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MPC - Q3 2014 Marathon Petroleum Corp Earnings Call

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OVERVIEW:

MPC reported 3Q14 net income of $672m and diluted EPS of $2.36.

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PRESENTATION

Operator

Welcome to the Marathon Petroleum third-quarter 2014 earnings call. My name is Vivian and I'll be our operator for today's call.

(Operator Instructions)

Please note that this conference is being recorded.

I will now turn the call over to Mr. Tim Griffith. Mr. Griffith, you may begin.

Tim Griffith - *Marathon Petroleum Corporation - VP, Finance and IR & Treasurer*

Okay, thank you, Vivian. Welcome this morning to Marathon Petroleum's third-quarter 2014 earnings webcast and conference call. The synchronized slides that accompany this call can be found on our website at www.marathonpetroleum.com under the investor center tab.

On the call today are Gary Heminger, President and CEO; Don Templin, Senior Vice President and CFO; Mike Palmer, Senior Vice President of Supply, Distribution and Planning; Pam Beall, Senior Vice President of Corporate Planning and Government and Public Affairs; and Tony Kenney, President of Speedway.

We invite you to read the Safe Harbor Statements on slide 2, it's a reminder that we will be making forward-looking statements during the presentation and during the question-and-answer session. Actual results may differ materially from what we expect today. Factors that could cause actual results to differ are included here as well as in our filings with the SEC. Now I'll turn the call over to Gary Heminger for opening remarks and highlights.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Thanks, Tim, and good morning and thank you for joining our call. We are pleased to report strong results for the quarter with $672 million of net income in the third quarter. The efficiency, flexibility and optionality in our integrated downstream system enabled us to continue capturing opportunities in the markets we serve. Our ability to supply refined products to the markets of greatest value continues to serve consumers and our shareholders well.

Speedway, our Company owned and operated retail system achieved record results for the quarter. This was particularly impressive because they achieved these results while working to close the Hess retail acquisition which occurred on September 30. This expansion makes Speedway the largest Company owned convenient store chain in the United States by revenue. Speedway's consistent ability to generate strong merchandise margins in the store will provide great synergies with a strong volume that Hess locations have historically experienced.

We are confident we can leverage these potential synergies further as we introduce Speedway's focused merchandising approach to these 1,245 locations. We're also pleased to welcome our new employees to the Speedway family and are eager to expand the relationships with the new customers along the Eastern Seaboard who will come to know us under our Speedway brand.

Return of capital continues to be an important element of our strategy. And our activity in the third quarter underscores this enduring commitment. We returned a total of $442 million to our shareholders during the third quarter with $301 million coming in the form of share repurchases. Don will take -- will talk a little further about our capital return activity over the last 12 months. But we continue to have one of the highest effective capital return yields in our competitor group.

We are also announcing plans this morning to significantly accelerate the growth of MPLX. Initially coming in the form of larger drops into MPLX, our intent is to grow the partnership substantially and accelerate the annual distribution growth rate to average in the mid 20% range over the next five years. As we evolve MPLX into a large cap diversified MLP, we will be focused on building size and scale in the partnership more rapidly in the near term.

As a part of this acceleration, the MPC Board has authorized a sale of the remaining 31% interest in Pipe Line Holdings to MPLX with the objective of growing MPLX's December 2015 annualized EBITDA to at least $450 million. We can turn to the graphic on slide 4, where you can see this is about three times the annualized EBITDA of MPLX for the third quarter of 2014. The roughly $80 million of EBITDA represented by the remainder of our Pipe Line Holdings is an important piece of that growth plan and we would expect those earnings to become part of the MPLX earning stream in the near term.

I wanted to provide some color on what has changed in our perspective and why we believe now is the right time to execute this acceleration strategy. Slide 5 provides a few of the elements which have impacted our thinking and shift in strategy. The substantial growth in domestic oil and gas production and the tremendous midstream build out in the US creates numerous opportunities where size and scale become strategically important to the midstream growth vehicles like MPLX. And it is fully our intent to participate in that development.

The acquisition of the Hess retail system has also expanded our opportunity set by providing an additional source of MLP qualifying income through the fuels distribution piece of the business. Adding the roughly 3 billion gallons which have historically been part of Hess' business to the volumes from MPC's total system results in wholesale volumes totaling approximately 20 billion gallons. Attaching the reasonable margin to these volumes results in approximately $600 million in MLP qualifying earnings, which is in addition to the $1.1 billion we have discussed previously, bringing the total potential pool of eligible earnings to $1.7 billion.

Finally, we remain convinced the market has failed to recognize the total value of our enterprise, including the substantial contribution of MPLX to the business. Accelerating the growth of this highly valued portion of our business, as we are doing with Speedway, will highlight the tremendous value of our business that we believe is being missed in our current valuation.

With the amount of discussions surrounding the potential crude oil exports in the US, I also want to provide some of our perspectives on these issues. Before we consider crude exports, it's important to acknowledge that we faced market distorting regulations and conditions both here and abroad that make it difficult and sometimes impossible for the free market to function.

We also must keep in mind that the issue of crude exports is often based on the misperception that there is a glut of light sweet crude oil in the US. We are in the market buying $5 billion worth of crude oil every month and we do not see a glut of light sweet crude. In fact, there have been times during the year when producers could not deliver the volumes they committed to sell us. MPC and the US refining industry as a whole is keeping pace with the supply.

The studies that encourage looking to crude oil ban tend to make the same flawed assumption that US refiners cannot and will not be able to process the increasing supply of light crude being produced in this country. And we disagree with these assumptions. We and others in the industry are making significant investments today that will allow us to process more light sweet crude in the medium and long-term. In fact, all of the project announced by refiners and midstream companies to process light oil add up to more capacity than MPC's forecast of incremental shale crude growth.

We should also keep in mind that our country still imports up to 8 million barrels of crude oil per day. For decades, energy policy has been focused on energy security for our country. That vision can be a reality, but it can only be achieved with a vibrant refining industry to process the light crude oil we produce in this country into usable products. For that to happen, refiners need certainty.

MPC remains an ardent supporter of free markets, and the unrestricted movement of commodities, goods and services to the market of greatest efficiency and value. We continue to support policy actions that move the US economy in that direction. But we believe strongly that the underlying assumptions dictating any policy change must be based on facts rather than the misperceptions about our industry.

To wrap up my opening comments, I'd like to highlight that MPC shareholders now own the largest refining, logistics and retail systems east of the Mississippi. Our successful retail segment has almost doubled in size and our midstream business, increasingly represented by MPLX, is well positioned to grow along with the considerable developments in North America energy production.

Our world-class refining system is characterized by top-tier assets located in attractive geographic markets. The investments we are making in the business continue to build stable cash flow, highly valued businesses and we are fundamentally committed to long-term value creation for our shareholders. And with that, let me turn it over to Don to review our financial performance for the quarter. Don?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Thanks, Gary. Slide 6 provides earnings both on an absolute and per share basis. Our third-quarter 2014 earnings were $672 million compared to $168 million in the third quarter of 2013. Third-quarter 2014 earnings included pretax pension settlement expenses of $21 million, while the third quarter of 2013 include $23 million of comparable expenses. Earnings per diluted share were $2.36 per share for the third quarter of 2014. We reported $0.54 per share for the same period last year.

The bridge on slide 7 shows the change in earnings by segment from the third quarter of 2013 to the third quarter of 2014. The primary driver for the change was the increase the refining and marketing segment income which I will discuss shortly. Items not allocated to segments includes $11 million related to acquisition cost for the Hess retail operations.

As shown on slide 8, refining and marketing segment income from operations was $971 million in the third quarter of 2014 compared with $227 million in the same quarter last year. The change from 2013 was primarily due to higher product price realizations and improved crack spreads, partially offset by higher direct operating costs.

As indicated in the earnings walk, the higher LLS 6-3-2-1 blended crack spread had a positive impact on earnings of approximately $379 million. The blended crack spread was $8.70 per barrel in the third quarter of 2014, compared to $6.52 per barrel in 2013. The increase in LLS prompt versus delivered also had a favorable impact on earnings that was largely offset by backwardation in the market.

Direct operating costs increased quarter over quarter due to higher turnaround and maintenance costs as well as higher natural gas prices versus last year. The impact of higher product price realizations as reflected in the $548 million change in other gross margin. You may recall that the third quarter of 2013 product price realizations compared to spot market values were negatively impacted by the affects of renewable identification number, or RINS.

RIN prices averaged approximately $0.085 on a per E10 gallon basis for the third quarter of 2013 compared to $0.05 per gallon in the third quarter of 2014. In addition, consistent with last quarter we continue to see strong product price realizations in the third quarter of 2014.

Slide 9 provides a sequential earnings walk for our refining and marketing segment. The primary drivers for the decrease in income over the second quarter were lower crack spreads and higher refinery operating expenses. The LLS 6-3-2-1 blended crack spread decreased $1.70 per barrel from second quarter which reduced earnings by approximately $229 million. Refinery direct operating costs increased $62 million, primarily due to higher turnaround costs in the third quarter compared to the second quarter. Product price realizations are included in the other gross margin amount.

Turning to Speedway segment results on slide 10. Income from operations was $119 million in the third quarter of 2014 compared with $102 million in the third quarter of 2013. Excluding a $6 million impact from the Hess acquisition, Speedway segment income was $125 million, which as Gary referenced, represents of record quarter for the business. Speedway's light product gross margin was $22 million higher in the third quarter of 2014, compared with the same quarter last year as gross margin increased by $0.019 per gallon.

Merchandise margin was $235 million in the third quarter of 2014, compared with $224 million last year. This $11 million increase was due to higher merchandise sales and merchandise margin percentage. The unfavorable $16 million other variance primarily relates to Speedway operating expenses, which were higher in the third quarter of 2014, largely driven by an increase in the number of stores versus previous year levels.

On a same-store basis, gasoline sales volumes decreased 0.8% and merchandise sales excluding cigarettes increased 4.8% in the third quarter of 2014, compared to the third quarter of 2013. Activity in October has been positive with a 1.2% increase in same-store gasoline sales volumes versus the similar period last year.

Slide 11 shows changes in our Pipeline Transportation segment income. Income from operations was $69 million in the third quarter of 2014 compared with $54 million in the third quarter of 2013. The increase of $15 million was primarily attributable to higher transportation revenue and pipeline affiliate income, partially offset by higher operating expenses attributable mainly to the timing of pipeline maintenance and expenses related to MPLX's proposed Cornerstone pipeline project. $11 million of $15 million increase in transportation revenue was attributable to the recognition of deferred transportation credits during the quarter. The remainder was primarily due to higher average tariff rates.

Slide 12 presents the significant drivers of changes in our cash flow for the third quarter of 2014. At June 30, 2014, our cash balance was just over $2.1 billion and we ended the third quarter with just under $1.9 billion of cash. Operating cash flow before changes in working capital was an approximately $1 billion source of cash due to the strong financial performance in the third quarter. We borrowed approximately $2.7 billion in debt during the quarter to finance the $2.8 billion acquisition of Hess' retail operations. This is shown separately from the $736 million of capital spending in the quarter.

As Gary highlighted, we continued delivering on our commitment to balanced investments in the business with return of capital to our shareholders. We repurchased $301 million worth of shares and paid $141 million of dividends in the third quarter, continuing the regular returns of capital Gary alluded to in his remarks.

Slide 13 shows that at the end of the third quarter, we had $1.9 billion of cash and $6.3 billion of debt. With EBITDA of about $5.1 billion during the last 12 months, we continue to be in a very manageable debt position with leverage of 1.2 times EBITDA and a debt to total capital ratio of 36%.

Turning to slide 14, during the last 12 months we generated $4.1 billion in cash from operations and nearly $2.1 billion of free cash flow excluding the Hess retail acquisition. Over this period we've returned $2.4 billion to shareholders through dividends and share repurchases, or approximately 1.2 times our adjusted free cash flow.

During the third quarter of 2014 we purchased approximately 4 million shares for $301 million through open market repurchases. It is our intention to continue returning capital to our shareholders that is not currently needed to support the operational and investment needs of the business, and we continue to believe share repurchases are the most efficient way to do so.

Slide 15 provides our outlook for key operating metrics for MPC for the fourth quarter of 2014. We are planning for fourth-quarter throughput volumes to be slightly less than the third quarter of 2014 but up compared to fourth quarter last year due to less planned maintenance.

Before I conclude my comments, I wanted to highlight one of the points Gary referred to earlier around the tremendous value contribution of MPLX to MPC. Slide 16 provides an illustration of the potential cash distributions for MPC's limited partner units and general partner interest over the next five years assuming a 25% average growth rate of LP distributions.

The chart on the right illustrates potential 2019 valuations using a range of recent market multiples for LPs and GPs. As I hope is clear from this illustration, the embedded value to MPC is considerable. Now I will turn the call back to Tim Griffith.

Tim Griffith - *Marathon Petroleum Corporation - VP, Finance and IR & Treasurer*

Thanks, Don. As we open up the call for questions, we ask that you limit yourself to one question plus a follow up. You may reprompt for additional question as time permits. With that, Vivian, we're prepared to open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And our first question comes from Ed Westlake from Credit Suisse.

Ed Westlake - *Credit Suisse - Analyst*

Congratulation on the strong earnings and thanks for the slides on MPLX visibility. A quick question, I'm sure I could do the math, but what type of drop downs are you assuming say on an annual run rate say from here through to 2019 to drive this GP distribution, LP distribution growth?

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Don, you want to handle that?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Sure, Ed, we haven't given specific drop down guidance. What we are showing here is that over that time period we would expect to grow the LP distributions by an average compounded annual growth rate of 25%. And as we showed in the slide deck, that has an even more powerful impact on the GP distributions through our IDR ownerships or our IDR cash flows. But we've not given a specific guidance on individual drop downs or the timing of those.

Ed Westlake - *Credit Suisse - Analyst*

And then on slide 19 you've got the $1.7 billion of currently identified eligible MLP EBITDA sources which presumably is part of MPLX as well as MPC. Maybe clarify whether that's held by the parent as opposed to the current MPLX EBITDA stream. And then does that include any growth or is all of the growth that you obviously were investing for on top of that $1.7 billion? Thank you.

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Sure. The $1.7 billion, Ed, reflects the $800 million that we had originally pointed to at the time of the IPO of MPLX. So it would have included Pipe Line Holdings as well, but there have been some additions there.

Then there's been about $300 million of growth projects that we've identified and elaborated on over a period of time, and that would include the investments in Sandpiper, Southern Access Extension, the condensate splitters, that broadly adds another $300 million. And then that fuels distribution is really incremental to that and for this purposes we valued that at approximately $600 million, which is 20 billion gallons at a $0.03 average.

Ed Westlake - *Credit Suisse - Analyst*

So an MLP of the fuels distribution business potentially?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Those are MLP qualifying EBIT -- that's MLP qualifying EBITDA and it's our view that we want to continue to drive value for the MPC shareholders by making sure that we're maximizing that which can be dropped into an MLP.

Ed Westlake - *Credit Suisse - Analyst*

Very clear. Thanks very much.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

And Ed, let me add to that. Our strategy with MPLX and our whole midstream system is that just like a production company look that reserves, we want to keep a very strong reserve base of eligible assets that can be dropped into an MLP.

But secondly, we plan to continue to have very strong organic growth from projects inside the Company, very strong third-party growth as we continue to invest in the projects like Cornerstone that we've talked about. And then we've geared up and have been very active looking at projects in and around some of the production fields and other gathering type systems that could make sense to be bolt-ons to our system.

So we're not just going to be limited to -- this is not a drop down story, this is going to be an aggressive growth strategy as we see this, the MLP business continuing to consolidate.

Ed Westlake - *Credit Suisse - Analyst*

Thank you.

Operator

And our next question comes from Doug Terreson from ISI Group.

Doug Terreson - *ISI Group - Analyst*

Gary, this -- the retail transaction appears transformative for the business, or for that business rather as you indicate and I have a couple questions about that. First, how was the transaction financed, meaning last quarter I think we talked about available cash and debt?

And then second, with your EBITDA per store much higher than Hess and the other peers too, you guys seem justifiably enthusiastic about the outlook for the combination. So now that it's closed and the team has had the opportunity to take a closer look, I wanted to see if you could spend just a minute on some of the financial or strategic opportunities that appear most obvious to the team and the ones that you guys are most excited about it as you go through the integration process.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Sure, Doug, and let me ask Don to take the first part, Don or Tim, to handle the financing piece. And I invited Tony to be on the call today who runs all of Speedway and I'll have Tony take the strategic and the synergistic questions.

Doug Terreson - *ISI Group - Analyst*

Okay.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

So Don?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Sure. Doug, at the end of the third quarter we had about $6.3 billion of debt and the increases of debt during the quarter were primarily in two areas. We had a $700 million term loan and then we issued $1.95 billion of senior notes. So the transaction was largely funded with debt, but we also had available cash that we use.

Doug Terreson - *ISI Group - Analyst*

Okay.

Tony Kenney - *Marathon Petroleum Corporation - President of Speedway LLC*

And as far as the opportunity with the assets. What we see and you correctly pointed out, Doug, the difference in the EBITDA between the Speedway assets and the Hess assets. All of that is due to the difference in the performance inside the store. So from a like product perspective, Hess had always performed well on the volume and the margin outside. So the opportunity really is upgrading or enhancing the performance inside the store.

And what really comes into play there is some of the elements that we bring in terms of some of our merchandising and specifically the loyalty program that we've had in place for over 10 years on the Speedway side. So we think while leveraging some opportunities in food service, general merchandise in combination with partnerships with our key suppliers and consumer product companies, with our loyalty program is going to give us an opportunity to leverage the traditional Speedway performance into the Hess assets. So I think that's where the upside is and along with that we'll generate a number of synergies on those marketing enhancements.

Doug Terreson - *ISI Group - Analyst*

Great. Thanks a lot.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

And Doug, just to let you know, we've been managing these for all of 30 days now.

Doug Terreson - *ISI Group - Analyst*

That's all right.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Right. But the -- what Tony and his team have learned that is the administrative synergies that we have identified and some procurement type synergies, not getting into the marketing synergies that we expect due to the incremental merchandise sales. So just those that we identified, we're way ahead of what our first year plan was in being able to capture synergies. So we've already identified significantly more than we had expected to achieve in the first year. So very pleased with how the transition has gone and how we're really starting up the operation.

Doug Terreson - *ISI Group - Analyst*

Yes and Gary, we could just -- I could tell by your tone over the past several months, you've gotten more and more enthusiastic. So it seems like this thing is really pointed in a positive direction, so thanks a lot.

Operator

And our next question comes from Evan Calio from Morgan Stanley.

Evan Calio - *Morgan Stanley - Analyst*

Hey, Gary, great strategy shift this morning for midstream, it should begin to unlock some value for your shareholders. But I know it's in line with your highest growth peers now, can you discuss how you arrived at the new pace for distribution growth, the mid-twenties over that five-year period as you look at your potential? And then how does this stream of visible and less cyclical cash, less cyclical cash flow, affect your potential pace on the buyback?

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Sure. I'll take the first part and ask Don to talk about the potential buyback. But we've been studying this strategy for quite some time. And with the Hess acquisition, this had always been part of our strategy with this acquisition that those assets should be able to throw off eligible type earnings. So we got the transaction complete and over this same period of time we were doing this strategic study to determine what the best way forward.

And as I said in my speech that we believe now is the time. We believe the -- first of all, we've recognized a significant under performance, if you will, in pull through that the market has not recognized in our -- in the assets of the Company. And the question of how committed are we going to be to grow in this MLP. I think this shows clearly how committed we are to growing this MLP. We've always been committed, it's just when was the right time to be able to bring all this together.

So with the addition of the Hess wholesale fuels distribution, and I'm talking about on top of the other 17 billion gallons that we already had, this was the perfect timing we believe to be able to highlight this. And really to be able to communicate to the market how much value is underlying the value of MPC, but how fast we can grow MPLX. And how fast therefore the GP should grow and we should get that pull through back into the marketplace. And, Don, do you want to handle the use of cash?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Sure, Evan, I think that we'll continue to view the cash that would come back to us from both the drops and the distributions and the ownership of the LP units similar to how we do it now. We are and have been very committed to achieving a balance between investing in the business and returning capital to our shareholders and we would expect that that will certainly continue.

One of the things that is nice about having these drops is that you will generate cash that can continue to be redeployed in the increased growth and build out of the midstream infrastructure. And while we would like to the maximum extent possible have projects funded initially from MPLX, there may be times or will be times when a project may be bigger or the timeline over the cash profile might be longer than we can -- that makes sense for us to have it in MPLX initially.

And we'll use that cash to invest in midstream, hold it at MPC until it is MLP ready and then drop it in. So I view this as being a continual cycle here of getting cash that we can return to our shareholders. But also getting cash that we can continue to invest in the midstream and infrastructure build out.

Evan Calio - *Morgan Stanley - Analyst*

Great. Well be clearly increases that cash amount. Some color specifically, do you anticipate the drops that you laid out for cash or units or a combination of both? And secondly, do you see structures other than taking units that allow capital gain deferral for -- that some of your other MLPs have employed?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Yes, I think we will for every drop that occurs Evan, we will certainly evaluate the tax implications of those. And we will I think continually balance making sure that we're doing them in the most tax efficient way with also making sure that we're meeting the business needs of MPC and MPLX. And if there's a need for cash either to return it to shareholders or to invest in the business, we're more likely to take cash. If there is an opportunity to do something in a tax efficient way, we might end up taking back units or issuing more units. So I think it'll be a fact in circumstance driven decision versus a philosophical or a policy around how everything is going to occur.

Evan Calio - *Morgan Stanley - Analyst*

That's great. One last one, if I may. It's somewhat related, but your announcement that you and your partners are evaluating options for Capline, while preliminary, do you see the need for reverse pipe of that size to the Gulf Coast or do you envision some coordinated project that would -- with other logistics that would move Canadian crudes into that Chicago market? Any preliminary thoughts there on how that might work out?

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Well if you really look at this -- this is just an announcement of a preliminary study. If you look at the Louisiana side of the refining sector, refining corridor in the Louisiana or Gulf Coast, we do not have an efficient manner and what -- to be able to get heavy crude down there. The Houston side of the Gulf is in great shape and we expect Keystone will eventually be approved and we'll even be in better shape.

So therefore, it opens itself for the question why not improve the logistics to the Gulf Coast? So this isn't a study to look at just Chicago, you look at the volumes that goes south to north and we were always going to need a good supply source from south to north to be able to feed the path to refineries.

So this is a study to determine long term does it make sense to look at Capline in a different type of operation than it is today. And all of the things that you mentioned are on the table as we do this very detailed analysis.

Evan Calio - *Morgan Stanley - Analyst*

Great, that make sense. Thank you.

Operator

And our next question comes from Paul Cheng from Barclays.

Paul Cheng - *Barclays Capital - Analyst*

Want to say thank you for helping the information about MPLX into your presentation, really helpful. I have a couple questions. First on MPLX, I don't -- from a (inaudible) standpoint can you tell us that what is the kind of comfortable level the balance sheet could support in terms of whether it's an outside acquisition or that an internal acquisition drop down on the per year basis? Is it $1 billion a year or that you think is going to be -- the balance sheet would be able to support bigger?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Well I think the way we would look at the balance sheet, Paul, is by making sure that we have a good balance between issuing equity and maintaining a debt profile that we want to be investment grade. And so the way that we think about investment grade profile would be to have a debt to EBITDA ratio of probably somewhere -=- managing to somewhere no more than 4 times. And so that is how we will look at -- that's how we will look at and evaluate opportunities.

And in a growing environment, when MPLX is growing quickly, our view around that 4 times debt to EBITDA would be on the last quarter annualized or a run rate EBITDA versus the last 12 months just because you don't want to get yourself into a situation where you're getting -- you're incurring debt at an acquisition date but not getting any benefit for that EBITDA. So when I say 4 times it's really around a run rate EBITDA number.

And we feel comfortable doing that because we believe that when something finds its way into MPLX, it is revenue stream that's largely certain and there won't be a lot of -- there's not a lot of volatility around commodity risk or something like that.

Paul Cheng - *Barclays Capital - Analyst*

Okay. The second question is that for either Tony or Don, do you have a number that you can share after the Hess acquisition on the pro forma basis, the impact to your Speedway gross margin on the fuel and gross margin on the C store look like? And also, Don, do you have the inventory market [inventory] in excess of both working capital and the long-term debt for the MPC [comp level]? Thank you.

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

So long-term debt is 6, just under $6.3 billion. The excess of fair value over book value for inventory is $5 billion. And working capital is $2.5 billion.

Paul Cheng - *Barclays Capital - Analyst*

The $2.5 billion is including cash or not including cash?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

It is including cash.

Paul Cheng - *Barclays Capital - Analyst*

Okay, yes.

Tony Kenney - *Marathon Petroleum Corporation - President of Speedway LLC*

Paul on the enhancements I think what I would say is that with the synergies and the synergies will cut across both existing Speedway assets as well as the Hess assets we'll enjoy some uplift in our gross margin inside the store from realizing those synergies. I don't have a specific number on that. We know what we've said publicly in terms of all of the marketing synergies in the deal, year three run rate is $70 million in total. But I can't give you a split between how much of that is on the Speedway side and the existing Hess assets.

Paul Cheng - *Barclays Capital - Analyst*

Tony, do you have a pro forma for the fourth quarter in terms of (inaudible)? If we say if you have closed a deal as June 30 and wondering, what will be the reported fuel margin and the C store margin in the third quarter so that we can use it as a baseline to project forward?

Tony Kenney - *Marathon Petroleum Corporation - President of Speedway LLC*

Yes, Paul, I don't have that number. I've really not done any work around that. We're really just now beginning to integrate the two financial systems to understand exactly what that would look like. But that's all I could say about that now.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

And Paul, as you know we've never given forward guidance.

Paul Cheng - *Barclays Capital - Analyst*

No, fully understand. Just want to look at say on the actual, on the pro forma basis what is the baseline we should use.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

All right, let us continue to get this transition under our belt and we'll see what we can prepare.

Paul Cheng - *Barclays Capital - Analyst*

All right. Thank you.

Operator

And our next question comes from Brad Heffern from RBC Capital Markets,

Brad Heffern - *RBC Capital Markets - Analyst*

Attacking a previous question slightly different way. Looking at the acceleration in MPLX, how much of that is due to faster drops? And then you also mentioned potential consolidation in midstream, are you assuming some incremental acquisitions in order to triple the EBITDA there?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

So Brad, this is Don. The -- when we did the modeling there, that is a projected EBITDA growth rate. And that was a projected EBITDA growth rate or distribution growth rate that we can easily support with the portfolio of assets that we currently have. Now that doesn't mean that we're -- in fact we're very focused on growing organic projects, identifying the next big opportunity, identifying potentials for M&A that might make sense and be strategic to us. But we're very comfortable that we can support the growth rate that we've identified there solely with assets that exist at MPC, but knowing that we will certainly over time grow MPLX in other ways. And that would be through organic means and through M&A.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay, got it. Thanks. And then talking about Capline, is that in the EBITDA drop inventory number you typically provide? And if ultimately it was reversed, do you think that that would have a substantial impact on the drop to you going forward?

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Don, you want to take the first part and I'll take the second?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Yes, so currently we haven't indicated actual EBITDA from those types of assets, but the EBITDA from Capline right now would be not a significant number. And so to the extent there was a reversal and it was more fully utilized, I'm assuming that there would be incremental EBITDA that could accrue from that. But in terms of the numbers that we're showing here, there's a lot of other contributors that are probably more meaningful to that EBITDA number, Brad.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Right. And Brad, the last part is it's too early to be able to put a forecast. But if heavy crude from the Canadian region was available, there's substantial demand in the Louisiana refining corridor, most of those refineries from Baton Rouge through Garyville and on are heavy refineries. So I think there could be a lot of volume that could go that direction someday. So we don't have any pro formas on what that is yet, but I think it could be significant value.

Brad Heffern - *RBC Capital Markets - Analyst*

Thanks, guys.

Operator

And our next question comes from Paul Sankey from Wolfe Research.

Paul Sankey - *Wolfe Research - Analyst*

Forgive me if I missed it, but did you talk about the Garyville hydrocracker expansion? I guess we were wondering whether there'd be a decision on that this year and if the CapEx would then be starting next year? Thanks.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Yes, Paul, we have not discussed that yet. We will -- our plan that we've always been on schedule with is to make that decision sometime around end of the year to the first part of next year. We're just wrapping up our front end engineering and design work that then drives all the capital investment type final numbers. So we won't make that decision again until the end of the year.

If we were to go forward, the -- in 2015 the capital would not be that significant in 2015 because it takes a -- you would get in -- you would finish up the detailed design and engineering and start some of the land excavation work and piling in 2015 and 2016. So really the bigger part of that CapEx would not come for a couple years yet.

Paul Sankey - *Wolfe Research - Analyst*

Okay, understood, Gary, thanks. Gary, on global oil markets, do you expect OPEC to cut production in the November meeting?

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Well, I'm not close enough to OPEC to be able to give you a good answer on that. But the discussion so far they've been very clear that they're not going to cut production at this time. When you look, though, at a lot of analysis that's been put out on countries such as OPEC, it would suggest that the majority of the countries need a higher price than is in the marketplace today in order to be able to support the budgets that they have.

So I see -- I expect that the markets going to continue to be volatile on the front end here. But based on a lot of the discussion that's been going on, I would be surprised to see that there would be a change in the direction that has been stated so far.

Paul Sankey - *Wolfe Research - Analyst*

Thanks. And then finally, the bigger issue is demand. We just heard Tom O'Malley saying he thought that yesterdays draws in inventories products were extraordinarily bullish for refiners. Can you -- it seems that the distillate market may well be a lot stronger than people realize globally, would that be -- would you agree with that?

And could you also just talk about your -- I always ask you this firstly about your exports distillate and gasoline and secondly about the demand that you're seeing across your networks. Thanks.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Okay. Mike Palmer, you want to handle the majority of those questions?

Mike Palmer - *Marathon Petroleum Corporation - SVP of Supply, Distribution, and Planning*

Yes, sure, Gary. Paul with regard to our exports, the third quarter was still very strong. We probably see just a little bit of weakness in Europe and a lot of strength in Latin America. But we're still at those record level of exports and don't have a reason to believe that ought to change.

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

And, Paul, this is Don. The actual volumes were 299,000 barrel a day for third quarter for exports. About two thirds of that was distillate, the remainder was predominately gasoline.

Paul Sankey - *Wolfe Research - Analyst*

And gasoline demand coming back with low prices in your networks?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

I think what we're seeing in October was that we're up slightly over 1% same-store gasoline demand.

Paul Sankey - *Wolfe Research - Analyst*

Great. Thank you.

Operator

And our next question comes from Doug Leggate from Bank of America, Merrill Lynch.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Congratulations on your announcement this morning. I'd like to dig in a little bit to hold the balance, if I may, on the MLP growth impacts, the cost base of the refining business. It's obvious we've had very strong refining environment with the benefit of crude spreads and so on. But if we had to go back to a normalized level, let's assume it was not as high as we are currently. I'm trying to understand what the priority is in the MLP drop downs in the context of what it means for the cost base for the refining business. So wonder if you could help me with that starting first with the $450 million run rate, what does that mean for the cost basis of the refining business?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Doug, this is Don. I'm sorry, Gary.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

[Great] question, but the way we have always model things and the way we've always done our business, Doug, is we've tried to transfer our prices at market. And the way we value those assets are all at market. So I don't think it changes from a market competitive standpoint, it changes any of those dynamics. Don, you were going to add something?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Doug, I wasn't exactly sure I understood what your question was around the impact on refining.

Doug Leggate - *BofA Merrill Lynch - Analyst*

So let me try a different way, Don. So previously before today you talked about I think $1.1 billion of EBITDA, $300 million organic and $800 million within the existing system. So when you transferred that ratable EBITDA to the MLP, one has to imagine someone is paying for that and that cost is I'm guessing is going to be a cost within your refining business. So I'm trying to understand where the transfer of cost take place and what it does to the base ratable stable earnings within the refining business, if you like. Do you see what I mean? Am I explaining that well or not?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Yes, well, yes. So in terms of the EBITDA, clearly that is embedded now within MPC on a consolidated basis. One of the things that ends up happening is that if you drop those assets down, you get paid a reasonable multiple already for those assets. And then at MPC we continued to participate in the -- a portion of that EBITDA stream just based upon our LP ownership.

So our view around the drop off in EBITDA or the cost transfer that you're speaking with is that it is not that significant. And if we get proceeds back to MPC, we will evaluate how to deploy those proceeds. And sometimes they may end up getting deployed into capital projects at refining that continue to grow the refining EBITDA. A good example would be as we continue to considered the ROUX project.

So to me I think this is all about a growth story rather than a story where we're just moving EBITDA from one legal entity to another legal entity. This is about an opportunity to grow MPC and MPLX, to be able to take advantage of the capital markets in order to be able to grow both our midstream with the rest of our business.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Okay, I'll take the details offline. I understand the IDT or the IDR benefit and all the rest of that, but I'm trying to wrestle with what happens in a down cycle for refining when you've got the added cost base, that's -- but we can take it offline.

My follow up is I may have missed this in your prepared remarks, but on slide 8 of the presentation, can you quantify again what the other gross margin the 548, what is that? And what was the absolute in the quarter?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

So --

Doug Leggate - *BofA Merrill Lynch - Analyst*

As opposed to variance.

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Yes, we did not -- the absolute in other gross margin for the quarter, just one second here, is 500 -- the absolute is $501 million which is an our appendix, slide 26.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Okay. And what is that?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

It's a condemnation of a number of things that what would be in there, and so that includes our product price realizations, it includes refinery gains, it includes our repurchase for retail activity. We have not given any color on the individual components.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Yes, okay thanks. Don, forgive me, I want to go back very quickly, the $1.7 billion is that inclusive of the original $1.1 billion or is that added to that, I assume it's inclusive of.

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

So the $1.7 billion is the original $800 million plus $300 million of projects which would be [SAX], Sandpiper, condensate splitters and whatnot. And then $600 million of fuels distribution.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Got it, appreciate the clarification. Thanks, fellas.

Operator

And our next question comes from Phil Gresh from JPMorgan.

Phil Gresh - *JPMorgan - Analyst*

First question was a clarification when you were talking about the uses of cash from this acceleration plan, with the leverage levels where they are you've had a step function change with the Hess deal, are you anticipating that we're going to keep it at this new level moving forward? Or would some of that cash actually be used to slowly delever that balance sheet for other opportunities? Your thinking around that.

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Phil, our expectation is that we would continue to -- we are committed to maintaining an investment grade credit profile. So we would maintain -- or would not go past a leverage model that would put pressure on that. But we're very comfortable with where our balance sheet is currently on a leverage basis and we think it has allowed us to access some attractively priced capital.

Phil Gresh - *JPMorgan - Analyst*

Got it, okay. Second question is on the in the gasoline markets. We're seeing a divergence in the fundamentals in the Gulf Coast cracks versus what we're seeing in the East Coast and Mid continent. So I'm wondering if you could give a little bit of color what you're saying there and how you might expect that to play out in the fourth quarter?

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Mike?

Mike Palmer - *Marathon Petroleum Corporation - SVP of Supply, Distribution, and Planning*

Yes, Gary. So, Phil, what I would say is that if you look at the gasoline markets by region for most of the year, what you've really seen I think is that the Chicago area, the New York has been stronger than the Gulf Coast. And I think certainly within the Gulf Coast there's a lot more refining capacity to make gasoline than the region can absorb. And that gasoline must be exported to the other markets and I think that's what you're seeing. So I think from a macro standpoint, that's going to continue to be the case.

The other thing that certainly happens is that during periods, during quarters you get many events that take place. You get pipeline issues, you get the refinery planned maintenance as well as unplanned maintenance, and that can have a pretty significant impact on a specific region. And certainly the -- that's been the case. We've seen some refinery downtime in the Midwest region over the last several months I think that's contributed to margins.

Phil Gresh - *JPMorgan - Analyst*

Understood, thanks for the color. Last question is on the retail side. I appreciate the color on how things are going early days. Would you say that for now you guys are mostly just focused on the integration of Hess and as opposed to organic store openings and/or additional acquisitions within the retail business? I know you had talked about perhaps slowing the pace of the organics store openings, but it sounds like things are going well. So wondering perhaps the growth side of that story.

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Tony?

Tony Kenney - *Marathon Petroleum Corporation - President of Speedway LLC*

Yes, as far as the integration, that's our number one focus. But backing up from there let me just say this. What was important was as we transferred ownership and operation from Hess to Speedway, the most important thing was making sure there was no impact to the customer. And I think we've accomplished that. So as we move forward from there then as day two and beyond progresses, we're looking to be able to integrate both the Hess and Speedway operations to take advantage of the synergies that are available there.

And the capital that we'll spend this year as far as new store openings, we did have an organic growth plan in the base Speedway business and we're continuing to execute on that. We're probably going to complete approximately 60 new stores or rebuild openings this year. So we're balancing the focus on both the existing or the base Speedway business as well as the integration, the re-identification and then eventually some remodeling of some of the Hess assets to bring the entire chain together under a common brand.

Phil Gresh - *JPMorgan - Analyst*

Got it, okay. And on the acquisition side of things?

Tony Kenney - *Marathon Petroleum Corporation - President of Speedway LLC*

Yes, we don't comment on what we may or may not want to do in that arena. I think it's going to be opportunistic. We'll look at things but beyond that, probably don't have much I can add to that.

Phil Gresh - *JPMorgan - Analyst*

Okay, fair enough. Thanks, I'll turn it over.

Operator

And our next question comes from Ryan Todd from Deutsche Bank.

Ryan Todd - *Deutsche Bank - Analyst*

A couple follow-up questions. I know it's theoretical at this point, but on Capline, if the decision were to be made following this study about a potential reversal, what would be the timing in terms of how long it would take to get that done?

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Ryan, it's just way too early to look at that including in the study. First of all, they're going to do a market study, supply, demand study. Then if it would point towards -- let's look at from an engineering standpoint what it would take, we've already done some work but a lot of hydraulic analysis work needs to be complete. So we're not far enough yet that I can give you a good timeframe.

Ryan Todd - *Deutsche Bank - Analyst*

Okay, thanks. And another follow up on the retail side on the MLP and the retail eligible income, a couple things. On the question -- I think it sounds like the EBITDA is purely a throughput volume times margin on the retail business. Does that include at all any of the rental income or leasing income from the stations? And then on the -- would we expect if this were eventually to make its way into an MLP, would it be a standalone MLP or would you drop it in the MPLX?

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Don?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Yes, the calculation is truly a volume times a $0.03 per gallon, so we're primarily focused in that analysis on -- or that estimation on refinery to rack volumes. It does not include anything that would be incremental to that. So it's 20 billion gallons times $0.03.

With respect to plans for how it gets dropped, when it gets dropped, we're going to continue to evaluate the timing and what makes sense. And I guess our view is it is -- it's just increased our portfolio of opportunity. The opportunity set is now bigger and gives us even more confidence in our ability to really grow MPLX so that we can participate in this midstream infrastructure build out.

Ryan Todd - *Deutsche Bank - Analyst*

Okay, that's helpful. And then if I could -- one final one actually on the refining business. Your gasoline yield was down to probably the lowest level that we've seen in quite a while in the quarter, is this a sustainable trend? And I think you were at 45% yield in the quarter, how -- and if we're moving in that direction, can you continue to reduce that yield and shift more towards distillate further going forward or how should we think about that going forward?

Rich Bedell - *Marathon Petroleum Corporation - SVP of Refining*

I think -- this is Rich Bedell. I think probably it's more a reflection of some of the turnarounds that were going on and the process units that were off-line for turnaround than anything else. There hasn't really been a fundamental shift in our yields. We had been increasing our distillate percentage through some of the projects and that will continue on into some next year, but nothing that would have swung those volumes other that maybe turnarounds.

Ryan Todd - *Deutsche Bank - Analyst*

Okay, thanks. That's helpful, I'll leave it there.

Operator

And our next question comes from Roger Read from Wells Fargo.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

I'd like to come back a little bit on the Capline. Can you walk us through the ownership structure and what the decision-making process is there? I understand too early to say what the timing would be and all that. But how exactly are decisions made there, what's your influences, et cetera?

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Right, there are three owners, BP, Plains and Marathon. And in order to be able to make a change of service like this study is it's going to be done it takes all three to approve such a change.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

Okay. And then coming back to the other gross margin that Doug asked about earlier. Obviously it was a big component of the Q2 out performance and Q3's overall performance. Any guidance you can give us at this point, and I know you're not big on guidance, but maybe some help you can give us on how to think about that performance as we look forward not just to the fourth quarter but also to next year? Is there some seasonality to that number? Is it just a function of market conditions at any given moment? Any color you can offer us on that would be helpful.

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Yes, Roger, I guess what I would say is both second -- at the second quarter and this quarter, the comparable periods last year included some noise around the RIN impact on the market. And you'll recall that we used market indicators that start with the 6-3-2-1 crack and we try to build to it.

One of the reasons that we wanted to show and have been showing a sequential walk is to maybe give you a little bit of color or maybe the absence of a really big green bar or change quarter to quarter would suggest that maybe the unusual circumstances existed last year as opposed to the unusual circumstances existing this year.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

So if we were to compare to 2012, we might not see such a large green bar as the other way that think about it?

Don Templin - *Marathon Petroleum Corporation - SVP & CFO*

Yes, that might be it. I have not done that but that might be another way to do it. But we're also growing our portfolio and our reach every year as well. But I think 2013 was a little bit abnormal and so that's why you're seeing maybe the big differences.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

Okay, that's helpful. And then the last question on the acceleration in the MLP whether it's internal drop downs or something on the other side, what would you look at in terms of acquisitions? Should we think of something that's a fairly significant step out or is it you want to stick close to your knitting, you want to do something close to the assets you already hold?

Gary Heminger - *Marathon Petroleum Corporation - President & CEO*

Roger, it's just too early to -- and we don't comment on M&A activity. But what I said in my script was we expect to be a very big player in the develop -- further development of the North America oil and gas transformation and renaissance. So -- and that includes all liquids, not just oil and refined products, but also the natural gas and LPG markets. So we have -- the capacity is from an operating and engineering standpoint to operate in all of those different businesses. So we plan on being right on the forefront of that development.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

All right. So casting a wide net and now we're all going to be MLP analysts as well. All right, thank you.

Operator

And our last question comes from Allen Good from MorningStar. And I'm not showing any further questions. I'll now turn the call back over to the speakers for closing remarks.

Tim Griffith - *Marathon Petroleum Corporation - VP, Finance and IR & Treasurer*

Okay, thank you, Vivian. Well we want to thank everyone for joining us on the call today and your continuing interest in Marathon Petroleum Corporation. If there are additional questions or if you'd like clarification on any of the topics discussed this morning, Geri Ewing and Teresa Homan will be available for questions. Thank you for joining us.

Operator

Thank you, ladies and gentlemen, this concludes today's conference. Thank you for participating, you may now disconnect.