MARATHON OIL CORP
Form 10-Q
August 07, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended June 30, 2007

OR

o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 1-5153

Marathon Oil Corporation

(Exact name of registrant as specified in its charter)

Delaware	**25-0996816**
(State of Incorporation)	(I.R.S. Employer Identification No.)

5555 San Felipe Road, Houston, TX 77056-2723
(Address of principal executive offices)

(713) 629-6600
(Registrant s telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x **Accelerated filer o** **Non-accelerated filer o**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x

There were 681,102,025 shares of Marathon Oil Corporation common stock outstanding as of July 31, 2007.

MARATHON OIL CORPORATION

Form 10-Q

Quarter Ended June 30, 2007

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Unless the context otherwise indicates, references in this Form 10-Q to Marathon, we, our, or us are references to Marathon Oil Corporation, including its wholly-owned and majority-owned subsidiaries, and its ownership interests in equity method investees (corporate entities, partnerships, limited liability companies and other ventures over which Marathon exerts significant influence by virtue of its ownership interest).

Part I - Financial Information

Item 1. Financial Statements

MARATHON OIL CORPORATION

Consolidated Statements of Income (Unaudited)

(Dollars in millions, except per share data)	Second Quarter Ended June 30, 2007	2006	Six Months Ended June 30, 2007	2006
Revenues and other income:				
Sales and other operating revenues (including consumer excise taxes)	$ 16,260	$ 15,962	$ 28,751	$ 28,862
Revenues from matching buy/sell transactions	65	1,806	123	5,012
Sales to related parties	411	411	731	723
Income from equity method investments	117	97	224	189
Net gains on disposal of assets	7	5	18	16
Other income	27	9	42	27
Total revenues and other income	16,887	18,290	29,889	34,829
Costs and expenses:				
Cost of revenues (excludes items below)	11,755	11,628	21,297	21,387
Purchases related to matching buy/sell transactions	84	1,750	145	4,983
Purchases from related parties	54	47	101	98
Consumer excise taxes	1,307	1,277	2,504	2,442
Depreciation, depletion and amortization	396	369	789	769
Selling, general and administrative expenses	327	308	614	595
Other taxes	93	91	191	188
Exploration expenses	115	66	176	137
Total costs and expenses	14,131	15,536	25,817	30,599
Income from operations	2,756	2,754	4,072	4,230
Net interest and other financing costs (income)	(20)	(9)	(39)	14
Loss on early extinguishment of debt	1		3	
Minority interests in loss of Equatorial Guinea LNG Holdings Limited	(1)	(2)	(3)	(5)
Income from continuing operations before income taxes	2,776	2,765	4,111	4,221
Provision for income taxes	1,234	1,281	1,852	1,966
Income from continuing operations	1,542	1,484	2,259	2,255
Discontinued operations	8	264	8	277
Net income	$ 1,550	$ 1,748	$ 2,267	$ 2,532
Per Share Data				
Basic:				
Income from continuing operations	$ 2.26	$ 2.05	$ 3.29	$ 3.11
Discontinued operations	$ 0.01	$ 0.37	$ 0.01	$ 0.38
Net income	$ 2.27	$ 2.42	$ 3.30	$ 3.49
Diluted:				

Income from continuing operations	$	2.24	$	2.04	$	3.27	$	3.08
Discontinued operations	$	0.01	$	0.36	$	0.01	$	0.38
Net income	$	2.25	$	2.40	$	3.28	$	3.46
Dividends paid	$	0.24	$	0.20	$	0.44	$	0.36

The accompanying notes are an integral part of these consolidated financial statements.

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MARATHON OIL CORPORATION

Consolidated Balance Sheets (Unaudited)

(Dollars in millions, except per share data)	**June 30, 2007**	**December 31, 2006**
Assets		
Current assets:		
Cash and cash equivalents	$ 2,331	$ 2,585
Receivables, less allowance for doubtful accounts of $3 and $3	4,744	4,114
Receivables from United States Steel	31	32
Receivables from related parties	92	63
Inventories	4,310	3,173
Other current assets	191	129
Total current assets	11,699	10,096
Equity method investments	2,583	1,539
Receivables from United States Steel	488	498
Property, plant and equipment, less accumulated depreciation, depletion and amortization of $14,213 and $13,573	16,037	16,653
Goodwill	1,393	1,398
Intangible assets, less accumulated amortization of $83 and $75	176	180
Other noncurrent assets	1,229	467
Total assets	$ 33,605	$ 30,831
Liabilities		
Current liabilities:		
Accounts payable	$ 6,684	$ 5,586
Payable to United States Steel		13
Payables to related parties	38	264
Payroll and benefits payable	287	409
Accrued taxes	649	598
Deferred income taxes	641	631
Accrued interest	93	89
Long-term debt due within one year	421	471
Total current liabilities	8,813	8,061
Long-term debt	4,237	3,061
Deferred income taxes	1,935	1,897
Defined benefit postretirement plan obligations	1,341	1,245
Asset retirement obligations	1,078	1,044
Payable to United States Steel	6	7
Deferred credits and other liabilities	380	391
Total liabilities	17,790	15,706
Minority interests in Equatorial Guinea LNG Holdings Limited		518
Commitments and contingencies		
Stockholders Equity		
Common stock issued 735,703,116 shares (par value $1 per share, 1,100,000,000 shares authorized)	736	736
Common stock held in treasury, at cost 54,427,392 and 40,161,340 shares	(2,364)	(1,638)
Additional paid-in capital	4,787	4,784
Retained earnings	13,058	11,093
Accumulated other comprehensive loss	(402)	(368)
Total stockholders' equity	15,815	14,607

Total liabilities and stockholders' equity	$	33,605	$	30,831

The accompanying notes are an integral part of these consolidated financial statements.

MARATHON OIL CORPORATION

Consolidated Statements of Cash Flows (Unaudited)

(Dollars in millions)	Six Months Ended June 30, 2007	2006
Increase (decrease) in cash and cash equivalents		
Operating activities:		
Net income	$ 2,267	$ 2,532
Adjustments to reconcile net income to net cash provided from operating activities:		
Loss on early extinguishment of debt	3	
Income from discontinued operations	(8)	(277)
Deferred income taxes	122	134
Minority interests in loss of Equatorial Guinea LNG Holdings Limited	(3)	(5)
Depreciation, depletion and amortization	789	769
Pension and other postretirement benefits, net	20	(41)
Exploratory dry well costs and unproved property impairments	75	69
Net gains on disposal of assets	(18)	(16)
Equity method investments, net	(78)	(134)
Changes in the fair value of long-term U.K. natural gas contracts	(12)	(61)
Changes in:		
Current receivables	(639)	(833)
Inventories	(1,150)	(777)
Current accounts payable and accrued expenses	1,037	916
All other, net	(39)	(46)
Net cash provided from continuing operations	2,366	2,230
Net cash provided from discontinued operations		69
Net cash provided from operating activities	2,366	2,299
Investing activities:		
Capital expenditures	(1,699)	(1,308)
Acquisitions		(543)
Disposal of assets	48	49
Disposal of discontinued operations		832
Investments - loans and advances	(64)	(2)
Investments - repayments of loans and return of capital	34	146
Deconsolidation of Equatorial Guinea LNG Holdings Limited	(37)	
Investing activities of discontinued operations		(45)
All other, net	(10)	14
Net cash used in investing activities	(1,728)	(857)
Financing activities:		
Borrowings	578	
Debt issuance costs	(8)	
Debt repayments	(469)	(303)
Issuance of common stock	18	19
Purchases of common stock	(776)	(554)
Excess tax benefits from stock-based compensation arrangements	24	14
Dividends paid	(302)	(265)
Contributions from minority shareholders of Equatorial Guinea LNG Holdings Limited	39	41
Net cash used in financing activities	(896)	(1,048)
Effect of exchange rate changes on cash	4	15
Net increase (decrease) in cash and cash equivalents	(254)	409

Cash and cash equivalents at beginning of period	2,585	2,617
Cash and cash equivalents at end of period	$ 2,331	$ 3,026

The accompanying notes are an integral part of these consolidated financial statements.

MARATHON OIL CORPORATION

Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

These consolidated financial statements are unaudited but, in the opinion of management, reflect all adjustments necessary for a fair presentation of the results for the periods reported. All such adjustments are of a normal recurring nature unless disclosed otherwise. These consolidated financial statements, including selected notes, have been prepared in accordance with the applicable rules of the Securities and Exchange Commission and do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. Certain reclassifications of prior year data have been made to conform to 2007 classifications. These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Marathon Oil Corporation (Marathon or the Company) 2006 Annual Report on Form 10-K.

2. New Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. AUG AIR-1, Accounting for Planned Major Maintenance Activities. This FSP prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods. Marathon adopted FSP No. AUG AIR-1 effective January 1, 2007. Prior to adoption, Marathon expensed such costs in the same annual period as incurred; however, estimated annual major maintenance costs were recognized as expense throughout the year on a pro rata basis. As such, the adoption of this FSP has no impact on Marathon s annual consolidated financial statements. The FSP has not been applied retrospectively because the impact on the Company s prior interim consolidated financial statements was not significant.

In July 2006, the FASB issued FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109. FIN No. 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The new standard also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, transition and disclosure. Marathon adopted FIN No. 48 effective January 1, 2007, and adoption did not have a significant effect on its consolidated results of operations, financial position or cash flows. See Note 9 for other disclosures required by FIN No. 48.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets An Amendment of FASB Statement No. 140. This statement amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. Marathon adopted SFAS No. 156 effective January 1, 2007, and adoption did not have a significant effect on its consolidated results of operations, financial position or cash flows.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments An Amendment of FASB Statements No. 133 and 140. SFAS No. 155 simplifies the accounting for certain hybrid financial instruments, eliminates the interim FASB guidance which provided that beneficial interests in securitized financial assets are not subject to the provisions of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and eliminates the restriction on the passive derivative instruments that a qualifying special-purpose entity may hold. Effective January 1, 2007, Marathon adopted the provisions of SFAS No. 155 prospectively for all financial instruments acquired or issued on or after January 1, 2007. Adoption of this statement did not have a significant effect on Marathon s consolidated results of operations, financial position or cash flows.

3. Deconsolidation of Equatorial Guinea LNG Holdings Limited

Equatorial Guinea LNG Holdings Limited (EGHoldings), in which Marathon holds a 60 percent interest, was formed for the purpose of constructing and operating a liquefied natural gas (LNG) production facility. During facility construction, EGHoldings was a variable interest entity (VIE) that was consolidated by Marathon because Marathon was its primary beneficiary. Once the LNG production facility commenced its primary operations and began to generate revenue in May 2007, EGHoldings was no longer a VIE. Effective May 1, 2007, Marathon no longer consolidates EGHoldings, despite the fact that the Company holds majority ownership, because the minority shareholders have rights limiting Marathon s ability to exercise control over the entity. Marathon s investment is accounted for prospectively using the equity method of accounting and is carried at the Company s share of net assets plus loans and advances, which totaled $961 million as of June 30, 2007, and is included in equity method investments in the consolidated balance sheet as of that date.

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4. Common Stock Split

On April 25, 2007, Marathon s stockholders approved an increase in the number of authorized shares of common stock from 550 million to 1.1 billion shares, and the Company s Board of Directors subsequently declared a two-for-one split of the Company s common stock. The stock split was effected in the form of a stock dividend distributed on June 18, 2007, to stockholders of record at the close of business on May 23, 2007. Stockholders received one additional share of Marathon Oil Corporation common stock for each share of common stock held as of the close of business on the record date. In addition, shares of common stock issued or issuable for stock-based awards under Marathon s incentive compensation plans were proportionately increased in accordance with the terms of the plans. Common share and per share (except par value) information for all periods presented has been restated in the consolidated financial statements and notes to reflect the stock split.

5. Discontinued Operations

On June 2, 2006, Marathon sold its Russian oil exploration and production businesses in the Khanty-Mansiysk region of western Siberia. A gain on the sale of $243 million ($342 million before income taxes) was reported in discontinued operations in the second quarter of 2006. During the second quarter of 2007, adjustments to the sales price were substantially completed and an additional gain on the sale of $8 million ($13 million before income taxes) was recognized.

The activities of the Russian businesses have been reported as discontinued operations in the consolidated statements of income and cash flows for 2006. Revenues applicable to discontinued operations were $74 million and $173 million for the second quarter and first six months of 2006. Pretax income from discontinued operations was $24 million and $45 million for the second quarter and first six months of 2006.

6. Income per Common Share

Basic income per share is based on the weighted average number of common shares outstanding. Diluted income per share assumes exercise of stock options, provided the effect is not antidilutive.

	Second Quarter Ended June 30,			
	2007		**2006**	
(In millions, except per share data)	**Basic**	**Diluted**	**Basic**	**Diluted**
Income from continuing operations	$ 1,542	$ 1,542	$ 1,484	$ 1,484
Discontinued operations	8	8	264	264
Net income	$ 1,550	$ 1,550	$ 1,748	$ 1,748
Weighted average common shares outstanding	683	683	722	722
Effect of dilutive securities		6		6
Weighted average common shares, including dilutive effect	683	689	722	728
Per share:				
Income from continuing operations	$ 2.26	$ 2.24	$ 2.05	$ 2.04
Discontinued operations	$ 0.01	$ 0.01	$ 0.37	$ 0.36
Net income	$ 2.27	$ 2.25	$ 2.42	$ 2.40

	Six Months Ended June 30,			
	2007		2006	
(In millions, except per share data)	**Basic**	**Diluted**	**Basic**	**Diluted**
Income from continuing operations	$ 2,259	$ 2,259	$ 2,255	$ 2,255
Discontinued operations	8	8	277	277
Net income	$ 2,267	$ 2,267	$ 2,532	$ 2,532
Weighted average common shares outstanding	686	686	726	726
Effect of dilutive securities		5		7
Weighted average common shares, including dilutive effect	686	691	726	733
Per share:				
Income from continuing operations	$ 3.29	$ 3.27	$ 3.11	$ 3.08
Discontinued operations	$ 0.01	$ 0.01	$ 0.38	$ 0.38
Net income	$ 3.30	$ 3.28	$ 3.49	$ 3.46

The per share calculations above exclude 3.0 million stock options for the second quarter and first six months of 2007 and 3.2 million stock options for the second quarter and first six months of 2006, as they were antidilutive.

7. Segment Information

Marathon s operations consist of three reportable operating segments:

1) Exploration and Production (E&P) explores for, produces and markets crude oil and natural gas on a worldwide basis;

2) Refining, Marketing and Transportation (RM&T) refines, markets and transports crude oil and petroleum products, primarily in the Midwest, the upper Great Plains and southeastern United States; and

3) Integrated Gas (IG) markets and transports products manufactured from natural gas, such as LNG and methanol, on a worldwide basis, and is developing other projects to link stranded natural gas resources with key demand areas.

As discussed in Note 5 above, the Russian businesses sold in June 2006 were accounted for as discontinued operations. Segment information for the second quarter and first six months of 2006 excludes the operating results for these Russian operations.

(In millions)	**E&P**	**RM&T**	**IG**	**Total**
Second Quarter Ended June 30, 2007				
Revenues:				
Customer	$ 2,018	$ 14,248	$ 68	$ 16,334
Intersegment (a)	116	83		199
Related parties	7	404		411
Segment revenues	2,141	14,735	68	16,944
Elimination of intersegment revenues	(116)	(83)		(199)
Loss on long-term U.K. natural gas contracts	(9)			(9)
Total revenues	$ 2,016	$ 14,652	$ 68	$ 16,736
Segment income	$ 400	$ 1,246	$ 12	$ 1,658

Income from equity method investments	64	31	22	117
Depreciation, depletion and amortization (b)	237	149	3	389
Minority interests in loss of subsidiary			(1)	(1)
Income tax provision (b)	480	721	4	1,205
Capital expenditures (c)	580	334	34	948

(In millions)	E&P	RM&T	IG	Total
Second Quarter Ended June 30, 2006				
Revenues:				
Customer	$ 2,325	$ 15,390	$ 70	$ 17,785
Intersegment (a)	187	2		189
Related parties	3	408		411
Segment revenues	2,515	15,800	70	18,385
Elimination of intersegment revenues	(187)	(2)		(189)
Loss on long-term U.K. natural gas contracts	(17)			(17)
Total revenues	$ 2,311	$ 15,798	$ 70	$ 18,179
Segment income	$ 659	$ 917	$ 17	$ 1,593
Income from equity method investments	53	32	12	97
Depreciation, depletion and amortization (b)	221	137	2	360
Minority interests in loss of subsidiary			(2)	(2)
Income tax provision (benefit) (b)	716	564	(1)	1,279
Capital expenditures (c)	463	200	70	733

(In millions)	E&P	RM&T	IG	Total
Six Months Ended June 30, 2007				
Revenues:				
Customer	$ 3,723	$ 25,015	$ 124	$ 28,862
Intersegment (a)	256	84		340
Related parties	11	720		731
Segment revenues	3,990	25,819		