Marathon Petroleum Corp. (MPC)

Updated November 5th, 2019 by Aristofanis Papadatos

Key Metrics

Current Price:	$68	**5 Year CAGR Estimate:**	7.6%	**Volatility Percentile:**	87.7%
Fair Value Price:	$49	**5 Year Growth Estimate:**	11.7%	**Momentum Percentile:**	26.7%
% Fair Value:	139%	**5 Year Valuation Multiple Estimate:**	-6.4%	**Growth Percentile:**	96.8%
Dividend Yield:	3.1%	**5 Year Price Target**	$85	**Valuation Percentile:**	18.5%
Dividend Risk Score:	C	**Retirement Suitability Score:**	C	**Total Return Percentile:**	63.9%

Overview & Current Events

Marathon Petroleum Corp. (MPC) was spun off from Marathon Oil Corp. (MRO) in 2011. After the acquisition of Andeavor Logistics in October of 2018, MPC has become the largest U.S. refiner, with 16 refineries and a refining capacity of 3.1 million barrels per day. It also has a marketing system that includes ~6,800 branded locations, ~3,900 convenience stores (~2740 are Speedway), and ~1,000 direct dealer locations. In addition, MPC owns a midstream MLP, (MPLX), which has gathering and processing assets as well as pipelines for crude oil and light products. MPLX completed the $9 billion Andeavor acquisition on 7/30/19. Marathon Petroleum Corp. has a market capitalization of $44 billion.

In late October, Marathon Petroleum reported (10/31/19) financial results for the third quarter of fiscal 2019. The company exceeded the analysts' earnings-per-share estimates by an impressive $0.30 ($1.63 vs. $1.33) thanks to strong performance in all segments. The retail segment almost tripled its operating income thanks to the addition of the Andeavor retail network. In the first nine months of the year, MPC has achieved $686 million of synergies from the takeover of Andeavor and thus it has exceeded its goal of $600 million for this year. It also continues to aim for $1.4 billion of synergies by the end of 2021.

More importantly, activist investors, including Elliot Management, exerted pressure on MPC for structural changes in an attempt to unlock shareholder value. As a result, MPC will change its CEO and will spin off its Speedway gas station business. It will also form a special committee, which will examine ways to unlock value from the midstream business. Thanks to the market's enthusiasm over the outcome from the pressure of activist investors and the upcoming new marine standard, which will greatly benefit the refining segment, the stock of MPC has rallied 50% in about two months.

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	***$4.60***	***$8.00***
DPS	---	---	$0.23	$0.60	$0.77	$0.92	$1.14	$1.36	$1.52	$1.84	***$2.12***	***$3.00***
Shares[1]	---	---	714.0	666.0	594.0	548.0	531.0	528.0	486.0	704.0	***660.0***	***600.0***

MPC 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. MPC is properly positioned to benefit from the new marine rules. Thanks to a series of past investments, the refiner can upgrade about 600,000 barrels per day of low-value residue to diesel. Given all the above factors, we believe that MPC can grow its earnings-per-share from about $4.60 this year to at least $8.00 in 2024.

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	***14.8***	***10.6***
Avg. Yld.	---	---	1.3%	2.6%	2.0%	2.1%	2.3%	3.4%	2.8%	2.5%	***3.1%***	***3.5%***

[1] In millions of shares

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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Thanks to its 50% rally since late August, Marathon is now trading at a price-to-earnings ratio of 14.8, which is much higher than its historical average of 10.6. If the stock reverts to its average earnings multiple over the next 5 years, it will incur a 6.4% annualized drag 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%	***46.1%***	***37.5%***

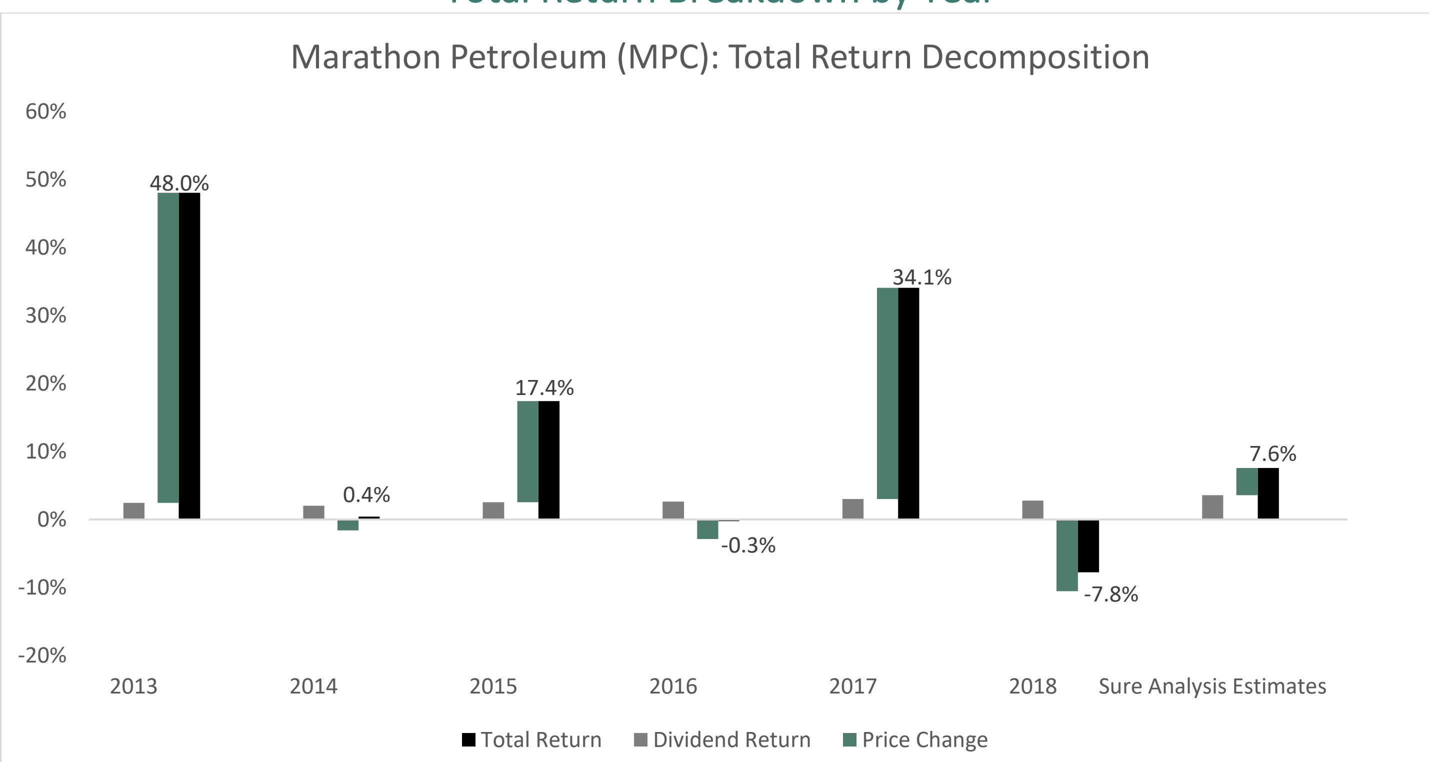
The acquisition of Andeavor has greatly enhanced the geographic diversification of Marathon and its potential to take advantage of fluctuations in price spreads among different types of crude oil and the dynamics of export markets. The acquisition will thus increase the earnings of the company and its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

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

Final Thoughts & Recommendation

In our previous research report, in August, we stated that MPC had become highly undervalued. Our thesis proved correct much earlier than we expected. Thanks to the market's enthusiasm over the structural changes triggered by activist investors and the upcoming new international marine standard, MPC has rallied 50% in about two months. Unfortunately, the stock has now become less attractive and can now offer a 7.6% average annual return over the next five years. We thus rate it as a hold at its current price. As the positive stock price momentum is likely to persist for a while, the stock may approach our 5-year target price of $85 much earlier than we expected. In such a case, investors should take profits, as the stock will have almost exhausted its upside potential. Investors should also always keep in mind that refining is a highly cyclical business.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	45639	62487	78638	82243	100B	97817	72051	63339	74733	96504
Gross Profit	7319	8163	10927	13295	12402	13542	15790	6524	7644	10438
Gross Margin	16.0%	13.1%	13.9%	16.2%	12.4%	13.8%	21.9%	10.3%	10.2%	10.8%
SG&A Exp.	842	874	1059	1223	1248	1375	1576	1597	1694	2418
D&A Exp.	670	941	891	995	1220	1326	1502	2001	2114	2490
Operating Profit	5578	930	3683	5144	3383	3877	4741	2669	3702	5175
Op. Margin	12.2%	1.5%	4.7%	6.3%	3.4%	4.0%	6.6%	4.2%	5.0%	5.4%
Net Profit	449	623	2389	3389	2112	2524	2852	1215	3497	2855
Net Margin	1.0%	1.0%	3.0%	4.1%	2.1%	2.6%	4.0%	1.9%	4.7%	3.0%
Free Cash Flow	-436	1000	2124	3123	2199	1630	2075	1125	3880	2580
Income Tax	236	400	1330	1845	1113	1280	1506	609	-460	962

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	21254	23232	25745	27223	28385	30425	43115	44413	49047	92940
Cash & Equivalents	128	118	3079	4860	2292	1494	1127	887	3011	1687
Acc. Receivable	N/A	N/A	5461	4610	5559	4058	2927	3617	4695	5853
Inventories	3324	3071	3320	3449	4689	5642	5225	5656	5550	9837
Goodwill & Int.	872	837	842	930	938	1566	4019	3587	4217	23498
Total Liabilities	12082	14988	16240	15118	17053	19035	23440	24210	28219	48891
Accounts Payable	5507	6453	8189	6785	8234	6661	4743	5593	8297	9366
Long-Term Debt	2612	3897	3307	3361	3396	6602	11925	10572	12946	27524
Total Equity	9172	8244	9505	11694	10920	10751	13237	13557	14033	35175
D/E Ratio	0.28	0.47	0.35	0.29	0.31	0.61	0.90	0.78	0.92	0.78

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	2.3%	2.8%	9.8%	12.8%	7.6%	8.6%	7.8%	2.8%	7.5%	4.0%
Return on Equity	5.0%	7.2%	26.9%	32.0%	18.7%	23.3%	23.8%	9.1%	25.3%	11.6%
ROIC	3.9%	5.2%	19.1%	24.0%	14.0%	15.4%	11.5%	3.9%	10.8%	5.4%
Shares Out.	---	---	714.0	666.0	594.0	548.0	531.0	528.0	486.0	704.0
Revenue/Share	63.74	87.27	110.14	120.24	157.98	170.41	132.94	119.51	145.96	183.47
FCF/Share	-0.61	1.40	2.97	4.57	3.47	2.84	3.83	2.12	7.58	4.90

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