# Marathon Petroleum (MPC)

*Updated February 12th, 2019 by Aristofanis Papadatos*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $62 | **5 Year CAGR Estimate:** | 9.8% | **Volatility Percentile:** | 72.0% |
| **Fair Value Price:** | $68 | **5 Year Growth Estimate:** | 4.6% | **Momentum Percentile:** | 39.9% |
| **% Fair Value:** | 92% | **5 Year Valuation Multiple Estimate:** | 1.8% | **Growth Percentile:** | 33.1% |
| **Dividend Yield:** | 3.4% | **5 Year Price Target** | $85 | **Valuation Percentile:** | 67.0% |
| **Dividend Risk Score:** | D | **Retirement Suitability Score:** | D | **Total Return Percentile:** | 54.6% |

## 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 February, Marathon Petroleum reported (2/7/19) financial results for the fourth quarter of fiscal 2018. Excluding the costs related to the acquisition of Andeavor, which were $1.06 per share, the company posted adjusted earnings-per-share of $2.41, which exceeded analysts' estimates by $0.52 or 28%. The impressive performance, which was similar to that of the other domestic refiners, resulted from higher refining throughput thanks to the acquisition of Andeavor and purchases of widely discounted crude types. The company has already realized $160 million of synergies from its acquisition in just three months, and is still on track for annual gross run-rate synergies of up to $600 million at the end of this year and $1.4 billion by the end of 2021. Thanks to strong performance and the promising prospects, management raised the annual dividend by 15%, from $1.84 to $2.12.

## Growth on a Per-Share Basis

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EPS** | ---- | ---- | $3.34 | $4.95 | $3.32 | $4.39 | $5.26 | $2.21 | $3.77 | $6.78 | ***$6.40*** | ***$8.00*** |
| **DPS** | ---- | ---- | $0.23 | $0.60 | $0.77 | $0.92 | $1.14 | $1.36 | $1.52 | $1.84 | ***$2.12*** | ***$3.00*** |
| **Shares** | ---- | ---- | 714.0 | 666.0 | 594.0 | 548.0 | 531.0 | 528.0 | 486.0 | 704.0 | ***700.0*** | ***600.0*** |

Since early October, U.S. refining margins have plunged 50%, from ~$13.00 to ~$6.50 per barrel. The collapse can be partly attributed to adverse seasonality, as refining margins are much lower in the winter due to low demand for gasoline. However, refining margins are currently half of what they were last winter. While we expect them to recover during the summer, their current depressed level which has resulted from high product inventory, is concerning.

On the other hand, just like the other U.S. refiners, Marathon took advantage of the deep discount of some crude oil grades to WTI and posted impressive results in the fourth quarter despite the plunge of benchmark margins. Moreover, Marathon greatly benefits 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 deep discount to WTI so they enjoy high margins. Furthermore, U.S. refiners will greatly benefit from the new international marine rules which will come in effect in January-2020. As per these rules, vessels that sail in international waters will be forced to burn diesel instead of heavy fuel oil. As the former is much more expensive than the latter, it should boost refiner earnings. In October, the U.S. government was rumored to be trying to postpone the implementation of the new standard in the U.S. However, it is doubtful that the government will stop implementation of the new standard. At most, it could be postponed 1 to 2 years.

Given all the above factors, Marathon is likely to grow its earnings-per-share from about $6.40 this year to at least $8.00 in 2024. We have chosen to be somewhat conservative in our estimate for this year due to the current suppressed level of benchmark refining margins.

*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 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | Now | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/E** | ---- | ---- | 5.4 | 4.7 | 11.6 | 10.0 | 9.6 | 18.2 | 14.4 | 10.8 | ***9.7*** | ***10.6*** |
| **Avg. Yld.** | ---- | ---- | 1.3% | 2.6% | 2.0% | 2.1% | 2.3% | 3.4% | 2.8% | 2.5% | ***3.4%*** | ***3.5%*** |

Since early October, Marathon has incurred a 28% correction due to the above rumor and the plunge of benchmark refining margins. As a result, it is now trading at a P/E ratio of 9.7, which is lower than its historical average of 10.6. If the stock approaches its average P/E over the next 5 years, it will enjoy a 1.8% annualized boost in its returns.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Payout** | ---- | ---- | 6.9% | 12.1% | 23.2% | 21.0% | 21.7% | 61.5% | 40.3% | 34.8% | ***33.1%*** | ***37.5%*** |

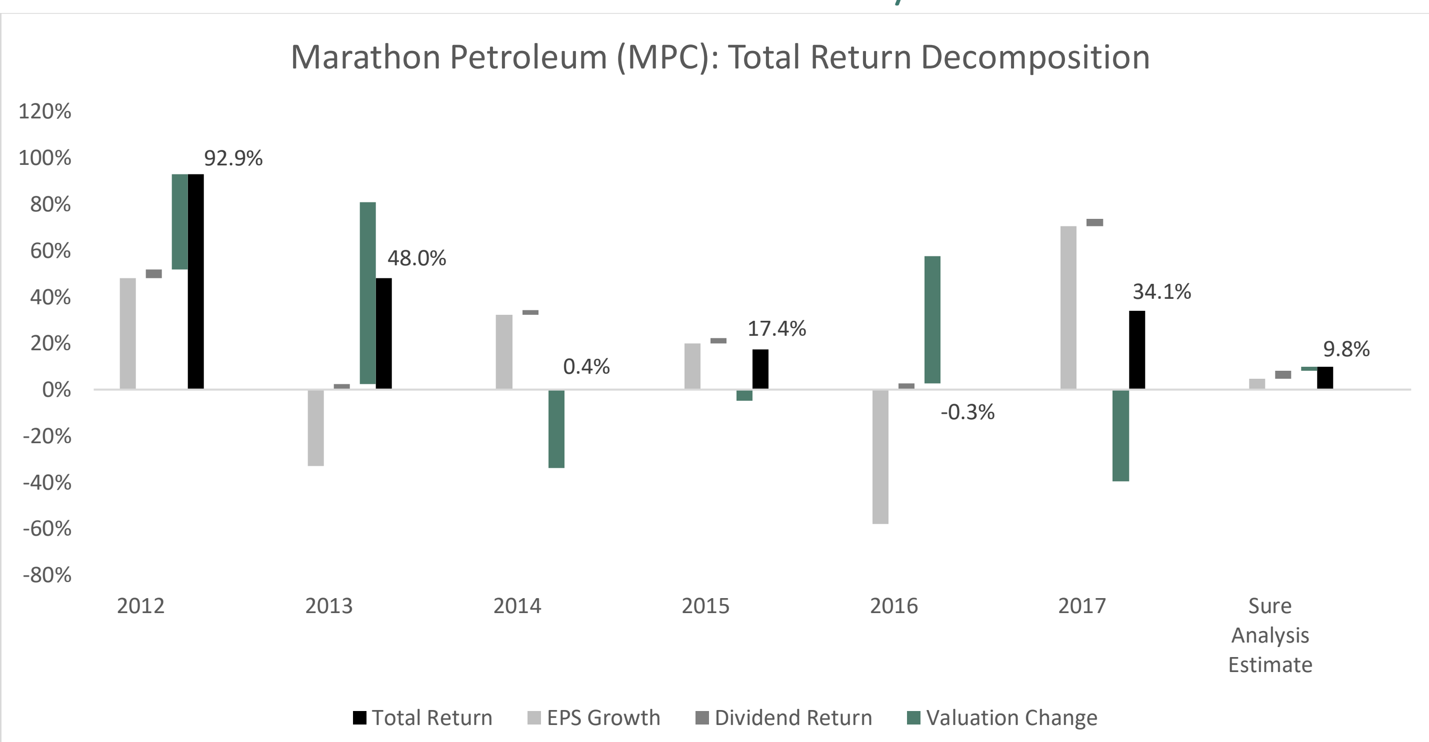
The acquisition of Andeavor has greatly enhanced the geographic diversification of Marathon and its potential to take advantage of fluctuations in spreads among different types of crude oil and the dynamics of export markets. The acquisition will thus increase the earnings of the company and its resilience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

Since our last research report (in November), Marathon has lost 10%. As a result, its valuation looks better. The stock now offers a 9.8% average annual return over the next 5 years. Nevertheless, while the stock is on the verge of earning a buy rating, we prefer to remain cautious and maintain our hold rating due to the plunge of benchmark refining margins.

## 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.*