# Marathon Petroleum (MPC)

*Updated November 5th, 2018 by Aristofanis Papadatos*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $69 | **5 Year CAGR Estimate:** | 9.0% | **Volatility Percentile:** | 83.7% |
| **Fair Value Price:** | $61 | **5 Year Growth Estimate:** | 8.6% | **Momentum Percentile:** | 75.1% |
| **% Fair Value:** | 113% | **5 Year Valuation Multiple Estimate:** | -2.3% | **Growth Percentile:** | 81.5% |
| **Dividend Yield:** | 2.7% | **5 Year Price Target** | $92 | **Valuation Percentile:** | 30.0% |
| **Dividend Risk Score:** | C | **Retirement Suitability Score:** | C | **Total Return Percentile:** | 45.3% |

## Overview & Current Events

Marathon Petroleum was spun off from Marathon Oil in 2011. After completing the acquisition of Andeavor on October 1st, it has become the largest U.S. refiner, with 16 refineries and a refining capacity slightly above 3.0 M barrels per day. It also has a marketing system that includes 7,800 branded locations and about 3,900 Speedway convenience stores. In addition, it owns two midstream MLPs, MPLX and Andeavor Logistics LP, which own gathering and processing assets.

In early November, Marathon Petroleum reported (11/1/18) its financial results for the third quarter of fiscal 2018. The earnings-per-share of the company decreased 8.5% over last year, from $1.77 to $1.62 and were thus slightly below the consensus of $1.63. The decrease of the earnings resulted from lower Midwest and Gulf Coast crack spreads. On the other hand, the midstream segment grew its operating income from $585 million to $679 million thanks to high transported volumes.

## 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 | ***$5.10*** | ***$7.70*** |
| **DPS** | ---- | ---- | ---- | $0.23 | $0.60 | $0.77 | $0.92 | $1.14 | $1.36 | $1.52 | ***$1.84*** | ***$3.00*** |
| **Shares** | ---- | ---- | ---- | 714.0 | 666.0 | 594.0 | 548.0 | 531.0 | 528.0 | 486.0 | ***450.0*** | ***360.0*** |

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 January, 2020. According to the new standard, all vessels that sail in international waters 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 boost refining margins. There was a recent rumor that the U.S. government was trying to postpone the implementation of the new marine rules in the U.S. The rumor caused a sell-off of all the domestic refiners but it is doubtful whether the government will succeed. Even if it does, domestic refiners will eventually benefit from the new rules in the years ahead.

The major 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.

The acquisition of Andeavor by Marathon is a game changer, as the new entity is the largest U.S. refiner. Management expects to achieve more than $1 billion of annual run-rate synergies within the first three years thanks to this deal. Marathon already has a proven record of synergies, as it has achieved more than $200 million of synergies with its Hess Retail takeover. Moreover, 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 high margins. Given all the above factors, Marathon is likely to grow its earnings-per-share from $5.10 this year to at least $7.70 in 2023. Due to favorable refining margins and strong performance of Marathon's midstream segment, we have raised our expected 2018 earnings-per-share estimate by 4%, from $4.90 to $5.10.

*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.*

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## 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 | ***13.5*** | ***12.0*** |
| Avg. Yld. | ---- | ---- | ---- | 1.3% | 2.6% | 2.0% | 2.1% | 2.3% | 3.4% | 2.8% | ***2.7%*** | ***3.3%*** |

Marathon has corrected 20% in the last month, partly due to the above rumor. As a result, it is now trading at a P/E ratio of 13.5, which is higher than its historical average of 10.6. With the takeover of Andeavor and its history of success since its spin-off, we believe this high-quality refiner should trade at a higher P/E ratio than its historical average. We are targeting a fair P/E ratio of 12. If the stock approaches this P/E over the next 5 years, it will incur a 2.3% annualized drag.

## 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% | ***71.0%*** | ***65.0%*** |
| Int. Cov. | ---- | ---- | ---- | 51.8 | 48.9 | 19.1 | 18.7 | 14.9 | 4.2 | 6.4 | ***6.0*** | ***8.0*** |
| Payout | ---- | ---- | ---- | 6.9% | 12.1% | 23.2% | 21.0% | 21.7% | 61.5% | 40.3% | ***36.1%*** | ***39.0%*** |
| Std. Dev. | ---- | ---- | ---- | 20.0% | 38.5% | 40.5% | 30.0% | 34.0% | 41.7% | 16.7% | ***16.0%*** | ***16.0%*** |

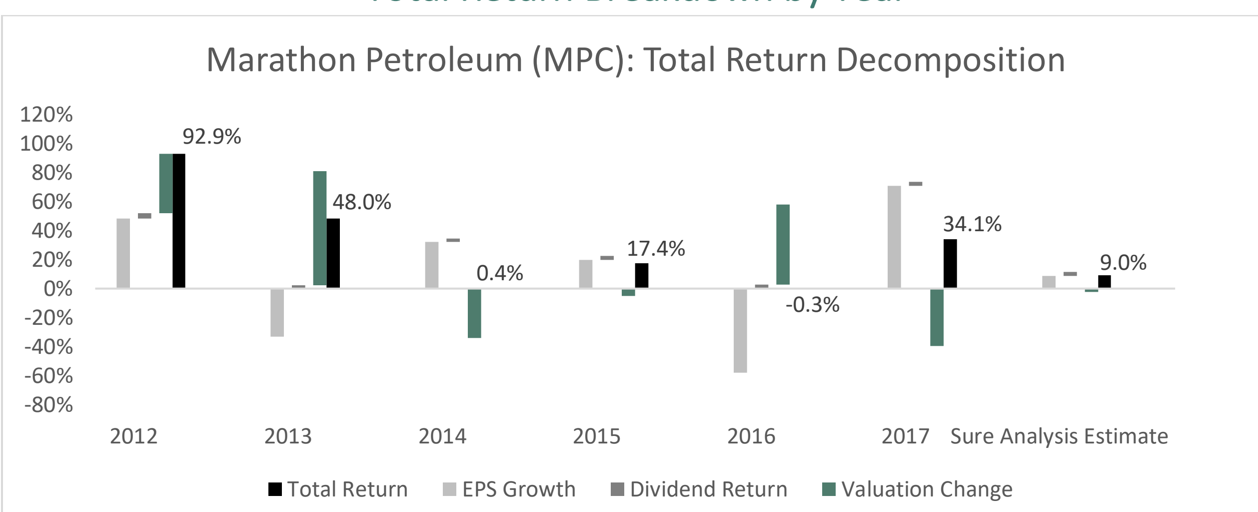
The acquisition of Andeavor will greatly enhance the geographic diversification of Marathon and its potential to take advantage of fluctuations in spreads among different types of crude oil and the dynamics of export markets. The acquisition will thus increase the earnings of the company and its resilience during downturns.

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

In our last research report, we recommended avoiding Marathon due to its rich valuation. Our thesis has played out, as the stock has lost 20% in the last month. Thanks to this correction, the great synergies that will result from the takeover of Andeavor and the new marine rules, the stock has become more attractive. It is likely to offer a 9.0% average annual return over the next five years. We currently rate it as a hold; it is a buy at or below fair value.

## Total Return Breakdown by Year

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## Income Statement Metrics

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 65258 | 45639 | 62487 | 78638 | 82243 | 100B | 97817 | 72051 | 63339 | 74733 |
| Gross Profit | 8731 | 7319 | 8163 | 10927 | 13295 | 12402 | 13542 | 15790 | 14030 | 15403 |
| Gross Margin | 13.4% | 16.0% | 13.1% | 13.9% | 16.2% | 12.4% | 13.8% | 21.9% | 22.2% | 20.6% |
| SG&A Exp. | 961 | 842 | 874 | 1059 | 1223 | 1248 | 1375 | 1576 | 1605 | 1743 |
| D&A Exp. | 606 | 670 | 941 | 891 | 995 | 1220 | 1326 | 1502 | 2001 | 2114 |
| Operating Profit | 6920 | 5578 | 930 | 3683 | 5144 | 3383 | 3877 | 4741 | 2661 | 3653 |
| Op. Margin | 10.6% | 12.2% | 1.5% | 4.7% | 6.3% | 3.4% | 4.0% | 6.6% | 4.2% | 4.9% |
| Net Profit | 1215 | 449 | 623 | 2389 | 3389 | 2112 | 2524 | 2852 | 1215 | 3497 |
| Net Margin | 1.9% | 1.0% | 1.0% | 3.0% | 4.1% | 2.1% | 2.6% | 4.0% | 1.9% | 4.7% |
| Free Cash Flow | -2103 | -436 | 1000 | 2124 | 3123 | 2199 | 1630 | 2075 | 1103 | 3877 |
| Income Tax | 670 | 236 | 400 | 1330 | 1845 | 1113 | 1280 | 1506 | 609 | -460 |

## Balance Sheet Metrics

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Assets | 18177 | 21254 | 23232 | 25745 | 27223 | 28385 | 30425 | 43115 | 44413 | 49047 |
| Cash & Equivalents | 108 | 128 | 118 | 3079 | 4860 | 2292 | 1494 | 1127 | 887 | 3011 |
| Acc. Receivable | 2077 | | | 5461 | 4610 | 5559 | 4058 | 2927 | 3617 | 4695 |
| Inventories | 3302 | 3324 | 3071 | 3320 | 3449 | 4689 | 5642 | 5225 | 5656 | 5550 |
| Goodwill & Int. | 866 | 872 | 837 | 842 | 930 | 938 | 1566 | 4019 | 3587 | 3586 |
| Total Liabilities | 9241 | 12082 | 14988 | 16240 | 15118 | 17053 | 19035 | 23440 | 24210 | 28219 |
| Accounts Payable | 3345 | 5507 | 6453 | 8189 | 6785 | 8234 | 6661 | 4743 | 5593 | 8297 |
| Long-Term Debt | 2525 | 2612 | 3897 | 3307 | 3361 | 3396 | 6602 | 11925 | 10572 | 12946 |
| Total Equity | 8936 | 9172 | 8244 | 9505 | 11694 | 10920 | 10751 | 13237 | 13557 | 14033 |
| D/E Ratio | 0.28 | 0.28 | 0.47 | 0.35 | 0.29 | 0.31 | 0.61 | 0.90 | 0.78 | 0.92 |

## Profitability & Per Share Metrics

| Year | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|
| Return on Assets | N/A | 2.3% | 2.8% | 9.8% | 12.8% | 7.6% | 8.6% | 7.8% | 2.8% | 7.5% |
| Return on Equity | N/A | 5.0% | 7.2% | 26.9% | 32.0% | 18.7% | 23.3% | 23.8% | 9.1% | 25.3% |
| ROIC | N/A | 3.9% | 5.2% | 19.1% | 24.0% | 14.0% | 15.4% | 11.5% | 3.9% | 10.8% |
| Shares Out. | N/A | N/A | N/A | 714.0 | 666.0 | 594.0 | 548.0 | 531.0 | 528.0 | 486.0 |
| Revenue/Share | 91.14 | 63.74 | 87.27 | 110.14 | 120.24 | 157.98 | 170.41 | 132.94 | 119.51 | 145.96 |
| FCF/Share | -2.94 | -0.61 | 1.40 | 2.97 | 4.57 | 3.47 | 2.84 | 3.83 | 2.08 | 7.57 |

*Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.*