragic Hurricane Katrina caused a week or so of downtime for Marathon's largest refinery with 245,000 barrels daily capacity at Garyville, Louisiana. As terrible as the natural disaster was, it illustrated the need for more refining capacity that can only be justified by the expectation of better refining profits than has been the case for the past two decades.

Downstream Present Value Could Be Higher

In our current framework, downstream accounts for 46% of the value of Marathon (see table [Functional Cash Flow and Present Value](#)). The telling number is the present value cash flow multiple of 4.5 years for Downstream. The median multiple for our estimates of downstream

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value for 14 peer companies is 6.3 years. We could resolve much of the difference with an increase in present value of the stock to \$75 a share from \$65. If there are no negative surprises in Marathon's third quarter to be reported next month and industry conditions remain favorable we could change our estimate.

Downstream Earnings Could Be Higher

We think estimated earnings of \$9.54 for the next twelve months are consistent with downstream cash flow that averages 25% higher than that for the past four quarters (see table Next Twelve Months Operating and Financial Estimates). Projections are adjusted for the change in ownership effective July 1, 2005.

Marathon Oil Corporation **Functional Cash Flow and Present Value**

	<i>NTM</i> <i>Ebitda</i>	<i>Adjusted</i> <i>R/P</i>	<i>PV/</i> <i>Ebitda</i>	<i>Present</i> <i>Value</i>	
North American Natural Gas	1,310	5.7	3.5	4,600	14%
Rest of World Natural Gas	270	11.2	9.3	2,500	8%
Oil	2,520	6.5	4.3	10,800	33%
Downstream	3,320		4.5	15,000	46%
	7,420	7.1	4.4	32,900	100%
Debt				9,000	
Net Present Value (\$mm)				23,900	
Shares				367	
Net Present Value (\$/sh)				65	

Among other factors, the outlook for downstream earnings depends on the crack spread, or refiner's margin, in Chicago, the hub of Marathon's Midwest business. Quarterly operating profit from refining and marketing roughly tracks the Chicago crack (see chart Refining Margin and Profits). The latest quarterly profit point of about \$800 million corresponds to the average crack in April, May and June of about \$11 a barrel. The similar crack spread in New York Harbor averages about \$15 a barrel as measured in actual daily quotes and futures prices. Taking that as an indication for Chicago - there are no widely traded futures for every location - suggests that quarterly operating profit could be \$1100 million. Adjust that to Ebitda chiefly by adding depreciation and projected earnings quickly climb above \$12 a share.

Exploration and Production Cash Flow Hurricane Sensitive

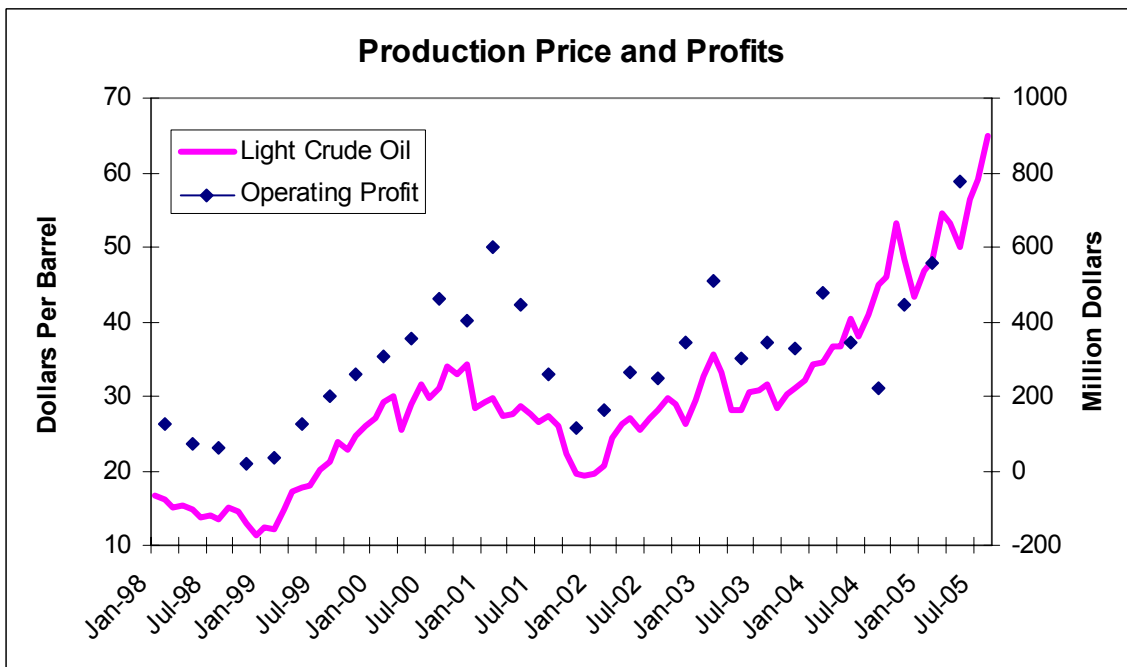
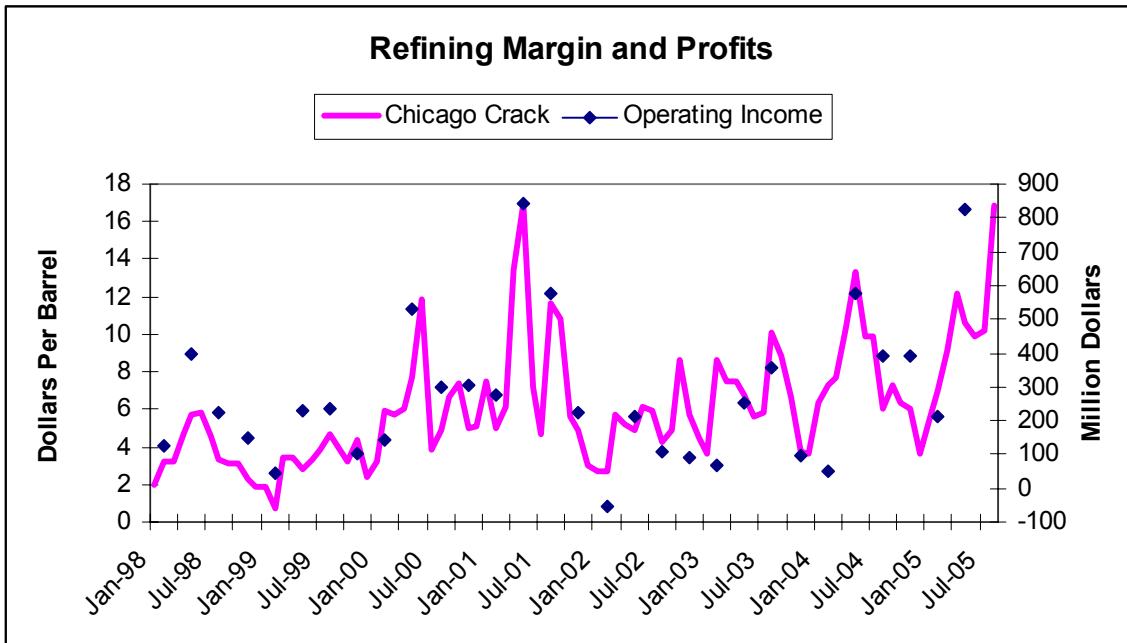
After Hurricane Ivan a year ago Marathon lost production from its Petronius platform for about six months. Petronius was hit by a 90 foot wave thought to be a rogue. Last month a 90 foot wave from Hurricane Katrina spared Marathon as it knocked out the Shell Mars platform for perhaps a year. It remains to be seen if Hurricane Rita currently in the Gulf of Mexico affects future production. Otherwise, exploration and production profits generally track crude oil price (see chart Production Price and Profits).

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Marathon Oil Corporation
Next Twelve Months Operating and Financial Estimates

	<i>Q4</i>	<i>Year</i>	<i>Q1</i>	<i>Q2</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Next</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>9/30/06</i>	<i>Twelve</i>
											<i>Months</i>
											<i>9/30/06</i>
Volume											
Natural Gas (mmcf)											
U.S. (or North America)	585	633	570	579	567	556	568	556	580	568	565
Overseas (or Int'l)	411	369	455	313	318	432	379	432	300	334	374
Total	996	1,002	1,025	892	886	988	947	988	880	902	939
Oil (mbd)	173	173	163	219	200	200	196	200	200	200	200
Total gas & oil (bcf)	187	746	180	201	192	201	774	197	189	193	781
Total gas & oil (mbd)	339	340	334	368	348	365	353	365	347	350	357
Price											
Natural gas (\$/mcf)											
Henry Hub (\$/mmbtu)	7.10	6.15	6.27	6.76	8.56	13.23	8.70	13.73	10.47	10.36	11.95
U.S. (or North America)	5.09	4.89	4.95	5.76	7.30	11.28	7.31	11.70	8.92	8.83	10.16
Overseas (or Int'l)	3.79	3.33	4.17	3.22	3.22	3.22	3.50	3.22	3.22	3.22	3.22
Total	4.55	4.31	4.60	4.87	5.83	7.76	5.78	8.00	6.98	6.76	7.40
Oil (\$/bbl)											
WTI Cushing	48.31	41.44	49.65	53.05	62.59	67.50	58.20	68.17	66.73	65.34	66.94
Worldwide	34.80	32.24	38.82	43.87	51.76	55.82	47.94	56.37	55.18	54.03	55.34
Total gas & oil (\$/mcf)	5.19	4.85	5.52	6.32	7.44	8.60	7.01	8.76	8.26	8.04	8.42
NY Harbor 3-2-1 (\$/bbl)	5.72	7.74	6.17	10.59	16.19	16.93	12.47	14.49	15.22	14.16	15.20
Revenue (\$mm)											
Natural Gas											
U.S. (or North America)	274	1,129	254	303	381	577	1,516	586	471	462	2,096
Overseas (or Int'l)	143	449	171	92	94	128	485	125	88	99	440
Total	417	1,578	425	395	475	705	2,000	711	559	561	2,535
Oil	554	2,041	570	874	952	1,027	3,423	1,015	1,004	994	4,040
Other	13,335	46,289	12,016	14,832	14,832	14,832	56,510	14,832	14,832	14,832	59,326
Total	14,306	49,907	13,010	16,101	16,259	16,563	61,934	16,557	16,395	16,387	65,902
Expense (\$mm)											
Fixed	171	649	90	108	108	108	412	108	108	108	430
Variable	171	649	269	323	402	554	1,547	551	470	466	2,040
Other	12,895	44,727	11,716	14,132	14,002	14,002	53,850	14,002	14,002	14,002	56,006
Ebitda (\$mm)											
Exploration and Production	630	2,320	636	839	918	1,070	3,464	1,067	986	982	4,105
Other	440	1,561	300	700	830	830	2,660	830	830	830	3,320
Total Ebitda	1,070	3,881	936	1,539	1,748	1,900	6,124	1,897	1,816	1,812	7,425
Exploration	94	189	34	37	60	60	191	60	60	60	240
Deprec., Deplet., & Amort.	308	1,217	323	339	400	400	1,462	400	400	400	1,600
Other non cash		200					-				-
Ebit	668	2,275	579	1,163	1,288	1,440	4,471	1,437	1,356	1,352	5,585
Interest	32	161	32	-	50	50	132	50	50	50	200
Ebt	636	2,114	547	1,163	1,238	1,390	4,339	1,387	1,306	1,302	5,385
Income Tax	223	740	191	407	433	487	1,518	485	457	456	1,885
Net Income (\$mm)											
Exploration and Production	443	1,508	555	776							
Other	265	947	217	519							
Unallocated	(295)	(1,081)	(416)	(539)							
Total	413	1,374	356	756	805	904	2,820	902	849	846	3,500
Shares (millions)	347	339	349	350	367	367	360	367	367	367	367
Per share (\$)	1.19	4.05	1.02	2.16	2.19	2.46	7.84	2.46	2.31	2.31	9.54
Ebitda Margin (E&P)	65%	64%	64%	66%	64%	62%	64%	62%	63%	63%	62%
Tax Rate	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%

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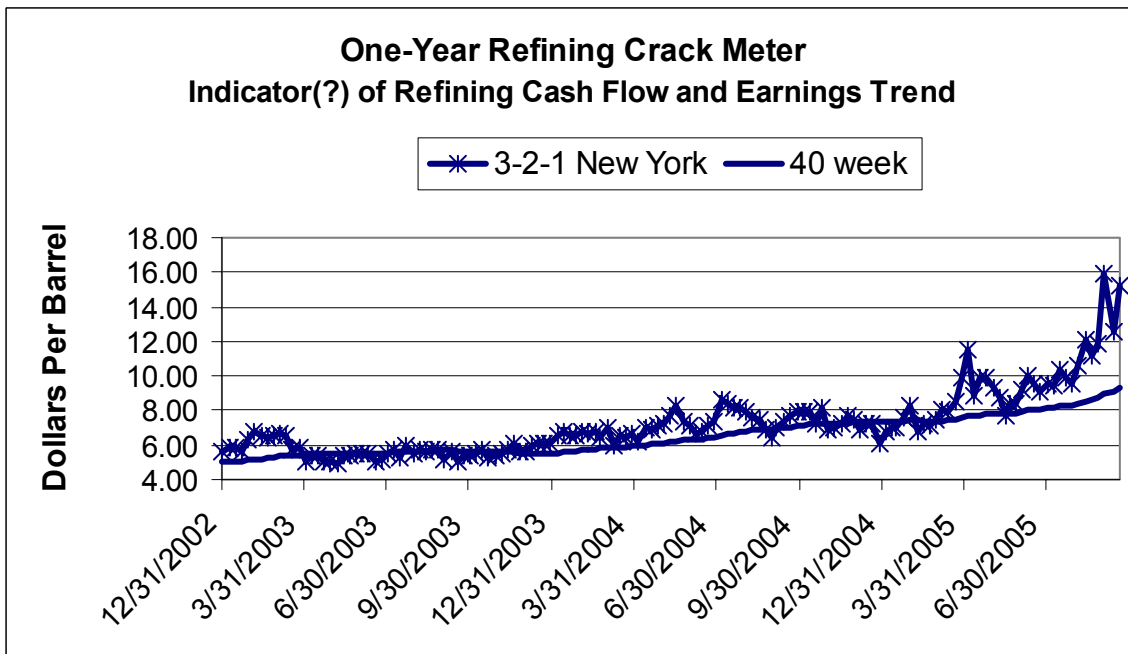
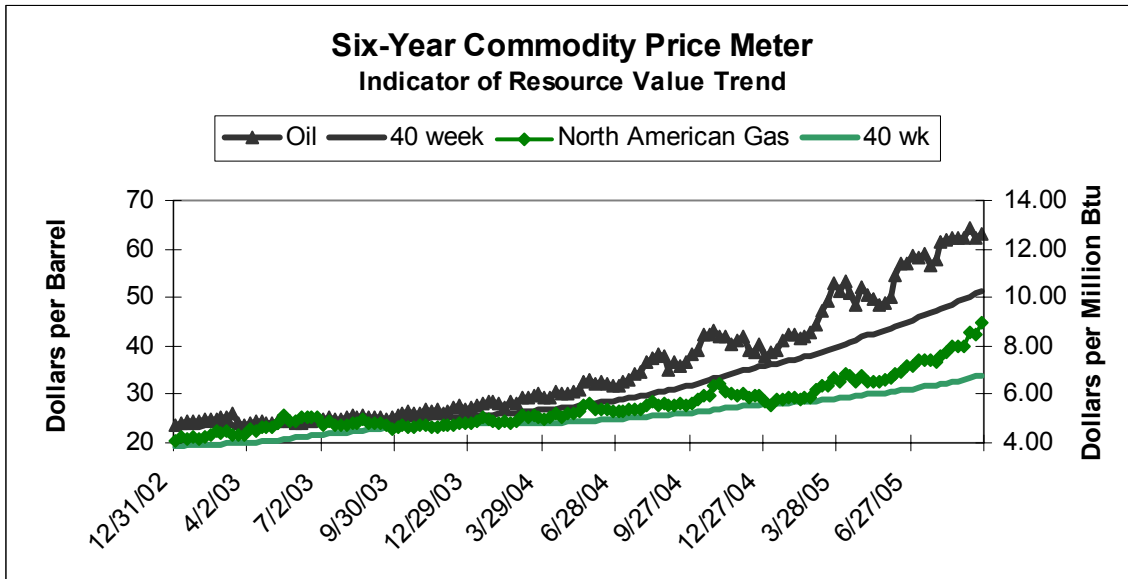
Trends Favor Investment

Six-year oil is \$67, natural gas is \$9 and the one-year crack is \$15 (see charts [Six-Year Commodity Price Meter](#) and [One-Year Refining Crack Meter](#)). Producer/Refiner stocks are at a median McDep Ratio of 0.90 (see table [Rank by McDep Ratio](#)). A McDep Ratio of 1.0 presumes six-year oil of \$50, natural gas of \$10 and one-year crack of \$10. It looks like buy

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recommended Marathon and peers can appreciate further though it is sure to be up and down in the weeks ahead. Shorter term, Hurricane Rita appears to be roiling markets as she moves across the Gulf of Mexico. Longer term, the growing preference for cleaner energy favors oil over coal, natural gas over oil and widening refining margin. Energy and economic growth correlate directly.

Kurt H. Wulff, CFA



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

	<i>Symbol/</i>	<i>Rating</i>	<i>Price</i> <i>(\$/sh)</i>	<i>Shares</i>	<i>Market</i>	<i>Net</i>	<i>Debt/</i>	<i>McDep</i>
			<i>21-Sep</i>	<i>(mm)</i>	<i>Cap</i>	<i>Present</i>	<i>Present</i>	<i>Ratio</i>
			<i>2005</i>		<i>(\$mm)</i>	<i>Value</i>	<i>Value</i>	
Producer/Refiners - Large Cap and Mid Cap								
Kinder Morgan, Inc.	KMI	S2	95.95	123	11,810	20.00	0.76	1.92
Imperial Oil Limited (30%)	IMO	B	114.85	104	11,890	84.00	0.09	1.33
Marathon Oil Corporation	MRO	B	70.83	367	25,990	65.00	0.27	1.06
Petro-Canada	PCZ	B	42.70	526	22,460	42.00	0.19	1.01
Norsk Hydro ASA	NHY	B	116.39	251	29,220	130.00	0.13	0.91
Suncor Energy	SU	B	59.74	461	27,550	68.00	0.10	0.89
Lukoil Oil Company	LUKOY	B	56.68	830	47,000	65.00	0.02	0.87
ConocoPhillips	COP	B	70.43	1,419	99,900	100.00	0.15	0.75
Gazprom (50%)	OGZPF	B	64.00	1,022	65,400	90.00	0.03	0.72
PetroChina Company Ltd (10%)	PTR	B	82.37	176	14,480	120.00	0.01	0.69
	<i>Total or Median</i>				<i>356,000</i>		<i>0.11</i>	<i>0.90</i>

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