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MPC - Q4 2014 Marathon Petroleum Corp Earnings Call

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OVERVIEW:

MPC reported full-year 2014 earnings of over $2.5b and diluted EPS of $8.78. 4Q14 earnings were $798m or $2.86 per diluted share.

CORPORATE PARTICIPANTS

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

Gary Heminger *Marathon Petroleum Corporation - President and CEO*

Don Templin *Marathon Petroleum Corporation - SVP and CFO*

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

Rich Bedell *Marathon Petroleum Corporation - SVP of Refining*

Tony Kenney *Speedway - President*

CONFERENCE CALL PARTICIPANTS

Evan Calio *Morgan Stanley - Analyst*

Ed Westlake *Credit Suisse - Analyst*

Phil Gresh *JPMorgan - Analyst*

Paul Sankey *Wolfe Research - Analyst*

Neil Mehta *Goldman Sachs - Analyst*

Paul Cheng *Barclays Capital - Analyst*

Jeff Dietert *Simmons & Company International - Analyst*

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Brad Heffern *RBC Capital Markets - Analyst*

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PRESENTATION

Operator

Good morning, and welcome to the fourth-quarter 2014 Marathon Petroleum earnings call. My name is Brandon, and I'll be your operator for today.

(Operator Instructions)

Please note that this conference is being recorded. And I will now turn it over to Mr. Tim Griffith. You may begin, sir.

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

Okay. Thank you, Brandon. Good morning. Welcome to Marathon Petroleum Corporation's fourth-quarter 2014 earnings webcast and conference call. The synchronized slides to the conference call can be found on our website at 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; Rich Bedell, Senior Vice President of Refining; 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 statement 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.

With that, I'm happy to turn the call over to Gary Heminger for opening remarks and highlights. Gary.

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

Thank you, Tim. And good morning for everyone, and thank you for joining our call. We are pleased to report strong results for the quarter and full year, with $798 million of earnings in the fourth quarter, and $2.5 billion of earnings for the full year.

MPC completed another milestone year. Our refining and marketing segment achieved income from operations of $3.6 billion for the year, while executing the largest series of planned refinery maintenance projects in the Company's history. Our achievements, such as the acquisition of Hess' retail operations and the acceleration of MPLX growth, underscore our commitment to grow higher-value, stable cash flow segments of the Business while optimizing our refining system for stronger returns.

While crude oil prices fell, and crack spreads narrowed during the fourth quarter, we experienced strong product price realizations at both the wholesale and retail level. Speedway reported record earnings of $273 million for the quarter, including the newly acquired Hess locations, and posted what would have been record earnings for just the legacy Speedway locations. Conversions of these new locations, and the deployment of Speedway's highly successful merchandise model, are progressing well.

As of January 31, 134 of the 1,245 acquired stores have been converted. We are taking the opportunity to evaluate ways to leverage existing and best practices of both business models, and implementing those practices across the entire Speedway platform. The earnings power of this combined Business will be tremendous, and we are well positioned to execute our strategy to grow the EBITDA of this business to over $1 billion.

MPC completed its third and largest drop-down to MPLX during the fourth quarter of 2014, which increased MPLX's interest in Pipe Line Holdings to 99.5%. This drop-down was an important first step in our strategy to substantially accelerate the growth of MPLX. As the sponsor of MPLX, MPC intends to maintain a growing reserve of MLP-eligible assets. That growth in reserves will be accomplished through MPC's continued focus on midstream investments, and both entities' participation in the energy infrastructure buildout that continues in North America.

MPC continued to deliver peer-leading capital returns to its shareholders. MPC returned a total of $2.7 billion of capital to shareholders in 2014, $820 million of which occurred in the fourth quarter. We have repurchased approximately 25% of the shares that were outstanding when we became a stand-alone Company. MPC remains focused on the long-term value proposition for our investors.

We also announced this morning our 2015 investment plan of $2.5 billion, which includes $1.3 billion for the refining and marketing segment, $452 million for the Speedway segment, and $659 million for the pipeline transportation segment.

With respect to the residual oil upgrader expansion project at the Garyville refinery, we believe this project has great potential returns, but we are deferring a final investment decision as we further evaluate the implications of current market conditions on the project.

MPC's 2015 capital plan reflects our commitment to further develop the stable cash-flow-generating segments of our Business, while enhancing refining margins. This will be done by growing our midstream assets, integrating the Hess retail operations into our Speedway business, and continue to implement the margin-enhancing projects in refining, including synergistic projects at our Galveston Bay refinery, which we acquired in 2013.

Before I turn it over to Don, I also want to take this opportunity to remind investors that in the backdrop of the volatile crude price environment we experienced over the last six months, we continue to be enthusiastic about the prospects for this Business. Our flexible refining system, large retail presence, and extensive logistics network allowed us to successfully adapt to changing production and supply patterns. This was the year where our results clearly demonstrate the value of our integrated downstream system.

Looking ahead, I think it's important to continue to pay close attention to crude oil inventory in Pad 3 and Cushing. We believe as those inventory levels continue to rise, it will have a favorable impact on crude differentials in the coming months.

Fundamentally, ours is a spread business. We are well positioned to drive sustainable earnings in a variety of crude price environments, and we continue to believe that our best days are in front of us.

With that, let me ask Don to review our financial performance for the quarter, and provide some more detailed commentary on our 2015 capital plan.

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

Thanks, Gary. Slide 4 provides earnings, both on an absolute and per-share basis. Our financial performance for both the fourth-quarter and full-year 2014 was strong.

MPC had earnings of $798 million, or $2.86 per diluted share, during the fourth-quarter 2014, compared to $626 million, or $2.07 per diluted share, in last year's fourth quarter. For the full-year 2014, our earnings were over $2.5 billion, a $400-million improvement over the $2.1 billion of earnings in 2013. Earnings per diluted share were $8.78 for the full-year 2014, compared to $6.64 for 2013.

The chart on slide 5 shows, by segment, the change in earnings from the fourth quarter of 2013 to the fourth quarter of 2014. Speedway segment income was a major driver for our year-over-year increase, which I'll discuss in a minute. The refining and marketing segment income also contributed to the increase in overall earnings in the quarter.

Turning to slide 6; Refining and marketing segment income from operations was just over $1 billion in the fourth quarter of 2014, compared with $971 million in the fourth-quarter last year. The increase from 2013 was primarily due to higher product price realizations, and a favorable LIFO inventory accounting effect, partially offset by narrower sweet/sour crude oil differentials and a lower LLS 6-3-2-1 blended crack spread. The lower blended crack spread had a negative impact on earnings of approximately $197 million. The blended crack spread was $5.43 per barrel in the fourth quarter of 2014, compared to $6.82 per barrel last year. The narrower sweet/sour crude oil differential had a negative impact on earnings of approximately $240 million versus the fourth quarter of 2013.

There were three primary contributors to the $494-million increase in other gross margin. First, we recognized the build in our crude oil and refined products inventories in the 2014 fourth quarter when compared to year-end 2013. For purposes of our annual LIFO inventory costing, this increase in inventory is recorded based on pricing at the beginning of 2014, which was substantially higher than fourth-quarter prices. As a result, refining and marketing's segment income for the quarter reflects the favorable effect of approximately $240 million. Comparing the fourth quarter of 2014 to 2013, the LIFO impact was approximately $190 million, which is included in the $494-million increase in other gross margin shown here.

Second, we experienced strong product price realizations. Generally, as crude prices decline, our wholesale, brand, and Speedway prices tend to fall at a slower rate, leading to some margin expansion. For the wholesale and brand businesses, this margin impact is reflected in our refining and marketing segment, and represents about two-thirds of the non-LIFO change.

Finally, our actual crude and feedstock acquisition costs, compared to the market indicators, were more favorable during the fourth quarter of 2014 as compared to the fourth quarter of 2013. Segment income for the quarter was also impacted by the reinstatement of the biodiesel blenders credit on December 2014, retroactive to the beginning of the year.

Slide 7 provides the drivers for the change in refining and marketing segment income on a year-over-year basis. Refining and marketing segment income from operations was $3.6 billion for the full- year 2014, compared with $3.2 billion in 2013. The LLS 6-3-2-1 blended crack spread had a $761-million favorable impact on earnings. Both the sweet/sour and the LLS-to-WTI crude oil differentials narrowed in 2014 compared to 2013, resulting in negative impacts to earnings of approximately $489 million and $695 million, respectively.

All of the gross margin indicators utilize spot market values, and an estimated mix of crude purchases and products sold. Differences in our actual product price realizations, mix, and crude costs quarter to quarter are reflected in the other gross margin column. Given the substantial $1.7-billion impact of the items, let me make a few comments about these year-over-year differences.

The majority of the year-over-year change was attributable to product price realizations, which were substantially more favorable in 2014 than they were in 2013. The impact of falling crude oil prices on wholesale and brand margins had a positive impact in the latter part of the year. In addition, second- and third-quarter 2013 product price realizations compared to spot market values were negatively impacted by the effects of RINs, further driving the year-over-year change. The LIFO accounting effect that I described earlier also impacts the 2014 full-year earnings. And finally, our actual crude and feedstock acquisition costs compared to the market indicators were more favorable during 2014 as compared to 2013.

Moving to operating costs: Direct operating expenses were $913 million higher in 2014 compared to 2013, primarily due to higher turn-around expenses. As Gary highlighted, 2014 included the largest series of planned refinery maintenance projects in the Company's history.

On slide 8, we provide the Speedway segment earnings walk for both the fourth quarter and full year. Speedway's income from operations was $273 million in the fourth quarter of 2014, compared with $83 million last year. This is the first quarter with the results for the acquired Hess sites. The Hess locations contributed approximately $118 million to the segment's fourth-quarter income.

For the legacy Speedway sites, the light product gross margin was about $67 million higher in the fourth quarter of 2014 compared to last year. Overall, the Speedway segment's gasoline and distillate gross margin increased by more than $0.11 per gallon from fourth-quarter 2013 to fourth-quarter 2014. Speedway's merchandise margin in the legacy locations was $20 million higher in the fourth quarter of 2014 compared to fourth quarter of 2013.

On a same-store basis, gasoline sales volumes increased 0.3%; and merchandise sales, excluding cigarettes, increased 5.4% in the fourth quarter of 2014 compared with last year. In January 2015, we have seen a slight decrease in demand, with an approximately 0.8% decrease in the same-store gasoline sales volumes versus the prior year.

Speedway's income from operations for full-year 2014 was $544 million, compared with $375 million in 2013. The Hess locations contributed approximately $113 million of income in 2014. For the legacy Speedway sites, light product gross margins increased $50 million, and merchandise margins increased $55 million year over year.

For the Speedway segment, gasoline and distillate gross margins averaged $0.1775 per gallon in 2014, compared to $0.144 per gallon in 2013. On a same-store basis, gasoline sales volumes decreased 0.7% in 2014, and increased 0.5% in 2013. Partially offsetting the increases in Speedway income were higher operating expenses, primarily attributed to an increase in the number of stores.

Slide 9 provides the components of Speedway's fourth-quarter segment income on an absolute basis. The light product margin for the legacy Speedway and Hess locations were $176 million and $197 million, respectively. The legacy Speedway and Hess locations contributed $225 million and $99 million in merchandise margin, respectively. Operating and other net expenses were $424 million for the quarter.

Slide 10 shows fourth-quarter and full-year changes for our pipeline transportation segment. Income from operations was $58 million in the fourth quarter of 2014, compared with $47 million last year. Income from operations was $280 million for the full-year 2014, compared with $210 million for the full-year 2013. The increases for both the quarter and full year were primarily attributable to higher transportation revenue and pipeline affiliate income, partially offset by higher operating expenses associated with pipeline maintenance activities. The increase in transportation revenue for the quarter and year were attributable to higher average pipeline tariff rates, and an increase in the revenue recognized for volume deficiency credits in 2014.

Slide 11 presents the significant drivers of changes in our cash flow for the fourth quarter of 2014. At December 31, our cash balance was $1.5 billion. Operating cash flow before changes in working capital was a $1.1-billion source of cash. The $670-million use of working capital noted on the slide primarily relates to a $1.9-billion decrease in accounts payable, partially offset by a $1.2-billion decrease in accounts receivable. The decreases in accounts payable and accounts receivable were primarily due to the significant drop in crude oil and refined product prices during the quarter.

Long-term debt was a $371-million source of cash during the quarter, which was driven by MPLX's borrowings to help finance its acquisition of an additional 30.5% interest in Pipe Line Holdings in December. As Gary highlighted, we continue delivering on our commitment to balance investments in the Business with return of capital to our shareholders. We repurchased $682 million of shares, and paid $138 million of dividends in the fourth quarter, demonstrating this commitment to regular returns of capital.

MPLX also had a public equity issuance during the fourth quarter, with net proceeds of $221 million. That makes up the most significant portion of the other column.

Slide 12 shows that, at the end of the fourth quarter, we had $1.5 billion of cash, and approximately $6.6 billion of debt. With EBITDA of about $5.4 billion during the last 12 months, we continue to be in a very manageable debt position, with debt to EBITDA of 1.2 times, and a debt-to-total-capital ratio of 37%.

Turning to slide 13: During the last 12 months, we generated $3.1 billion in cash from operations, and $1 billion of free cash flow, excluding the Hess retail acquisition. Over this period, we've returned about $2.7 billion to shareholders through dividends and share repurchases, or approximately 2.7 times our adjusted free cash flow.

During the fourth quarter of 2014, we purchased approximately 7 million shares for $682 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 that share repurchases are the most efficient way to do so.

Slide 14 provides updated outlook information on key operating metrics for MPC for the first quarter of 2015. We are expecting first-quarter throughput volumes to be up compared to first-quarter 2014, due to less planned maintenance. Since we have no comparable 2014 data that includes the newly acquired Hess locations, we plan to provide Speedway outlook information by quarter for 2015. For the first-quarter 2015, we project Speedway's light product sales volume will be approximately 1.4 billion gallons.

Slide 15 provides a breakdown by segment of our 2014 capital expenditures and investments, excluding the acquisition of the Hess retail operations, along with our approved capital plan for 2015.

Slide 16 lists the significant capital projects that we will be working on in 2015 and beyond. Our capital investment plan is focused on growing our midstream business, integrating the Hess retail operations into our Speedway system, and pursuing margin-enhancing projects at our refineries, including further implementing synergistic projects at our Galveston Bay refinery.

This slide also shows the percentage of our 2015 capital plan allocated to the various operations of our Business. As you can see, 35% of our capital is being allocated to investments in midstream assets, 18% to Speedway, and 15% to margin-enhancing refining projects. The remainder is primarily attributable to refinery-sustaining capital. We believe this allocation of capital is consistent with our commitment to further develop the stable cash-flow-generating segments of our Business, while also enhancing refining margins.

Now I will turn the call back to Tim Griffith.

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

Thanks, Don. As we open up the call for your questions, we ask that you limit yourself to one question, plus a follow-up. You may re-prompt for additional questions as time permits.

With that, Brandon, we're prepared to open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Evan Calio, Morgan Stanley.

Evan Calio - *Morgan Stanley - Analyst*

Good morning, guys; very solid results today. My first question is on contango. I know you hedged 75% of your runs with the WTI contract.

Can you remind us how you benefit in a contango WTI market? And any thoughts on contango as we move into turnarounds with a growing and imbalanced crude market and storage limitations? And even how a steeper contango may relate to a wider WTI-Brent spread?

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

Hi, Evan. This is Mike Palmer. As you point out, not only are we able to lock in that front-month contango with our hedging strategies, but in terms of the purchase strategy for domestic crude, we also lock in that front-month contango. So, we are the beneficiary of that cheaper front month.

With regard to the rest of your question, -- what was next?

Evan Calio - *Morgan Stanley - Analyst*

More of an outlook item of what do you think of the structure on the curve as we move into peak US turnarounds with a growing imbalanced market? And even how storage limitations can factor into a return of some more favorable US pricing.

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

Well, that's the $64,000 question in my mind and in everyone's mind is: How long does this very weak market last? I think, to the extent that we see oversupply in the market, which certainly appears to be with us during the first half of the year, you'd believe that steep contango should be with us. As things come back more into balance in the second half of the year, then I would guess that the contango would narrow.

Evan Calio - *Morgan Stanley - Analyst*

Great. And then, the second question I have is really on the wholesale fuel distribution segment. I know that it increased following the Hess transaction, and it's included within the other gross margin in your R&M operations. And you included, I think, $600 million of MLP-able EBITDA, largely related to that fuel distribution business. Can you help us with what wholesale added in the fourth quarter? And really, how you define that wholesale margin, at least as for an internal transfer basis?

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

Evan, this is Don. We don't typically comment on individual components of the Business. When I was explaining the results for the quarter, in that other gross margin caption, about two-thirds of the differential from last year's fourth quarter was related to product price realizations. And that's really a function of wholesale brand, and brand. So, that, to me, is a demonstration, if you will, of the earnings power of that part of the Business.

But in terms of the -- when we had come up with the $600 million of the fuels distribution that could potentially be MLP-able, that was largely a function of our wholesale and brand volumes. So, 20 billion gallons, times -- we just used a $0.03 marker to get you 20 billion gallons times $0.03 to the $600 million.

Evan Calio - *Morgan Stanley - Analyst*

Okay. So, a portion of that -- the step-up quarter to quarter is ongoing, and a portion of that profitability relates to market conditions for both product and other feedstocks. I guess I'm trying to distill -- which would ultimately, at least how we model it, drive a higher capture rate going forward. So, I'm trying to find what that step change was, given the Hess assets within your portfolio. And I guess we could maybe use the volume metric time the margin that you provided?

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

I think that's the best way to do it, Evan.

Evan Calio - *Morgan Stanley - Analyst*

Great, I appreciate it.

Operator

Ed Westlake, Credit Suisse.

Ed Westlake - *Credit Suisse - Analyst*

Good morning, and I guess solid is an underestimation -- congratulations. Just on the same -- a follow-on from Evan's question: Where are you in terms of decision-making or process in terms of being able to perhaps monetize some of that wholesale EBITDA stream into the MLP?

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

Well, as we said, Ed -- this is Gary. As we said the last November when we brought out the acceleration, that the fuels distribution was just a piece of the backlog, if you will, of MLP-eligible assets. We are in the process of going through a private letter ruling on the fuels distribution just to confirm what our thoughts are that this will all be eligible earnings, and we're very confident that it will. But there are certain steps you have to take.

We would expect, as we go through it and look at future opportunities for MPLX, fuels distribution more than likely is going to have to follow the terminals as we go into that business. So, we have plenty of run room, before we need to consider dropping in the fuels distribution. But we are carefully working on it, and we expect to have that private letter ruling completed this year.

Ed Westlake - *Credit Suisse - Analyst*

And then, sticking with the MLP, obviously you mentioned that you've got the binding open season in the first quarter for Cornerstone, and there's the permitting issues on Sandpiper and SAX. But maybe just a general comment in terms of the response of potential shippers, given obviously the collapse in oil prices, in terms of your ability to execute?

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

It's very interesting, Ed. If you look at the rig count -- Mike Palmer was just sharing with me this morning. If you look at the rig counts in the Bakken, Niobrara, Eagle Ford, and how those rig counts have declined versus the Utica -- the Utica's rig counts are fairly unchanged at this point in time. And being one of the larger purchasers of the output of Utica, we continue to see growth in that volume. So, we continue to still be confident in our open season and the binding open season portion, and I think that truly reflects the change in the rig count.

Ed Westlake - *Credit Suisse - Analyst*

Right. And comments on Sandpiper, SAX?

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

Sandpiper and SAX, we unfortunately have the delay in the right-of-way of permits. They're moving along well; just completed some testimony last week on the right-of-way. But, as I say, that continues to move along well. So, it's just a delay in the permitting is why we're deferring the capital spend, but we expect both of them to be moving along once the right-of-way and the certificate of need is completed by the end of this year.

Ed Westlake - *Credit Suisse - Analyst*

Great. Thanks very much.

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

You're welcome, Ed. Thank you.

Operator

Phil Gresh, JPMorgan.

Phil Gresh - *JPMorgan - Analyst*

Hi, good morning. First question is just in terms of the Garyville hydrocracker project. Just wondering where things stand in terms of what contribution, if any, you're seeing?

And, just in general, your distillate production in the Gulf Coast in the fourth quarter was not up as much on a year-over-year basis as the third quarter. So, just curious if you could put those two things together, and talk about just any color you have in the distillate fundamentals in the Gulf Coast? Some of your peers have talked about weaker export markets recently.

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

Well, first of all, in the Garyville ROUX project, as we said in our earnings call this morning, and in our capital plan that was released, is that we are going to defer the final investment decision on the Garyville ROUX due to the very volatile crude markets, and the crude markets send that relay into the spreads that you will look between ultra-low sulfur diesel and the heavy resid. So, we're going to delay that for the time being; still believe that it's an outstanding project, and one that has great potential for us. But, at this point in time, we will delay, and come back and look at it at a later date.

On the distillate, I'll turn that over to Rich.

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

Phil, were you asking about the hydrocracker expansion we did at Garyville last year?

Phil Gresh - *JPMorgan - Analyst*

Yes. I was just -- you had an expected contribution from an EBITDA basis. I was just curious to get a snapshot of where you're at with that? And I just noticed that the distillate production wasn't up quite as much in the fourth quarter on a year-over-year basis. So, just wondering what's going on behind the scenes there?

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

Well, the Garyville distillate hydrocracker -- not distillate hydrocracker, but the hydrocracker expansion -- that was taken from 95,000 to 110,000, and it's doing all of that, and has been for most of the year. I think anything you see in distillate in the fourth quarter -- we had some hydrotreaters down, and some turn-around activities at Galveston Bay and Garyville on catalyst changes. So, that's probably what you're seeing there.

Phil Gresh - *JPMorgan - Analyst*

Got it.

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

And, Phil, I think you had asked -- this is Don. I think you had asked about export. We averaged about 282,000 barrels a day in the fourth quarter of exports. And about two-thirds of that was distillate; another third of that was gasoline. So, we continue to see strong markets in terms of our ability to place export products, both gasoline and distillate.

Phil Gresh - *JPMorgan - Analyst*

Got it. Okay.

Follow-up question just on the fundamentals as we look to the second half of the year -- [economists may] -- when we get past this oversupply situation. Just wondering how you think about crude differentials in that world? You have a long-term view of $7 to top $12 spread for Brent-WTI, for example. But also just wondering about Brent and LLS, and how you think about that in a world where crude production growth could actually maybe turn negative?

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

Well, Phil -- this is Mike Palmer. I guess the thing that we have been focused on of late is how quickly that Brent-WTI spread has moved out from something on the order of $1, out to $5 in that range. And I think that's related to something we've talked about before, and that's the inventories that are building up on the US Gulf Coast. It's extremely difficult to go out very far, and to try and forecast that differential, but it's at $5 today, and certainly, as inventories build, it could go wider.

Phil Gresh - *JPMorgan - Analyst*

Okay. Thanks.

Operator

Paul Sankey, Wolfe Research.

Paul Sankey - *Wolfe Research - Analyst*

Hi. Good morning, everyone. Gary, I was going to ask you about the hydrocracker decision, but I think you made that pretty clear in the previous answer. I don't know if there's anything more to add on that. I think our view is that we want to see a breather in terms of major projects. As I said, I'm not sure if you want to add anything. I think it was quite clear.

I'll go on to say, given the oil price environment, I just wanted -- for example, in the case of demand for oil -- in the past, you've talked about a view that distillate demand would exceed gasoline demand. We've obviously got a different situation right now. How sustainable do you think the strength in gasoline demand is going to prove to be? And how low do you think oil prices need to be for that to be the case? I'll leave it there, thanks.

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

Well, first of all, let me go back to your first comment on the Garyville project. I know you've always stated -- somewhat of a breather. However, I look at these projects as being very important for the long-term sustainability of the Company. And when you have a very strong project, we will continue to look at that.

But, as I stated, we have delayed any final investment decision, and we will continue to look at this. But we certainly need to see these crude markets come back to some normal range before we would step in and look at this again.

Paul Sankey - *Wolfe Research - Analyst*

If I could just jump in there, Gary. What would that be? At what point would you say: Okay, this makes much better sense now.

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

As I said earlier, you have to have a view, and a very strong view on where the ultra-low-sulfur-diesel-to-resid spread will go into the future. If you look at the projects based on flat-lining spreads and flat-lining different crude prices, even in today's markets, it is still a good project. But it's not as robust as we had seen at this time last year. So, as I said, we will continue to look at this, and determine where we go from there.

Looking at -- Mike Palmer and Rich just talked a little bit about exports. The export diesel across the globe is down just a little bit from the exports, and the gasoline has picked up somewhat. And if you look at gasoline prices in this market, gasoline was very strong in the second half of the fourth quarter. As prices continued to decline, we were able to see an uptick in gasoline demand.

But recognize we're comparing ourselves same period this year, when we look at same store results, we're looking at same period this year versus last year, and we had a lot of other issues going on last year. We had three polar vortex events, very heavy snowstorms. Now, this year, we have the addition of the Hess locations in the northeast. We have stores that we didn't have before that we're comparing some numbers against some -- this year, some very heavy snowstorms in the northeast that we did not have in the same period last year.

But we see gasoline demand; and my view is gasoline demand will continue to be strong this year. And I think it will -- even at these prices, anything below $2.50 is going to continue to be robust for gasoline demand. I think we're just in a little bit of a lull in Europe as far as diesel demand and the amount of exports of diesel, but we still see, fundamentally, across North America, and even into the international markets, we think diesel demand is going to be strong.

Paul Sankey - *Wolfe Research - Analyst*

I've got it. So, essentially it is more of a price effect on gasoline and the cyclical effect on diesel right now?

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

Yes, sir.

Paul Sankey - *Wolfe Research - Analyst*

Thanks, Gary.

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

All right, Paul, thank you.

Operator

Neil Mehta, Goldman Sachs.

Neil Mehta - *Goldman Sachs - Analyst*

Good morning, Gary. Can you walk us through a little bit the way you're thinking about your capital allocation strategy. You've been aggressive on the dividend and aggressive on buybacks. But as you look at the stock today, and as you think about the cash flow going forward, how do you think about weighting one versus the other?

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

Well, we have been and will continue to be very focused on capital discipline. If you look at the projects in our budgets, they -- and our capital plan for 2015, it aligns very much with the analysts day meeting we had at the end of 2013 where we said we were going to continue to invest in midstream, in our Speedway retail segment, and in those very strong projects within refining that would give us high rates of return. And that's exactly what we're doing.

At the time of that analysts meeting, we did not have the Hess acquisition on our radar. But the investments we're doing are in the legacy speedway locations where we're growing very strong. In fact, across the entire Speedway chain -- if I look at the return on capital employed in that segment over the last five years, we've continued to increase return on capital employed each year. So, we think that strategy and our deployment of capital in Speedway is very sound.

The same way in the midstream our strategy around Sandpiper-SAX and now Cornerstone are very strong, and that it provides very good earnings from a MLP-eligible earnings-type of a project. But behind that, it also has some very strong components that provide synergies to Mike Palmer's crude oil acquisition strategies, and also into some of our light product distribution strategies. So, we will continue to be focused on those components.

And then, let me turn it over to Don to talk about the balance sheet -- share repurchases versus dividend philosophy.

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

I think -- Neil, this is Don. We are not targeting a particular amount of share repurchases in any period. What we've historically believed was: The way to manage the balance sheet, and what we've communicated to you all is that we look to core liquidity, and that drives our investment allocation. So, to the extent that we have the cash on our balance sheet that supports our core liquidity, the incremental cash is either invested in the Business or returned to shareholders. And if it isn't being invested into the Business, we are returning it to the shareholders. So, that is really the way we look at that allocation of capital.

Neil Mehta - *Goldman Sachs - Analyst*

That was very clear, Don.

So, Gary and Don, as follow-up on two topics that have been in the news lately -- just any comments you might have on either of them would be great. One would be thoughts on the union strikes that have impacted your two facilities? And then, how you're responding to it, and how we should think about the path forward there?

And the other is the crude export discussion, which seems like the volume around that has died down a bit. But, Gary, I know you spend a lot of time in Washington talking to policymakers, so your latest temperature on that issue would be great.

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

Sure. Let me take both of those, Neil. First of all, the union and the strike at various refineries around the country -- it has been very orderly. We have two plants that have been affected -- our Galveston Bay refinery and Catlettsburg. And we were very well prepared in the event that this happened at any of our plants. I would say we were very well prepared.

We are operating these plants at a very clean -- I should say, clean turnover, is the word I was looking for. Clean turnover when the union workers left, and we took over. And we would expect to continue to have very strong operations. And, as I said, we're well prepared. We were well trained, and when you have these type of incidents, you have to be prepared. So, we will continue to see how this plays out.

On crude oil exports, and this really comes back to the crude oil exports that -- and it's a definition of crude oil exports. What is being exported is condensate; and as I've said in the past, and I've said in Washington, we really do not see that the condensate is an issue for US refining. What we've always said in the past is that there's not a glut of crude oil on the marketplace. Therefore, some innuendo that there was a glut of crude oil, therefore, we have to be able to export light crude oil -- we did not see that as factual. And as we continue each month to close out the books, we continue to see areas where we did not get to the deliveries of light crude that we had expected. And then, the backdrop of that is to look at the imports that are coming into the country still suggest that we have at least 50% or so of the crude oil requirements of North America being imported.

So, looking at the condensate that is being exported, I'm not so certain that the volume has increased that much as maybe the media around this issue has dropped off more. So, I think that's really more of the subject that is going on. But it has not affected us.

And I come back to the most important thing to watch is how the exports coming into the US Gulf Coast -- or I should say the imports -- but the exports from the Middle East and others that are coming into the Gulf Coast is to continue to watch how that grows. Look at inventory that is building up in Houston and Cushing.

I looked at the numbers in the last couple days to see how Pad 3, Pad 2, and Cushing inventories, and for the last three weeks in a row have continued to grow. If I take it even back to October, November, December, those inventories continued to grow in those markets. That is what is key, I think, to watch, to determine where crude spreads might be going, and overall, where the crude price may be going.

Neil Mehta - *Goldman Sachs - Analyst*

Thank you for your comments.

Operator

Paul Cheng, Barclays.

Paul Cheng - *Barclays Capital - Analyst*

Hey, guys; good morning. Gary, clearly the 2014 was a very heavy turn-around year. If that means that now Galveston Bay is pretty much up to your standard? And any rough estimate for the 2015 total turn-around expense? In 2014, it was about $1.2 billion.

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

Right. As I said, last year, it may have been on the call this same period, that we knew 2014 was going to be a very large turn-around year, especially for Galveston Bay as we went through two of their very large units. Yes, we now have been through the majority of the big units, and have those units close to our operating expectations. I'll let Rich go into that in a little more detail. And, Paul, as you know, we do not give out the actual numbers, nor do we give out a calendar for what our turnarounds are for this year. But it is going to be significantly less than the expenditures we had last year.

We had -- Don, do you want to cover that?

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

Yes, Paul. This is Don. You rightly note about $1.2 billion of turn-around expense last year. If you look at our guidance [through] just the outlook for the first quarter of 2015, you compare that to the first quarter of 2014. Our turnaround -- the projected turn-around expense is substantially down, and it's probably in the $250-million range or slightly higher than that compared to first quarter of 2013. So, we would also expect there to be a bit of that, that would play through at the rest of the year, but that's in the guidance, or the outlook information, that we have provided there.

Paul Cheng - *Barclays Capital - Analyst*

Don, is there a rough number for the cycle turn-around course for you guys? Is it $900 million a year? $800 million? $1 billion? Any rough number you can share?

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

I would say that number has probably been in the $800-million range broadly. It's hard to point to a typical year. I would say last year was $1.2 billion. Maybe there is a $400-million differential this year to last year. But it's hard to -- each year is different, and it depends on which units are being turned around and whatnot. But I'd say broadly, that would be a good guide.

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

And, Paul, let me ask Rich to make any comments after he has finished these two big turnarounds -- any further comments on what you see in the plant, and how you are in your staged planning that we talked about back at the acquisition date?

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

Well, we continue to work through, and we still have some more turnarounds out in the future on some of the CAT and ALKY areas, but that's out in the out-years. So, we've been through some of the crude units and the hydrocrackers, and we've been refurbishing them and getting them up to our standards. And we've seen, through last year, we've set record production rates on a number of units at that refinery, and we continue to optimize it. I think it's a great platform going forward.

Paul Cheng - *Barclays Capital - Analyst*

Okay. The second question: Do you have an update about where is the Capline discussion with your partners? And also, Mike, do you have -- well, maybe this is actually for Don. Do you have a number that what is the biodiesel branding credit -- that the catch-up from the last -- from the first nine months of the year, that you booked in the fourth quarter? Thank you.

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

Paul, that was about $40 million -- the biodiesel impact.

Paul Cheng - *Barclays Capital - Analyst*

Full year or just nine months, is the catch-up?

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

It was about $40 million for the catch-up, yes.

Paul Cheng - *Barclays Capital - Analyst*

Okay, thank you.

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

And, Paul, on Capline, we've talked about this somewhat before. We're completing the engineering -- and the engineering to reverse this pipeline is not that difficult. The engineering study will be complete here in the first quarter.

But the longer-term effect is really the commercial; and it really goes back to -- and especially in this crude market that we're seeing today, we have a lot of analysis to understand where is the -- do we have enough supply? And it needs to mainly be heavy -- so, Canadian heavy-type of input. And it's enough supply to be able to satisfy those refineries in the upper Pad 2 markets who have already converted and require Canadian heavy in order to be able to fill up their cokers.

And then, secondly, how much volume is available to get all the way down to the St. James and Louisiana Gulf Coast. So, that is the big study that is going to take the balance of the year to understand where you can line up the supply, how the supply will move to the markets, and how that supply may affect some of the upper Pad 2 refineries I discussed earlier.

Paul Cheng - *Barclays Capital - Analyst*

Thank you.

Operator

Jeff Dietert, Simmons.

Jeff Dietert - *Simmons & Company International - Analyst*

Good morning. I was wanting to follow up -- Don, I believe you mentioned same-store sales in your discussion lead-in. But I wanted to make sure I understood the January comparisons correctly. What were the comparisons for Speedway, and then for Hess, for January?

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

Why don't we turn that, Jeff, over to Tony Kenney who is with us today.

Tony Kenney - *Speedway - President*

Yes, Jeff. January, the gasoline same store, we reflect a negative 0.8% on gasoline, and that is only for the legacy Speedway stores. We are not tracking yet same-store metrics on the Hess assets until the 13th month when we have confidence in those metrics.

Jeff Dietert - *Simmons & Company International - Analyst*

Got you. Were there specific things that you attributed that decline to? The DOE stats are reporting gasoline up 7% or 8%; distillate up 5% or 6%, which -- sometimes those get revised in the monthly data. But I was curious if there's any specific items that cause yours to be lower? And anything that you're expecting to see on a response on the demand side to these lower prices?

Tony Kenney - *Speedway - President*

I guess what I would say is that, from a Speedway and Hess side of the Business, during the month of January, we actually saw about just under a 10% increase in the wholesale cost to our Business. So, as we have attempted to pass along those increased costs to the market, that price elasticity does come into play for us. So, as we're out there with those prices, there may be some shifting between gasoline volume between competitors in the market. And that's generally what I would say that the .8% reflects for Speedway.

Jeff Dietert - *Simmons & Company International - Analyst*

Great. And, secondly, your Hess retail -- obviously terrific performance in the quarter; excellent margin environment. Could you talk about operations and sales volumes, and how they're performing relative to expectations? And any update to synergies that you have there?

Tony Kenney - *Speedway - President*

Jeff, I would say that I'm very pleased with the overall -- from the very beginning -- we took over the operations on October 1. And really, a lot of credit goes to the wonderful people and the execution and the focus that Hess had on the business. It was seamless. So, the ongoing, day-to-day operations -- and probably the most important aspect is making sure we're taking care of the customer. And we've got some very good feedback from our customers. They've acknowledged the performance. I've been very pleased on that side of it.

In terms of the overall business, I think we're seeing that, as we continue to implement the best practices at a stepped-up pace, the conversions in branding from Hess to Speedway, as well as the implementation of the technology platforms inside the store, such as our Speedy rewards program, those are all generating the types of benefits that we would expect from that activity.

And a comment in terms of the synergies, we met the $20 million in the fourth quarter of 2014 that we told the market, and we are on pace to hit the 2015 mark as well for synergies. So, so far, so good.

Jeff Dietert - *Simmons & Company International - Analyst*

Thanks for your comments.

Operator

Chi Chow, Tudor, Pickering, Holt.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Great. Thanks. This is fantastic fourth-quarter earnings. It doesn't look like you're getting much credit, quite frankly, in the market today. So, I guess the question is: Don, you outlined, in some of the waterfall charts, the uptick on the product price realizations. I'm just wondering: Can the Company sustain that outperformance on those realizations when crude prices stabilize or increase? Or will that performance reverse in that sort of commodity price environment?

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

Chi, this is Don. I would say, broadly, if prices are falling quickly, we tend -- it tends to be sticky coming down, and we tend to outperform. If prices are rising quickly, the inverse is true. We tend to -- it tends to take us a little while to catch up.

So, in a flat environment, I would say we will typically perform consistent with how we've done in flat environments. In a dropping price environment, we tend to outperform. And this is really against the market metrics, as opposed to our ability to capture margin, but it's against the market metrics. And then, in a rising price environment, we tend -- the capture rate, at least as it's reflected against those market metrics, tend to show that we're not getting all of that as the price runs up.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Okay. Great.

And you also talked about realizing lower crude acquisition costs. Can you comment on that versus the indicators? And have you changed your crude slate versus historical levels? And is that lower cost basis sustainable in the coming quarters?

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

Yes, Chi, I would say that when you look at the crude slates in general, there have not been very significant changes to the crude slates. As you know, we basically have a process in place where we will take advantage of whatever the most advantageous crude is during a month when we're optimizing. So, I don't think that the changes to the crude slates have been huge.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Okay.

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

We continue to focus on the domestic crudes -- North American crudes -- Canada, as well as the US, and I think that will continue to be the case.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Okay. I guess one more question on the crude market then: Gary, you've talked about, and you made some comments today also that you don't really see a glut of crude developing in the Gulf Coast. Yet at the same time, you also comment on looking at rising inventory levels, and I think Mike even mentioned that maybe the WTI-Brent widens out beyond $5 here. How do you reconcile those two statements on no glut versus potentially widening differentials?

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

Well, I'm going to have Mike Palmer cover this, but the comments that have been made before is that there is a glut of light sweet crude. We ran 51% sour in the quarter, which means we ran 49% sweet. That says we -- and we believe we can run up to about 65% sweet crude -- light sweet crude -- in our units. That suggests we have a tremendous runway to run more light sweet crude if it is priced -- if it is at the right barrel. And if you look at the alternative barrel, if it's the next-best-price barrel, then that's what we would buy.

Let me have Mike go into this in a little more detail.

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

Yes, it's kind of an interesting phenomenon where you get the Pad 3 inventories that have been consistently rising. But certainly, that doesn't appear to be in the very light sweet crude oil, especially when you look at differentials. The differential between LLS-Mars has been fairly consistent around that $4 level, and there has been no compelling advantage to buy these light sweet crudes. And certainly when we look at the market today, and if you're in the market on a spot basis for some of these, again, light sweet shale crudes -- they're not very plentiful.

So, the inventories that are building up -- we don't have a breakdown of exactly what that is. But certainly the differentials don't reflect the fact that it's a glut of this very light sweet shale crude that producers have been worried about.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

So, Mike, are you suggesting then the inventory build is more on mediums? You think it's Gulf of Mexico-produced crudes? Or are there imports -- incremental imports coming in?

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

I think it's a combination of all those things, to be honest. I think that the other thing that is happening, as you know, is that the logistics systems continue to build out, so there's more line-fill that's needed. I think that's one of the differences between this year and last year. But we certainly don't see this glut of this very light material that producers have been worried about.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Okay, great. Thanks for your comments, appreciate it.

Operator

Brad Heffern, RBC Capital Markets.

Brad Heffern - *RBC Capital Markets - Analyst*

Good morning, everyone. One for Don, maybe, just looking at debt levels, certainly they've ticked up since the Speedway acquisition. I'm wondering how you think about returning cash to shareholders versus maybe using some cash to pay down debt?

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

I think our view and our commitment is to maintain an investment grade credit profile, so that will guide all of our actions around what our balance sheet looks like. And right now, we feel comfortable that our balance sheet comfortably supports an investment grade credit profile. And as we make investments in the Business, and as we continue to look at M&A opportunities, we will continue to evaluate what the balance sheet needs to look like to make sure that we don't cross the line or put any pressure on that investment grade credit profile.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay. Great. And then, I think the Canton condensate splitter has been online for a little while now. Can you talk about how that's running, and the benefit that you're seeing?

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

Yes, Fred. This is Rich Bedell. We put the Canton splitter online right at the end of the year, and it's running -- we've run it up to design capacity. We're running maybe 20,000 barrels a day in it right now. So, it's running very well.

Brad Heffern - *RBC Capital Markets - Analyst*

Great. Thanks.

Operator

Mohit Bhardwaj, Citigroup.

Mohit Bhardwaj - *Citigroup - Analyst*

Thanks for taking my question. Gary, we spent a lot of time looking at crude differentials and also talking about your integrated business. But one of the things that we've -- a lot of people forget is about some of the other feedstock prices like VGO prices, and they have been really low of late if you compare the differentials versus the traditional differentials that they had as compared to, say, a lower Brent pricing. Could you just talk about that? How does that impact your Business, and what kind of benefit it has been over the last six months?

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

Yes, this is Mike Palmer. Yes, what I would say is that we are a big player in that feedstock market. And, generally, when you're talking about VGO -- as you know, the VGO is just extremely sensitive to the operations of those Gulf Coast refineries. If you have a cat cracker go down, and it's surplussing VGO into the market, you can get very attractive differentials; and that is true of planned turnarounds as well.

So, that's a market that we're involved in all the time -- buying and selling in VGO. Our position changes depending upon our turn-around schedule, but it's something that we always take advantage of.

Mohit Bhardwaj - *Citigroup - Analyst*

Is there a number that you can provide -- was it anything different last year? Or is it really what your normal operations are, and there was no significant impact of it?

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

I don't think we really have any comparisons that we could provide today.

Mohit Bhardwaj - *Citigroup - Analyst*

Okay. Thank you.

And I know that we are just running over the hour here, but one final question. Don, you just mentioned M&A opportunities, and could you just comment on -- especially on the logistics side, if you're seeing, especially in the light of the crude prices where they are, do you see more opportunities here just to grow MPLX as you guys want to, with the higher rate of drop-downs and also high rate of distribution growth over there?

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

Mohit, this is Gary. The market that we are in -- and we're seeing many opportunities come across our desks throughout the entire market. I think we're very well positioned, if something made sense -- we're well positioned within our balance sheet, and very well positioned with MPLX if something made sense within the logistics or midstream side of the Business. We would, I think, be in a good position to be able to act. But the key here is to be cautious and to do your -- continue to do very strong due diligence on anything that might become available, because I think there will be more and more things available in the marketplace as we go forward.

Mohit Bhardwaj - *Citigroup - Analyst*

Thanks for your comments.

Operator

We will now turn it back to Tim Griffith for final remarks.

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

Thanks, Brandon. We want to thank everyone for joining us today, and for your interest in Marathon Petroleum. If there are additional questions or you'd like clarification on any of the topics discussed this morning, Geri Ewing and Teresa Homan we will be available to take your calls. Thanks for joining.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for joining. You may now disconnect.