

Rating: Buy  
S&P 500: 1274

## **Marathon Oil Corporation** **Raise Net Present Value to \$75 a Share**

<i>Symbol</i>	MRO	<i>Ebitda Next Twelve Months ending 12/31/06 (US\$m)</i>	7,900
<i>Rating</i>	Buy	<i>North American Natural Gas/Ebitda (%)</i>	12
<i>Price (US\$/sh)</i>	72.50	<i>Natural Gas and Oil Production/Ebitda (%)</i>	59
<i>Pricing Date</i>	1/26/06	<i>Adjusted Reserves/Production NTM</i>	6.5
<i>Shares (mm)</i>	368	<i>EV/Ebitda</i>	4.5
<i>Market Capitalization (US\$m)</i>	26,700	<i>PV/Ebitda</i>	4.6
<i>Debt (US\$m)</i>	9,000	<i>Undeveloped Reserves (%)</i>	38
<i>Enterprise Value (EV) (US\$m)</i>	35,700	<i>Natural Gas and Oil Ebitda (US\$/boe)</i>	33.10
<i>Present Value (PV) (US\$m)</i>	36,600	<i>Present Value Proven Reserves(US\$/boe)</i>	19.10
<i>Net Present Value (US\$/share)</i>	75	<i>Present Value Proven Reserves(US\$/mcf)</i>	3.18
<i>Debt/Present Value</i>	0.25	<i>Earnings Next Twelve Months (US\$/sh)</i>	10.39
<i>McDep Ratio - EV/PV</i>	0.97	<i>Price/Earnings Next Twelve Months</i>	7
<i>Dividend Yield (%/year)</i>	1.8	<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**

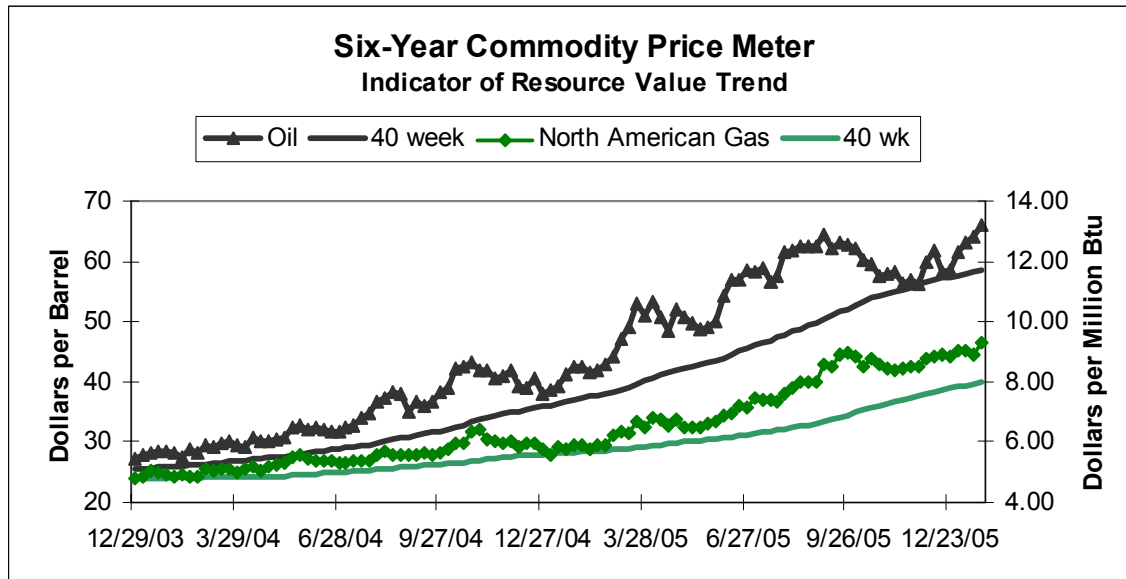
Buy-recommended **Marathon Oil Corporation (MRO)** delivered favorable performance in the fourth quarter of last year that prompts us to raise estimated net present value to \$75 a share from \$65. Reported cash flow from exploration and production as well as refining and marketing responded well to improving industry conditions.

### **McDep Ratio Relates Oil Price to Opportunity**

A McDep Ratio below 1.0 tells us that Marathon's market cap and debt, or enterprise value, is less than the estimated present value of its energy resources assuming a long-term real price of \$50 a barrel for Light, Sweet Crude Oil. Meanwhile six-year oil futures are about \$66 a barrel. Momentum has been positive for more than three years as the current quote stays above the 40-week average (see chart [Six-Year Commodity Price Meter](#)). Six-year oil has tripled in the four years we have been calculating it on a weekly basis. We do not need further gains in oil price to make money in buy recommendations. Yet our vision of \$150 oil in 2010 implies additional scope to exceed common expectations.

Marathon's McDep Ratio ranks in the midst of peer companies (see table [Rank by McDep Ratio](#)). Aside from the fundamental appreciation potential we outlined above, a McDep Ratio of 1.0 is an indication of takeover value. The McDep Ratio of buy-recommended **Burlington Resources (BR)**, increased to 1.0 immediately after buy-recommended **ConocoPhillips (COP)** announced its takeover offer.

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

	Symbol/ Rating	Price (\$/sh) 26-Jan 2006	Shares (mm)	Market Cap (\$mm)	Net Present Value (\$/sh)	Debt/ Present Value	McDep Ratio
<b>Producer/Refiners - Large Cap and Mid Cap</b>							
Kinder Morgan, Inc.	KMI S2	97.85	139	13,640	33.00	0.74	1.51
Imperial Oil Limited (30%)	IMO B	102.56	102	10,480	84.00	0.10	1.20
Petro-Canada	PCZ B	45.20	523	23,640	42.00	0.19	1.06
Suncor Energy	SU B	76.40	461	35,230	75.00	0.10	1.02
Marathon Oil Corporation	MRO B	72.50	368	26,670	75.00	0.25	0.97
Norsk Hydro ASA	NHY B	116.50	251	29,230	130.00	0.17	0.91
PetroChina Company Ltd (10%)	PTR B	94.56	176	16,620	120.00	0.01	0.79
Lukoil Oil Company	LUKOY B	77.80	830	65,000	100.00	0.01	0.78
Gazprom (50%)	OGZPF B	91.00	1,013	92,200	120.00	0.03	0.77
<i>Total or Median</i>				<i>313,000</i>		<i>0.10</i>	<i>0.97</i>

**Low Cash Flow Multiple**

Marathon has an adjusted reserve life index of 6.5 years, second lowest among peers (see table [Rank by EV/Ebitda](#)). That may change somewhat when final disclosures as of the end of 2005 become available. For now it is consistent that Marathon's unlevered multiple, EV/Ebitda, is also among the lowest of peers.

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**Rank by EV/Ebitda: Enterprise Value to Earnings Before Interest, Tax, Deprec.**

	Symbol/ Rating		Price (\$/sh) 26-Jan 2006	Adjstd Resrvs/ Prod NTM	PV/ Ebitda NTM	EV/ Ebitda NTM	P/E NTM	Divd or Distrib NTM (%)
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Kinder Morgan, Inc.	KMI	S2	97.85		8.2	12.4	20	3.6
Gazprom (50%)	OGZPF	B	91.00	20.0	10.7	8.2	14	0.5
Imperial Oil Limited (30%)	IMO	B	102.56	11.5	6.7	8.1	14	0.8
Suncor Energy	SU	B	76.40	17.7	7.4	7.5	15	0.3
Petro-Canada	PCZ	B	45.20	6.0	5.1	5.5	9	0.8
Norsk Hydro ASA	NHY	B	116.50	7.9	5.1	4.7	9	2.6
PetroChina Company Ltd (10%)	PTR	B	94.56	13.8	5.8	4.6	9	4.0
Marathon Oil Corporation	MRO	B	72.50	6.5	4.6	4.5	7	1.8
Lukoil Oil Company	LUKOY	B	77.80	19.7	5.5	4.3	6	1.3
	<i>Median</i>			<i>12.7</i>	<i>5.8</i>	<i>5.5</i>	<i>9</i>	<i>1.3</i>

**Highest Concentration on Downstream**

Each oil and gas stock has its own unique mix of energy resources (see table Business Segments). Marathon's concentration on downstream is the highest among peers at 41%.

**Home Country and Business Segments**

	Symbol/ Rating		Non- U.S. Domicile	North Amer. Natural Gas (%)	Rest of World Natural Gas (%)	Oil Prod'n (%)	Down- stream (%)	Total Present Value (US\$mm)
<b>Producer/Refiners - Large Cap and Mid Cap</b>								
Gazprom	OGZPF	B	Russia		100			251,000
PetroChina Company Ltd.	PTR	B	China	-	9	71	20	213,000
Lukoil Oil Company	LUKOY	B	Russia	-	-	75	25	83,600
Norsk Hydro ASA	NHY	B	Norway	-	29	38	33	39,400
Suncor Energy	SU	B	Canada	4	-	89	7	38,200
Marathon Oil Corporation	MRO	B		13	7	40	41	36,600
Imperial Oil Limited	IMO	B	Canada	13	-	62	25	31,900
Petro-Canada	PCZ	B	Canada	23	4	53	20	27,200
	<i>Median</i>			<i>4</i>	<i>5</i>	<i>62</i>	<i>25</i>	<i>721,000</i>

**Static Present Value Justified by Dynamic Cash Flow**

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 relationship is about \$10 a share higher than our steady 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	930	5.4	4.9	4,600	13%
Rest of World Natural Gas	580	11.0	4.3	2,500	7%
Oil	3,170	5.8	4.6	14,500	40%
Downstream	3,200		4.7	15,000	41%
	7,880	6.5	4.6	36,600	100%
Debt					9,000
Net Present Value (\$mm)					27,600
Shares					368
Net Present Value (\$/sh)					75
Over (-)/ Under (+) Correlation (US\$/sh)					10

**Futures Prices Propel Estimated Cash Flow by Quarter**

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 in our model.

Kurt H. Wulff, CFA

**Marathon Oil Corporation**  
**Next Twelve Months Operating and Financial Estimates**

	<i>Q4</i>	<i>Q3</i>	<i>Q4</i>	<i>Year</i>	<i>Q1E</i>	<i>Q2E</i>	<i>Q3E</i>	<i>Q4E</i>	<i>Next Twelve Months</i>
	<i>12/31/04</i>	<i>9/30/05</i>	<i>12/31/05</i>	<i>2005</i>	<i>3/31/06</i>	<i>6/30/06</i>	<i>9/30/06</i>	<i>12/31/06</i>	<i>12/31/06</i>
<b>Volume</b>									
Natural Gas (mmcf)									
U.S. (or North America)	585	562	599	<b>578</b>	599	599	599	599	<b>599</b>
Overseas (or Int'l)	411	245	406	<b>354</b>	380	380	380	380	<b>380</b>
Total	996	807	1,005	<b>932</b>	979	979	979	979	<b>979</b>
Oil (mbd)	173	157	224	<b>191</b>	224	224	224	224	<b>224</b>
Total gas & oil (bcf)	187	161	216	<b>758</b>	209	211	214	214	<b>848</b>
Total gas & oil (mbd)	339	292	392	<b>346</b>	387	387	387	387	<b>387</b>
<b>Price</b>									
Natural gas (\$/mcf)									
Henry Hub (\$/mmbtu)	7.10	8.56	13.00	<b>8.65</b>	9.56	8.95	9.20	10.11	<b>9.45</b>
U.S. (or North America)	5.09	6.56	8.30	<b>6.42</b>	6.10	5.71	5.87	6.45	<b>6.04</b>
Overseas (or Int'l)	3.79	3.12	5.92	<b>4.28</b>	5.92	5.92	5.92	5.92	<b>5.92</b>
Total	4.55	5.52	7.34	<b>5.61</b>	6.03	5.79	5.89	6.25	<b>5.99</b>
Oil (\$/bbl)									
WTI Cushing	48.31	62.52	60.02	<b>56.31</b>	67.34	69.02	69.68	69.95	<b>69.00</b>
Worldwide	34.80	50.11	47.98	<b>45.32</b>	53.84	55.18	55.71	55.93	<b>55.17</b>
Total gas & oil (\$/mcf)	5.19	7.04	7.72	<b>6.68</b>	7.73	7.76	7.85	8.03	<b>7.84</b>
NY Harbor 3-2-1 (\$/bbl)	5.72	16.70	9.05	<b>10.63</b>	8.04	11.92	12.44	10.23	<b>10.66</b>
<b>Revenue (\$mm)</b>									
Natural Gas									
U.S. (or North America)	274	339	457	<b>1,354</b>	329	311	324	356	<b>1,319</b>
Overseas (or Int'l)	143	70	221	<b>554</b>	202	205	207	207	<b>821</b>
Total	417	410	679	<b>1,908</b>	531	516	531	563	<b>2,141</b>
Oil	554	724	989	<b>3,156</b>	1,085	1,125	1,148	1,153	<b>4,511</b>
Other	13,335	16,115	15,647	<b>58,609</b>	15,647	15,647	15,647	15,647	<b>62,586</b>
Total	14,306	17,248	17,314	<b>63,673</b>	17,263	17,287	17,325	17,362	<b>69,238</b>
<b>Expense (\$mm)</b>									
Fixed	171	81	96	<b>365</b>	96	96	96	96	<b>382</b>
Variable	171	243	287	<b>1,095</b>	376	388	407	425	<b>1,597</b>
Other	12,895	15,272	14,385	<b>55,504</b>	14,847	14,847	14,847	14,847	<b>59,386</b>
<b>Ebitda (\$mm)</b>									
Exploration and Production	630	809	1,285	<b>3,604</b>	1,145	1,157	1,176	1,194	<b>4,672</b>
Other	440	843	1,261	<b>3,104</b>	800	800	800	800	<b>3,200</b>
Total Ebitda	1,070	1,652	2,546	<b>6,708</b>	1,945	1,957	1,976	1,994	<b>7,872</b>
Exploration	94	64	87	<b>222</b>	87	87	87	87	<b>348</b>
Deprec., Deplet., & Amort.	308	331	365	<b>1,358</b>	365	365	365	365	<b>1,460</b>
Other non cash				<b>-</b>					<b>-</b>
<b>Ebit</b>	668	1,257	2,094	<b>5,128</b>	1,493	1,505	1,524	1,542	<b>6,064</b>
Interest	32	32	46	<b>145</b>	46	46	46	46	<b>184</b>
<b>Ebt</b>	636	1,225	2,048	<b>4,983</b>	1,447	1,459	1,478	1,496	<b>5,880</b>
Income Tax	223	429	717	<b>1,744</b>	506	511	517	524	<b>2,058</b>
<b>Net Income (\$mm)</b>									
Exploration and Production	443	627	1,030						
Other	265	814	1,185						
Unallocated	(295)	(645)	(884)						
Total	413	796	1,331	<b>3,239</b>	941	948	961	973	<b>3,822</b>
<b>Shares (millions)</b>	347	369	369	<b>362</b>	369	369	367	367	<b>368</b>
Per share (\$)	1.19	2.16	3.61	<b>8.95</b>	2.55	2.57	2.62	2.65	<b>10.39</b>
Ebitda Margin (E&P)	65%	71%	77%	<b>71%</b>	71%	71%	70%	70%	<b>70%</b>
Tax Rate	35%	35%	35%	<b>35%</b>	35%	35%	35%	35%	<b>35%</b>

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