MARATHON OIL CORP
Form 10-Q
May 08, 2009

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 March 31, 2009

OR

[ ] 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 or other jurisdiction of incorporation or organization)	(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, including area code)

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 √ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Ö Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

There were 707,774,176 shares of Marathon Oil Corporation common stock outstanding as of April 30, 2009.

MARATHON OIL CORPORATION

Form 10-Q

Quarter Ended March 31, 2009

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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)

(In millions, except per share data)	Three Months Ended March 31, 2009	2008
Revenues and other income:		
Sales and other operating revenues (including consumer excise taxes)	$ 10,234	$ 17,280
Sales to related parties	20	542
Income from equity method investments	47	209
Net gain on disposal of assets	4	10
Other income	52	59
Total revenues and other income	10,357	18,100
Costs and expenses:		
Cost of revenues (excludes items below)	7,402	14,452
Purchases from related parties	95	139
Consumer excise taxes	1,174	1,216
Depreciation, depletion and amortization	665	451
Selling, general and administrative expenses	291	300
Other taxes	103	123
Exploration expenses	62	129
Total costs and expenses	9,792	16,810
Income from operations	565	1,290
Net interest and other financing income (costs)	(13)	9
Income before income taxes	552	1,299
Provision for income taxes	270	568
Net income	$ 282	$ 731
Per Share Data:		
Net income per share - basic	$ 0.40	$ 1.03
Net income per share - diluted	$ 0.40	$ 1.02

Dividends paid	$	0.24	$	0.24

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

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MARATHON OIL CORPORATION
Consolidated Balance Sheets (Unaudited)

(In millions, except per share data)	March 31, 2009	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	$ 1,869	$ 1,285
Receivables, less allowance for doubtful accounts of $5 and $6	2,870	3,094
Receivables from United States Steel	23	23
Receivables from related parties	46	33
Inventories	3,496	3,507
Other current assets	279	461
Total current assets	8,583	8,403
Equity method investments	2,046	2,080
Receivables from United States Steel	466	469
Property, plant and equipment, less accumulated depreciation, depletion and amortization of $16,203 and $15,581	30,066	29,414
Goodwill	1,445	1,447
Other noncurrent assets	706	873
Total assets	$ 43,312	$ 42,686
Liabilities		
Current liabilities:		
Accounts payable	$ 4,490	$ 4,712
Payables to related parties	24	21
Payroll and benefits payable	357	400
Accrued taxes	570	1,133
Deferred income taxes	618	561
Other current liabilities	768	828
Long-term debt due within one year	101	98
Total current liabilities	6,928	7,753
Long-term debt	8,590	7,087
Deferred income taxes	3,120	3,330
Defined benefit postretirement plan obligations	1,644	1,609
Asset retirement obligations	977	963
Payable to United States Steel	4	4
Deferred credits and other liabilities	538	531
Total liabilities	21,801	21,277
Commitments and contingencies		
Stockholders' Equity		
Preferred stock – 5 million shares issued, 1 million and 3 million shares outstanding (no par value, 6 million shares authorized)	-	-

Common stock:				
Issued – 769 million and 767 million shares (par value $1 per share, 1.1 billion shares authorized)		769		767
Securities exchangeable into common stock – 5 million shares issued, 1 million and 3 million shares outstanding (no par value, unlimited shares authorized)		-		-
Held in treasury, at cost – 61 million and 61 million shares		(2,711)		(2,720)
Additional paid-in capital		6,705		6,696
Retained earnings		17,371		17,259
Accumulated other comprehensive loss		(623)		(593)
Total stockholders' equity		21,511		21,409
Total liabilities and stockholders' equity	$	43,312	$	42,686

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

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MARATHON OIL CORPORATION
Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended March 31,	
(In millions)	2009	2008
Increase (decrease) in cash and cash equivalents		
Operating activities:		
Net income	$ 282	$ 731
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	51	72
Depreciation, depletion and amortization	665	451
Pension and other postretirement benefits, net	38	16
Exploratory dry well costs and unproved property impairments	16	44
Net gain on disposal of assets	(4)	(10)
Equity method investments, net	11	(73)
Changes in the fair value of U.K. natural gas contracts	(82)	70
Changes in:		
Current receivables	233	(118)
Inventories	47	(615)
Current accounts payable and accrued liabilities	(777)	271
All other, net	75	(42)
Net cash provided by operating activities	555	797
Investing activities:		
Capital expenditures	(1,336)	(1,537)
Disposal of assets	20	3
Trusteed funds - withdrawals	13	109
Investments - loans and advances	(3)	(46)
Investments - repayments of loans and return of capital	26	8
All other, net	6	6
Net cash used in investing activities	(1,274)	(1,457)
Financing activities:		
Short-term debt, net	-	958
Borrowings	1,491	1,247
Debt issuance costs	(11)	(7)
Debt repayments	(3)	(1,245)
Purchases of common stock	-	(143)
Dividends paid	(170)	(170)
All other, net	-	6
Net cash provided by financing activities	1,307	646
Effect of exchange rate changes on cash	(4)	4
Net increase (decrease) in cash and cash equivalents	584	(10)
Cash and cash equivalents at beginning of period	1,285	1,199
Cash and cash equivalents at end of period	$ 1,869	$ 1,189

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

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Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

These consolidated financial statements are unaudited however, in the opinion of management; reflect all adjustments necessary for a fair statement of the results for the periods reported. All such adjustments are of a normal recurring nature unless disclosed otherwise. These consolidated financial statements, including 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 2009 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") 2008 Annual Report on Form 10-K. The results of operations for the quarter ended March 31, 2009 are not necessarily indicative of the results to be expected for the full year.

2. New Accounting Standards

EITF 08-6 – In November 2008, the Financial Accounting Standards Board ("FASB") ratified Emerging Issues Task Force ("EITF") Issue No. 08-6, "Equity Method Investment Accounting Considerations" ("EITF 08-6") which clarifies how to account for certain transactions involving equity method investments. The initial measurement, decreases in value and changes in the level of ownership of the equity method investment are addressed. EITF 08-6 is effective on a prospective basis on January 1, 2009 and for interim periods. Early application by an entity that has previously adopted an alternative accounting policy is not permitted. Since this standard will be applied prospectively, adoption did not have a significant impact on our consolidated results of operations, financial position or cash flows.

FSP EITF 03-6-1 – In June 2008, the FASB issued FASB Staff Position ("FSP") on EITF Issue No. 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" ("FSP EITF 03-6-1") which provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and, therefore, need to be included in the earnings allocation in computing earnings per share ("EPS") under the two-class method. FSP EITF 03-6-1 is effective January 1, 2009 and all prior-period EPS data (including any amounts related to interim periods, summaries of earnings and selected financial data) will be adjusted retrospectively to conform to its provisions. While our restricted stock awards meet this definition of participating securities, the application of FSP EITF 03-6-1 did not have a significant impact on our reported EPS.

FSP FAS 142-3 – In April 2008, the FASB issued FSP on Financial Accounting Standard ("FAS") 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP FAS 142-3"), which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset. FSP FAS 142-3 is effective on January 1, 2009. Early adoption is prohibited. The provisions of FSP FAS 142-3 are to be applied prospectively to intangible assets acquired after the effective date, except for the disclosure requirements which must be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. Since this standard is applied prospectively, adoption did not have a significant impact on our consolidated results of operations, financial position or cash flows.

SFAS No. 161 – In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133." This statement expands the disclosure requirements for derivative instruments to provide information regarding (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. To meet these objectives, the statement requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts and gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. This standard is effective January 1, 2009. The statement encourages but does not require disclosures for earlier periods presented for comparative purposes at initial adoption. The disclosures required by SFAS No. 161 appear in Note 12.

SFAS No. 141(R) – In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" ("SFAS No. 141(R)"). This statement significantly changes the accounting for business combinations. Under SFAS No. 141(R), an acquiring entity will be required to recognize all the assets acquired, liabilities assumed and any noncontrolling interest in the acquiree at their acquisition-date fair value with limited exceptions. The statement expands the definition of a business and is expected to be applicable to more transactions than the previous standard on business combinations. The statement also changes the accounting treatment for changes in control, step acquisitions,

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Notes to Consolidated Financial Statements (Unaudited)

transaction costs, acquired contingent liabilities, in-process research and development, restructuring costs, changes in deferred tax asset valuation allowances as a result of a business combination and changes in income tax uncertainties after the acquisition date. Accounting for changes in valuation allowances for acquired deferred tax assets and the resolution of uncertain tax positions for prior business combinations will impact tax expense instead of impacting recorded goodwill. Additional disclosures are also required. In April 2009, the FASB issued an FSP on FAS 141(R), "Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies" ("FSP FAS 141(R)-1"), which addressed SFAS No. 141(R) implementation issues related to contingent assets and liabilities acquired in a business combination. Both SFAS No. 141(R) and FSP FAS 141(R)-1 are effective on January 1, 2009 for all new business combinations. Because we had no business combinations in progress at January 1, 2009, adoption of these standards did not have a significant impact on our consolidated results of operations, financial position or cash flows.

SFAS No. 160 – In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51." This statement establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement clarifies that a noncontrolling interest in a subsidiary (sometimes called a minority interest) is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements, but separate from the parent's equity. It requires that the amount of consolidated net income attributable to the noncontrolling interest be clearly identified and presented on the face of the consolidated income statement. SFAS No. 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated, based on the fair value of the noncontrolling equity investment on the deconsolidation date. Additional disclosures are required that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. In January 2009, the FASB ratified EITF Issue No. 08-10, "Selected Statement 160 Implementation Questions" ("EITF 08-10"). Both SFAS No. 160 and EITF 08-10 are effective January 1, 2009. The statements must be applied prospectively, except for the presentation and disclosure requirements which must be applied retrospectively for all periods presented in consolidated financial statements. We do not have significant noncontrolling interests in consolidated subsidiaries and therefore adoption of these standards did not have a significant impact on our consolidated results of operations, financial position or cash flows.

SFAS No. 157 – In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements but may require some entities to change their measurement practices. We adopted SFAS No. 157 effective January 1, 2008 with respect to financial assets and liabilities and effective January 1, 2009 with respect to nonfinancial assets and liabilities. Adoption did not have a significant effect on our consolidated results of operations, financial position or cash flows.

In February 2008, the FASB issued FSP FAS 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13," which removes certain leasing transactions from the scope of SFAS No. 157, and FSP FAS 157-2, "Effective Date of FASB Statement No. 157," which deferred the effective date of SFAS No. 157 for one year for certain nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis.

In October 2008, the FASB issued FSP FAS 157-3, “Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active,” which clarifies the application of SFAS No. 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP FAS 157-3 was effective upon issuance, including prior periods for which financial statements had not been issued, and any revisions resulting from a change in the valuation technique or its application were required to be accounted for as a change in accounting estimate. Application of FSP FAS 157-3 did not cause us to change our valuation techniques for assets and liabilities measured under SFAS No. 157.

The additional disclosures regarding assets and liabilities recorded at fair value and measured under SFAS No. 157 are presented in Note 11.

FSP FASB 132(R)-1 – Also in December 2008, the FASB issued an FSP on SFAS No. 132(R)-1, “Employers Disclosures about Postretirement Benefit Plan Assets” (“FSP FASB 132(R)-1”) which provides guidance on an employer’s disclosures about plan assets of defined benefit pension or other postretirement plans. This FSP requires additional disclosures about investment policies and strategies, the reporting of fair value by asset category and other information about fair value measurements. The FSP is effective January 1, 2009 and early application is permitted. Upon initial application, the provisions of FSP FAS 132(R)-1 are not required for earlier periods that are presented for comparative purposes. We will expand our disclosures in accordance with FSP FAS 132(R)-1 in our Annual Report on Form 10-K for

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Notes to Consolidated Financial Statements (Unaudited)

the year ending December 31, 2009; however, the adoption of this standard is not expected to have a significant impact on our consolidated results of operations, financial position or cash flows.

3. Income per Common Share

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

	Three Months Ended March 31,			
	2009		2008	
(In millions, except per share data)	Basic	Diluted	Basic	Diluted
Net income	$ 282	$ 282	$ 731	$ 731
Weighted average common shares outstanding	709	709	713	713
Effect of dilutive securities	-	3	-	4
Weighted average common shares, including dilutive effect	709	712	713	717
Per share:				
Net income	$ 0.40	$ 0.40	$ 1.03	$ 1.02

The per share calculations above exclude 9 million and 4 million stock options for the first three months of 2009 and 2008, as they were antidilutive.

4. Assets Held for Sale

As of March 31, 2009, assets held for sale primarily represented our operated properties in Ireland (Exploration and Production segment) as shown in the following table:

(In millions)	
Current assets	$ 110
Noncurrent assets	116
Total assets	226
Current liabilities	4
Noncurrent liabilities	203
Total liabilities	207
Net assets held for sale	$ 19

On April 17, 2009, we closed the sale of our operated properties in Ireland for proceeds of $186 million, before adjusting for cash on hand at closing estimated to be $84 million. An after-tax gain on the sale of these properties of approximately $100 million will be recorded in the second quarter of 2009. In addition, we terminated our pension plan in Ireland for which a separate pretax loss of $21 million will be recognized in the second quarter of 2009.

In April 2009, we entered into two agreements to sell a portion of our Permian Basin producing assets in New Mexico and west Texas (Exploration and Production segment). The total value of these transactions is $301 million, excluding any purchase price adjustments due at closing. The carrying value of these operating assets was $83 million at March 31, 2009 and will be classified as held for sale beginning April 1, 2009. These transactions are expected to close in the second quarter of 2009.

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Notes to Consolidated Financial Statements (Unaudited)

5. Segment Information

We have four reportable operating segments. Each of these segments is organized and managed based upon the nature of the products and services they offer.

1) Exploration and Production ("E&P") – explores for, produces and markets liquid hydrocarbons and natural gas on a worldwide basis;

2) Oil Sands Mining ("OSM") – mines, extracts and transports bitumen from oil sands deposits in Alberta, Canada, and upgrades the bitumen to produce and market synthetic crude oil and by-products;

3) Refining, Marketing and Transportation ("RM&T") – refines, markets and transports crude oil and petroleum products, primarily in the Midwest, upper Great Plains, Gulf Coast and southeastern regions of the U.S.; and

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

	Three Months Ended March 31, 2009				
(In millions)	E&P	OSM	RM&T	IG	Total
Revenues:					
Customer	$ 1,384	$ 97	$ 8,660	$ 11	$ 10,152
Intersegment (a)	119	25	9	-	153
Related parties (b)	15	-	5	-	20
Segment revenues	1,518	122	8,674	11	10,325
Elimination of intersegment revenues	(119)	(25)	(9)	-	(153)
Gain on U.K. natural gas contracts	82	-	-	-	82
Total revenues	$ 1,481	$ 97	$ 8,665	$ 11	$ 10,254
Segment income (loss)	$ 100	$ (24)	$ 159	$ 27	$ 262
Income (loss) from equity method investments(b)	11	-	(6)	42	47
Depreciation, depletion and amortization (c)	470	37	152	1	660
Income tax provision (benefit)(c)	189	(8)	106	13	300
Capital expenditures (d)	389	286	660	-	1,335

	Three Months Ended March 31, 2008				
(In millions)	E&P	OSM	RM&T	IG	Total
Revenues:					
Customer	$ 2,819	$ 179	$ 14,333	$ 19	$ 17,350
Intersegment (a)	159	20	165	-	344
Related parties (b)	14	-	528	-	542
Segment revenues	2,992	199	15,026	19	18,236

Elimination of intersegment revenues		(159)		(20)		(165)		-		(344)
Loss on U.K. natural gas contracts		(70)		-		-		-		(70)
Total revenues	$	2,763	$	179	$	14,861	$	19	$	17,822
Segment income (loss)	$	684	$	27	$	(75)	$	99	$	735
Income from equity method investments(b)		62		-		28		119		209
Depreciation, depletion and amortization (c)		259		34		148		1		442
Income tax provision (benefit)(c)		687		9		(45)		48		699
Capital expenditures (d)		775		248		511		1		1,535

(a) Management believes intersegment transactions were conducted under terms comparable to those with unrelated parties.

(b) Pilot Travel Centers LLC, which was reported in our RM&T segment, was sold in the fourth quarter of 2008.

(c) Differences between segment totals and our totals represent amounts related to corporate administrative activities and other unallocated items and are included in "Items not allocated to segments, net of income taxes" in reconciliation below.

(d) Differences between segment totals and our totals represent amounts related to corporate administrative activities.

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Notes to Consolidated Financial Statements (Unaudited)

The following reconciles segment income to net income as reported in the consolidated statements of income:

	Three Months Ended March 31,	
(In millions)	2009	2008
Segment income	$ 262	$ 735
Items not allocated to segments, net of income taxes:		
Corporate and other unallocated items	(22)	32
Gain (loss) on U.K. natural gas contracts	42	(36)
Net income	$ 282	$ 731

The following reconciles total revenues to sales and other operating revenues (including consumer excise taxes) as reported in the consolidated statements of income:

	Three Months Ended March 31,	
(In millions)	2009	2008
Total revenues	$ 10,254	$ 17,822
Less: Sales to related parties	20	542
Sales and other operating revenues (including consumer excise taxes)	$ 10,234	$ 17,280

6. Defined Benefit Postretirement Plans

The following summarizes the components of net periodic benefit cost:

	Three Months Ended March 31,			
	Pension Benefits		Other Benefits	
(In millions)	2009	2008	2009	2008
Service cost	$ 35	$ 34	$ 5	$ 5
Interest cost	42	39	11	12
Expected return on plan assets	(40)	(42)	-	-
Amortization:				
– prior service cost (credit)	3	3	(1)	(2)
– actuarial loss	6	4	-	1
Net periodic benefit cost	$ 46	$ 38	$ 15	$ 16

During the first three months of 2009, we made contributions of $9 million to our funded international pension plans. We expect to make additional contributions up to an estimated $356 million to our funded pension plans over the remainder of 2009, the majority of which will occur in the third quarter of 2009. We are still evaluating guidance issued by the Internal Revenue Service on March 31, 2009, which may defer required cash contributions to later periods. Current benefit payments related to unfunded pension and other postretirement benefit plans were $7 million and $8 million during the first three months of 2009.

7. Income Taxes

The following is an analysis of the effective income tax rates for the periods presented:

	Three Months Ended March 31,	
	2009	2008
Statutory U.S. income tax rate	35%	