

Rating: Buy  
S&P 500: 1179

## **Marathon Oil Corporation**

### **Downstream Gains**

<i>Symbol</i>	MRO	<i>Ebitda Next Twelve Months ending 9/30/06 (US\$m)</i>	6,600
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	19
<i>Price (US\$/sh)</i>	57.28	<i>Natural Gas and Oil Production/Ebitda (%)</i>	58
<i>Pricing Date</i>	10/27/05	<i>Adjusted Reserves/Production NTM</i>	7.4
<i>Shares (mm)</i>	368	<i>EV/Ebitda</i>	4.6
<i>Market Capitalization (US\$m)</i>	21,100	<i>PV/Ebitda</i>	5.0
<i>Debt (US\$m)</i>	9,000	<i>Undeveloped Reserves (%)</i>	38
<i>Enterprise Value (EV) (US\$m)</i>	30,100	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	30.80
<i>Present Value (PV) (US\$m)</i>	32,900	<i>Present Value Proven Reserves(US\$/boe)</i>	16.90
<i>Net Present Value (US\$/share)</i>	65	<i>Present Value Proven Reserves(US\$/mcf)</i>	2.82
<i>Debt/Present Value</i>	0.27	<i>Earnings Next Twelve Months (US\$/sh)</i>	8.62
<i>McDep Ratio - EV/PV</i>	0.91	<i>Price/Earnings Next Twelve Months</i>	7
<i>Dividend Yield (%/year)</i>	2.3	<i>Indicated Annual Dividend (US\$/sh)</i>	1.32

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-recommended **Marathon Oil Corporation (MRO)** offers 13% appreciation potential to estimated net present value of \$65 a share. Taking account of latest quarterly results, our correlation of 30 companies indicates net present value about \$3 a share higher than estimated. Downstream earnings and cash flow exceeded that from upstream in the first quarter of operations with full Marathon ownership of the former joint venture with Ashland.

### **Cash Flow and Reserve Life Point to Present Value**

McDep analysis presumes that fundamental value is measured by the projection of cash flows far into the future and discounting them to the present at a rate of return, currently 7% a year before inflation. Next Twelve Months (NTM) cash flow represents the volumes and costs that form the base for future projections. Reserve life index tells how long cash flow will last. NTM cash flow and reserve life are the two main variables in our correlation by function for about 30 companies. Net present value indicated by the current combined correlation is about \$3 a share higher than our ongoing standard estimate for the company (see table Functional Cash Flow and Present Value).

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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	1,280	5.7	3.6	4,600	14%
Rest of World Natural Gas	270	11.8	9.3	2,500	8%
Oil	2,300	6.8	4.7	10,800	33%
Downstream	2,740		5.5	15,000	46%
	6,590	7.4	5.0	32,900	100%
Debt					9,000
Net Present Value (\$mm)					23,900
Shares					368
Net Present Value (\$/sh)					65
Over (-)/ Under (+) Correlation (US\$/sh)					3

**Cash Flow by Quarter Depends on Latest Results and Futures Prices**

Cash flow for the next year is projected from a base through the latest reported quarter (see table Next Twelve Months Operating and Financial Estimates). Company disclosures provide the clues for future volumes and costs as well as geographic and quality differences in price. Futures prices from the New York Mercantile Exchange determine industry benchmarks for the next year.

**Industry Conditions Support Long-Term Price Expectation**

Present value estimates that form the denominator of the McDep Ratio and change only occasionally for all companies, most recently in early August, are tied to expected constant real long-term prices. Recent futures price for oil delivered over the next six years at \$58 a barrel exceeds our long-term expectation of \$50. One-year futures for natural gas exceed our long-term expectation while six-year futures for natural gas also have appreciation potential, in our opinion.

**Oil and Gas Commodity and Stock Price**  
**Thursday, October 27, 2005**

	<u><i>Units</i></u>	<u><i>Futures Price</i></u>		<u><i>McDep Ratio</i></u>
		<u><i>Six-Year</i></u>	<u><i>One-Year</i></u>	<u><i>Denominator</i></u>
<b>Crude Oil</b>	\$/barrel	58.13	62.00	50
<b>Natural Gas</b>	\$/million btu	8.65	11.96	10
<b>Oil Refining</b>	\$/barrel		12.41	10
	<u><i>Stocks</i></u>			<u><i>Median</i></u>
	<b>Producer/Refiner</b>			<u><i>McDep Ratio</i></u>
	<b>MRO</b>			0.80
				0.91

Source: McDep Associates, Bloomberg, New York Mercantile Exchange,  
 Yahoo and company disclosures

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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>Q3</i>	<i>Q4E</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</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>9/30/06</i>	<i>9/30/06</i>
<b>Volume</b>											
Natural Gas (mmcf)											
U.S. (or North America)	585	<b>633</b>	570	579	562	551	<b>565</b>	551	580	568	<b>562</b>
Overseas (or Int'l)	411	<b>369</b>	455	313	245	432	<b>361</b>	432	300	257	<b>355</b>
Total	996	<b>1,002</b>	1,025	892	807	982	<b>926</b>	982	880	826	<b>917</b>
Oil (mbd)	173	<b>173</b>	163	219	157	190	<b>182</b>	190	190	190	<b>190</b>
Total gas & oil (bcf)	187	<b>746</b>	180	201	161	195	<b>737</b>	191	184	181	<b>751</b>
Total gas & oil (mbd)	339	<b>340</b>	334	368	292	354	<b>337</b>	354	337	328	<b>343</b>
<b>Price</b>											
Natural gas (\$/mcf)											
Henry Hub (\$/mmbtu)	7.10	<b>6.15</b>	6.27	6.76	8.56	13.83	<b>8.85</b>	13.80	10.66	10.64	<b>12.23</b>
U.S. (or North America)	5.09	<b>4.89</b>	4.95	5.76	6.56	10.59	<b>6.95</b>	10.57	8.17	8.15	<b>9.34</b>
Overseas (or Int'l)	3.79	<b>3.33</b>	4.17	3.22	3.12	3.12	<b>3.47</b>	3.12	3.12	3.12	<b>3.12</b>
Total	4.55	<b>4.31</b>	4.60	4.87	5.52	7.31	<b>5.59</b>	7.30	6.45	6.58	<b>6.94</b>
Oil (\$/bbl)											
WTI Cushing	48.31	<b>41.44</b>	49.65	53.05	62.52	61.68	<b>56.73</b>	62.03	62.24	62.20	<b>62.03</b>
Worldwide	34.80	<b>32.24</b>	38.82	43.87	50.11	49.44	<b>45.57</b>	49.72	49.89	49.85	<b>49.72</b>
Total gas & oil (\$/mcf)	5.19	<b>4.85</b>	5.52	6.32	7.04	7.81	<b>6.68</b>	7.83	7.50	7.58	<b>7.68</b>
NY Harbor 3-2-1 (\$/bbl)	5.72	<b>7.74</b>	6.17	10.59	16.70	11.73	<b>11.30</b>	12.23	13.62	12.83	<b>12.60</b>
<b>Revenue (\$mm)</b>											
Natural Gas											
U.S. (or North America)	274	<b>1,129</b>	254	303	339	537	<b>1,433</b>	524	431	426	<b>1,918</b>
Overseas (or Int'l)	143	<b>449</b>	171	92	70	124	<b>457</b>	121	85	74	<b>404</b>
Total	417	<b>1,578</b>	425	395	410	661	<b>1,890</b>	645	516	500	<b>2,322</b>
Oil	554	<b>2,041</b>	570	874	724	864	<b>3,032</b>	850	863	871	<b>3,448</b>
Other	13,335	<b>46,289</b>	12,016	14,832	16,115	16,115	<b>59,077</b>	16,115	16,115	16,115	<b>64,459</b>
Total	14,306	<b>49,907</b>	13,010	16,101	17,248	17,639	<b>63,998</b>	17,610	17,494	17,486	<b>70,229</b>
<b>Expense (\$mm)</b>											
Fixed	171	<b>649</b>	90	99	81	81	<b>351</b>	81	81	81	<b>324</b>
Variable	171	<b>649</b>	269	297	243	439	<b>1,248</b>	424	366	362	<b>1,592</b>
Other	12,895	<b>44,727</b>	11,716	14,132	15,272	15,430	<b>56,549</b>	15,430	15,430	15,430	<b>61,719</b>
<b>Ebitda (\$mm)</b>											
Exploration and Production	630	<b>2,320</b>	636	874	809	1,005	<b>3,323</b>	990	932	928	<b>3,854</b>
Other	440	<b>1,561</b>	300	700	843	685	<b>2,528</b>	685	685	685	<b>2,740</b>
Total Ebitda	1,070	<b>3,881</b>	936	1,574	1,652	1,689	<b>5,851</b>	1,675	1,617	1,613	<b>6,594</b>
Exploration	94	<b>189</b>	34	37	64	64	<b>199</b>	64	64	64	<b>256</b>
Deprec., Deplet., & Amort.	308	<b>1,217</b>	323	339	331	331	<b>1,324</b>	331	331	331	<b>1,324</b>
Other non cash		<b>200</b>					<b>-</b>				<b>-</b>
<b>Ebit</b>	668	<b>2,275</b>	579	1,198	1,257	1,294	<b>4,328</b>	1,280	1,222	1,218	<b>5,014</b>
Interest	32	<b>161</b>	32	35	32	32	<b>131</b>	32	32	32	<b>128</b>
<b>Ebt</b>	636	<b>2,114</b>	547	1,163	1,225	1,262	<b>4,197</b>	1,248	1,190	1,186	<b>4,886</b>
Income Tax	223	<b>740</b>	191	407	429	442	<b>1,469</b>	437	416	415	<b>1,710</b>
<b>Net Income (\$mm)</b>											
Exploration and Production	443	<b>1,508</b>	555	776	627						
Other	265	<b>947</b>	217	519	814						
Unallocated	(295)	<b>(1,081)</b>	(416)	(539)	(645)						
Total	413	<b>1,374</b>	356	756	796	821	<b>2,728</b>	811	773	771	<b>3,176</b>
<b>Shares (millions)</b>	347	<b>339</b>	349	350	369	369	<b>361</b>	369	369	367	<b>368</b>
Per share (\$)	1.19	<b>4.05</b>	1.02	2.16	2.16	2.23	<b>7.57</b>	2.20	2.10	2.10	<b>8.62</b>
Ebitda Margin (E&P)	65%	<b>64%</b>	64%	69%	71%	66%	<b>68%</b>	66%	68%	68%	<b>67%</b>
Tax Rate	35%	<b>35%</b>	35%	35%	35%	35%	<b>35%</b>	35%	35%	35%	<b>35%</b>

**Buy Producer/Refiners**

Energy is necessary for world economic growth and clean energy provides a better quality of life. Producer/refiners are among the leading global suppliers of clean energy. Headquartered in Norway, Russia, China, Canada and the U.S., buy recommendations also offer political diversification. McDep Ratios that compare Enterprise Value with Present Value of energy and other businesses imply that the stock market undervalues the fundamental prospects. Stocks are ranked in descending order of McDep Ratio connoting “buy low, sell high” (see table Rank by McDep Ratio).

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

	<i>Symbol/ Rating</i>	<i>Price (\$/sh) 27-Oct 2005</i>	<i>Shares (mm)</i>	<i>Market Cap (\$mm)</i>	<i>Net Present Value (\$/sh)</i>	<i>Debt/ Present Value</i>	<i>McDep Ratio</i>
<b>Producer/Refiners - Large Cap and Mid Cap</b>							
Kinder Morgan, Inc.	KMI S2	87.78	123	10,800	20.00	0.76	1.82
Imperial Oil Limited (30%)	IMO B	87.92	102	8,980	84.00	0.10	1.04
Marathon Oil Corporation	MRO B	57.28	368	21,090	65.00	0.27	0.91
Petro-Canada	PCZ B	34.95	525	18,360	42.00	0.19	0.86
Lukoil Oil Company	LUKOY B	52.00	830	43,000	65.00	0.03	0.81
Suncor Energy	SU B	52.05	461	24,000	68.00	0.11	0.79
Norsk Hydro ASA	NHY B	97.21	251	24,390	130.00	0.12	0.78
ConocoPhillips	COP B	60.90	1,418	86,400	100.00	0.15	0.67
Gazprom (50%)	OGZPF B	57.40	1,022	58,600	90.00	0.03	0.65
PetroChina Company Ltd (10%)	PTR B	74.58	176	13,110	120.00	0.01	0.63
<i>Total or Median</i>				<i>309,000</i>		<i>0.11</i>	<i>0.80</i>

Kurt H. Wulff, CFA

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