Marathon Petroleum (MPC)

Updated June 1st, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	$80	**5 Year CAGR Estimate:**	5.2%	**Quality Percentile:**	N/A
Fair Value Price:	$58	**5 Year Growth Estimate:**	9.3%	**Momentum Percentile:**	N/A
% Fair Value:	139%	**5 Year Valuation Multiple Estimate:**	-6.4%	**Total Return Percentile:**	N/A
Dividend Yield:	2.3%	**5 Year Price Target**	$90	**Valuation Percentile:**	N/A

Overview & Current Events

Marathon Petroleum was spun off from Marathon Oil in 2011. It is currently the second largest U.S. refiner, with a refining capacity of 1.9 M barrels per day. It also sells gasoline via its 5600 retail outlets, operates 2740 Speedway convenience stores, and has a midstream entity, MPLX, which has gathering and processing facilities.

Just like the other domestic refiners, Marathon has pronouncedly outperformed the market in the last 12 months, as it has rallied 53% whereas S&P has gained 13% during this period. The vast outperformance has resulted from a series of positive factors, which have favored refiners lately.

U.S. oil production has reached record levels this year and is expected by the EIA to climb to new all-time highs next year. This supply glut has resulted in a wide discount of WTI to Brent, which is a strong tailwind for the margins of domestic refiners. Moreover, after having paid hefty amounts for biofuel blending costs in recent years, domestic refiners are likely to see these costs plunge thanks to an expected change in EPA regulation. While the magnitude of the relief and its timing are still unknown, the benefit is expected to be meaningful.

Finally, all the refiners will greatly benefit from the new international marine standard, which will come in effect in early 2020. According to the new standard, all the vessels will be forced to start burning low-sulfur diesel instead of heavy fuel oil. As a result, the demand for diesel will greatly increase and will thus provide a boost to the refining margins. In fact, Marathon completed a major upgrade in its Garyville refinery in Q1 in order to maximize its diesel output.

The only point of concern for refiners is the rising price of oil. Higher oil prices adversely affect the demand for oil products and thus exert pressure on refining margins. Due to the domestic crude supply glut, the rally of the oil price has not affected the refining margins yet. Nevertheless, it is a risk factor to consider for the future.

While all the above factors significantly affect refiners, the most important development for Marathon is its pending acquisition of Andeavor for about $23 B. The deal does not have any meaningful hurdles ahead and is thus expected to close in the second half of this year. As the deal price was 24% higher than the prevailing price of Andeavor, which was already an all-time high, the market initially punished Marathon with a 15% plunge. However, the market seems to have appreciated the prospects of the merger and hence the stock has almost retrieved its losses.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	----	----	----	$3.34	$4.95	$3.32	$4.39	$5.26	$2.21	$3.77	***$4.80***	***$7.50***
DPS	----	----	----	$0.23	$0.60	$0.77	$0.92	$1.14	$1.36	$1.52	***$1.84***	***$3.00***

Marathon expects to achieve more than $1 B in cost synergies thanks to the above deal. The combined entity will be the largest U.S. refiner, with a total capacity of 3.0 M barrels per day. Therefore, there is huge potential for cost savings. For instance, the new company will make over $10 B of purchases per year. As a result, even a 1% discount thanks to scale will result in $100 M savings. Moreover, Marathon already has a proven record of synergies, as it has achieved more than $200 M of synergies with its Hess Retail takeover.

Furthermore, Marathon will greatly benefit from the inland location of some of the refineries of Andeavor. Thanks to the oil supply glut, these refineries buy their crude oil at a discount to WTI so they enjoy markedly high margins. Given all the above factors, the new entity is likely to grow its EPS from $4.80 this year to at least $7.50 in 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	----	----	----	5.4	4.7	11.6	10.0	9.6	18.2	14.4	***16.7***	***12.0***
Avg. Yld.	----	----	----	1.3%	2.6%	2.0%	2.1%	2.3%	3.4%	2.8%	***2.3%***	***3.3%***

Thanks to its impressive 53% rally this year, Marathon is now trading at a P/E of 16.7, which is much higher than its historical average P/E of 10.6. As it is reasonable to expect the stock to revert towards its average P/E in the long run, it is reasonable to expect the P/E of the stock to drop at least down to 12.0 in the next five years. If this happens, the stock will incur a 6.4% annualized P/E contraction.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	----	----	----	42.4%	48.8%	43.7%	44.5%	36.6%	31.6%	31.4%	***31.0%***	***30.0%***
Debt/A	----	----	----	63.1%	55.5%	60.1%	62.6%	54.4%	54.5%	57.5%	***60.0%***	***65.0%***
Int. Cov.	----	----	----	51.8	48.9	19.1	18.7	14.9	4.2	6.4	***2.0***	***6.0***
Payout	----	----	----	6.9%	12.1%	23.2%	21.0%	21.7%	61.5%	40.3%	***38.3%***	***40.0%***
Std. Dev.	----	----	----	20.0%	38.5%	40.5%	30.0%	34.0%	41.7%	16.7%	***16.0%***	***16.0%***

The pending takeover of Andeavor will greatly expand the reach of Marathon, as the former operates in the Midwest and the West and the latter in the East. As a result, the new entity will have broad geographic diversification.

On the other hand, refining is a highly cyclical business and hence refiners are vulnerable to recessions. This was evident in the Great Recession, when the demand for oil products deteriorated and led the refining margins to plunge.

Final Thoughts & Recommendation

Marathon is in the process of acquiring Andeavor and becoming the largest domestic refiner. Nevertheless, due to its impressive 53% rally in the last 12 months, its potential future returns are somewhat limited. The stock is likely to offer a 5.2% average annual return over the next five years thanks to 9.3% EPS growth and its 2.3% dividend, which will be partly offset by a 6.4% annualized P/E contraction.

Total Return Breakdown by Year