Marathon Petroleum (MPC)

Updated July 28th, 2018 by Ben Reynolds

Key Metrics

Current Price:	$81	**5 Year CAGR Estimate:**	5.4%	**Volatility Percentile:**	85.5%
Fair Value Price:	$59	**5 Year Growth Estimate:**	9.3%	**Momentum Percentile:**	92.6%
% Fair Value:	139%	**5 Year Valuation Multiple Estimate:**	-6.2%	**Valuation Percentile:**	10.4%
Dividend Yield:	2.3%	**5 Year Price Target**	$92	**Total Return Percentile:**	31.4%

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.

On April 30th, Marathon Petroleum announced that it will acquire Andeavor (ANDV) for an enterprise value of $35.6 billion (including assumed debt). The acquisition will be funded by stock and cash, so it will be dilutive to Marathon Petroleum shareholders. With that said, the acquisition will significantly strengthen Marathon's competitive position and will also be immediately accretive to earnings-per-share. The deal is expected to close in the 2nd half of 2018.

Marathon Petroleum reported 2nd quarter earnings results on July 26th. The company generated earnings-per-share (EPS) of $2.27. This compares very favorably to $0.93 EPS from the same quarter a year ago. The company also repurchased $885 million worth of shares in the quarter, *2.4% of the company's market cap at current prices in just 1 quarter*. The market responded favorably to Marathon Petroleum's earnings; shares are up 11.7% over the last week.

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	***$4.90***	***$7.66***
DPS	----	----	----	$0.23	$0.60	$0.77	$0.92	$1.14	$1.36	$1.52	***$1.84***	***$3.00***

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. All refiners will also greatly benefit from the new international marine standard, which will come in effect in early 2020. According to the new standard, all vessels will be required to burn 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.

Marathon expects to achieve more than $1 billion in cost synergies thanks to the Andeavor deal. The combined entity will be the largest U.S. refiner, with a total capacity of 3.0 million barrels per day. Therefore, there is huge potential for cost savings. For instance, the new company will make over $10 billion of purchases per year. As a result, even a 1% discount thanks to scale will result in $100 million savings. Moreover, Marathon already has a proven record of synergies, as it has achieved more than $200 million 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 $4.90 this year to at least $7.66 in 2023. Due to Marathon's excellent second quarter, we've raised our expected 2018 EPS from $4.80 to $4.90.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

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	***16.5***	***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 44% rally this year, Marathon is now trading at a P/E of 16.5, which is much higher than its historical average P/E of 10.6. With the upcoming Andeavor acquisition and its history of success since its spin-off, we believe Marathon Petroleum should trade at a higher P/E ratio than its historical average. We are targeting a fair P/E ratio of 12 for this high-quality refiner.

Marathon Petroleum is currently trading in excess of fair value. If the company were to see its P/E ratio fall to our fair value target of 12 over the next 5 years, this would cause a 6.2% drag on annualized returns.

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%	***37.6%***	***39.2%***
Std. Dev.	----	----	----	20.0%	38.5%	40.5%	30.0%	34.0%	41.7%	16.7%	***16.0%***	***16.0%***

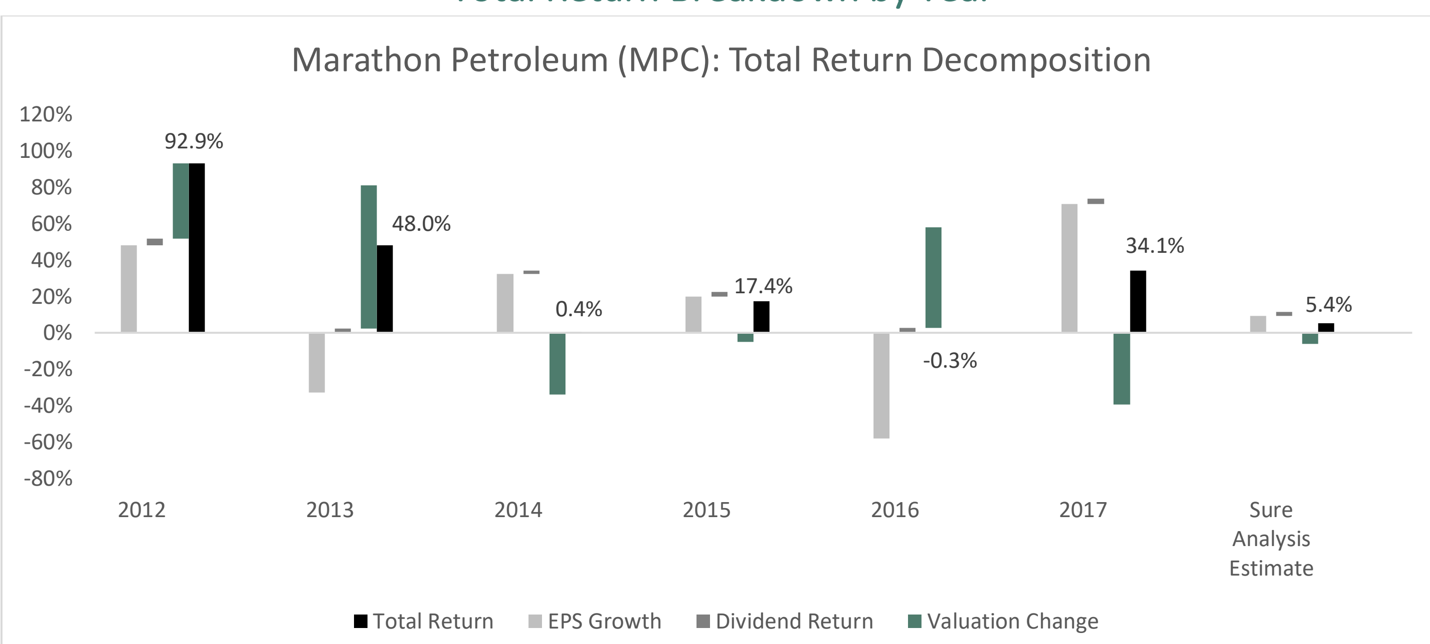
The pending takeover of Andeavor will greatly expand the reach of Marathon, as the former operates in the Midwest and the West and the latter in the East. As a result, the new entity will have broad geographic diversification.

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 is recent stock price appreciation, future returns are limited. The stock is likely to offer a 5.4% 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 6.2% annualized P/E contraction. Marathon Petroleum is certainly not a buy at current prices.

Total Return Breakdown by Year



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