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MPC - Q1 2015 Marathon Petroleum Corp Earnings Call

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OVERVIEW:

MPC reported 1Q15 earnings of $891m or $3.24 per diluted share.

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PRESENTATION

Operator

Welcome to the Marathon Petroleum First Quarter 2015 Earnings Conference Call. My name is Cynthia and I will be your operator for today's call.

(Operator Instructions)

Please note that this conference is being recorded. I will now turn the call over to Geri Ewing. Ms. Ewing, you may begin.

Geri Ewing - *Marathon Petroleum Corporation - IR*

Thank you, Cynthia. Welcome to Marathon Petroleum Corporation's First Quarter 2015 Earnings Webcast and Conference Call. The synchronized slides that accompany this 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, Executive Vice President of Supply, Transportation and Marketing; Tim Griffith, Senior Vice President and Chief Financial Officer; Mike Palmer, Senior Vice President of Supply, Distribution, and Planning; Rich Bedell, Senior Vice President Refining; Pam Beall, Senior Vice President of Corporate Planning, 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. These results may differ materially from what we expect today. Factors that could cause the results to differ are included here, as well as in our filings with the SEC. Now, we turn the call over to Gary Heminger for opening remarks and highlights.

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

Thank you, Geri and good morning to everyone. I appreciate you joining our call. We are pleased to report record first quarter results with $891 million of earnings. The outstanding results demonstrate our ability to take full advantage of favorable market conditions. MPC's extensive logistics and retail networks give us tremendous flexibility in feedstock acquisition and the ability to optimize refining operations and product distribution throughout our marketing footprint.

MPC's integrated refining system made a significant contribution to the quarter's earnings with the refining and marketing segment generating $1.3 billion of income during the quarter. Our refineries operated very well and we were able to capture the strong Gulf Coast and Midwest crack spreads. First quarter results also benefited from lower maintenance activity relative to the first quarter of last year.

I am particularly proud of the dedicated employees at both our Catlettsburg and Galveston Bay refineries for operating our facilities safely, efficiently, and without production impact during the recent work stoppage, which has ended at Catlettsburg, but continues at Galveston Bay. We look forward to a successful resolution at our Galveston Bay complex in the near term.

Speedway, MPC's retail segment, also performed very well during the quarter. Speedway's earnings, independent of the contribution from newly acquired retail operations, resulted in a record first quarter. Speedway continues to make excellent progress transitioning its new retail locations to the Speedway brand. As of today, we have converted more than 400 stores, including 260 completed during the first quarter.

The comprehensive transition for each store not only includes the changing of signs and canopies, but is a complete system changeover, which includes the back-office, point-of-sale, and inventory control systems, as well as integration of the Speedy Rewards loyalty program. With the majority of the Florida stores now converted, crews have been focused on conversions in the Northeast for the past month.

This rapid pace of store conversions contributes to our confidence that we will achieve the synergies and marketing enhancements we expect as we integrate this business. I am pleased to announce that MPC's Board has authorized the sale of its marine logistics business to MPLX, which we expect to close in the next several months.

MPC's marine transportation business is a fully integrated waterborne transportation service provider consisting of 18 towboats, 203 tank barges, and related assets supporting movement of light products, heavy oils, crude oil, renewable fuels, chemicals, and feedstocks throughout the Midwest and Gulf Coast regions of the US. The addition of the marine business to MPLX, along with its very stable earnings and cash flow, would support our plans to accelerate the growth of the partnership and provides increased asset diversity as MPLX continue to grow rapidly.

MPLX also completed a binding open season for its cornerstone pipeline project, which is being increased in diameter to 16 inches to provide an industry logistics solution, including opportunities to connect many Midwest refineries to production from the Utica shale with the potential to ultimately reach Chicago area refineries and pipelines that supply the diluent to Western Canada. This type of organic growth, in addition to both MPC-sponsored drop downs and third-party acquisition opportunities, demonstrates our commitment to grow MPLX into a large cap diversified MLP with an attractive distribution profile.

In addition, MPLX declared a $0.41 per common unit cash distribution last week, which puts MPC's general partner interest MPLX in the highest tier of the incentive distribution rights. The long-term growth profile of MPLX will provide significant value to MPC shareholders over time. We continued our commitment to capital returns in the first quarter with $209 million of shares repurchased in addition to $136 million in dividends.

In addition to the $0.50 per share dividend declared yesterday, our Board also announced yesterday a two for one stock split in the form of a stock dividend to be distributed to MPC shareholders on June 10. MPC has performed very well for its owners since we became an independent Company in mid-2011. Our share price has increased substantially since the spinoff and this stock split reflects our confidence in MPC's continued value creation making our shares more affordable for a wider range of investors.

The stock is expected to begin trading on a split basis on June 11. MPC's geographic footprint and large integrated platform, coupled with favorable market conditions, create a positive outlook for the business. Our large, integrated platform provides us excellent access to price advantaged domestic crude oil and low-cost natural gas and the significant planned maintenance activity we performed in 2014 has positioned us to run at high utilization for the balance of the year.

We also continued to invest in refining margin enhancement projects with approximately $830 million of ongoing capital investment over the next three years for projects focused on increasing our light sweet crude and condensate processing capacity, expanding our export capabilities, and increasing our distillate production. These projects are expected to generate approximately $650 million of annual EBITDA and exemplify the high return capital projects available across our system.

We are pleased with the startup of the condensate splitter at our Canton refinery in December, which is already operating above its 25,000-barrel per day design capacity. We look forward to the startup of the 35,000-barrel per day condensate splitter in Catlettsburg, which is expected to be online by the end of the quarter, positioning us very well as condensate production this region continue to grow.

Our efforts to accelerate the pace of growth at MPLX, grow our retail segment, and enhance refining margins support the diversified earnings power of the business and we remain confident in our ability to deliver long-term value for our shareholders. With that, let me turn the call to Tim to walk through the first quarter results and an update of our financial position. Tim?

Tim Griffith - *Marathon Petroleum Corporation - SVP & CFO*

Thanks, Gary. Slide 4 provides earnings, both on an absolute and per-share basis. As you can see in the green bars in the chart, our financial performance for the first quarter was quite strong. MPC had earnings of $891 million or $3.24 per diluted share during the first quarter of 2015 compared to $199 million or $0.67 per diluted share in last year's first quarter.

The chart on slide 5 shows by segment the change in earnings from the first quarter of last year. The primary drivers for the change was the $954 million increase in refining and marketing and the $110 million increase in Speedway income, partially offset by higher income taxes associated with those higher earnings. Turning to slide 6, refining and marketing segment income from operations was $1.3 billion in the first quarter of 2015 compared to $362 million in the same quarter last year.

The increase was primarily due to higher crack spreads in the US Gulf Coast and Chicago regions, as well as lower turnaround and other direct operating costs in the business. The higher blended crack spread had a positive impact on earnings of approximately $449 million. The blended crack spread was almost $2 per barrel higher at $9.69 per barrel in the first quarter compared to $7.85 per barrel in the first quarter of 2014.

The $503 million year-over-year benefit in direct operating costs relate primarily to the substantially lower turnaround activity in the first quarter versus the first quarter last year. Turnaround and major maintenance costs decreased to $0.79 per barrel in the first quarter from $3.15 per barrel in the same period in 2014. The lower turnaround activity also benefited throughputs, which were 202,000 barrels per day higher than the same period last year.

During the quarter, we recognized a reduction on our projected refined product inventories. The cost of these inventories was based on prices in early 2014, which were much higher than current prices. As a result, we recognized a pre-tax charge of approximately $30 million in connection with this LIFO inventory reduction.

On slide 7, we provide the Speedway segment earnings walk for the first quarter.

Speedway's income from operations was $110 million higher than in the quarter than in the first quarter of 2014. Speedway's newly acquired locations are performing better than expected, contributing income of approximately $36 million to the quarter's results or approximately $68 million of EBITDA during the period. For the legacy Speedway sites, the light product gross margin was about $70 million higher in the first quarter of 2015 compared to the same period last year.

Overall, the Speedway segment's gasoline and distillate gross margin increased by more than $0.08 to $0.197 per gallon in the first quarter versus the same quarter last year. Merchandise gross margin was $22 million higher in the first quarter of 2015 compared to the first quarter of 2014 for those legacy locations. On a same-store basis, which excludes locations acquired within the past year, gasoline sales volumes decreased 1.2% over the same period last year.

Merchandise sales in the quarter, excluding cigarettes, increased 6.2% on a same-store basis on a year-over-year basis. In April, we have seen no change in same-store gasoline volumes compared to last April.

Slide 8 shows the changes for our pipeline transportation segment versus the first quarter last year. Income from operations was down $5 million to $67 million in the first quarter.

The decrease was primarily due to increases in various operating expenses and lower pipeline affiliate income, partially offset by higher transportation revenue in the quarter. Slide 9 presents the significant elements of changes in our cash position for the quarter. Cash at the end of the quarter was $2.1 billion. Core operating cash flow was a $1.2 billion source of cash. Working capital was essentially flat for the quarter.

Long-term debt was a $103 million source of cash during the quarter, which was driven by MPLX's issuance of its first public debt during the quarter. Proceeds from the upsized debt offering were used to pay down its revolver, as well as for the continuing growth of the partnership. We continued delivering on our commitment to balance investments in the business with return of capital to our shareholders. We repurchased $209 million of shares and paid $136 million of dividends in the first quarter.

Share count at the end of the quarter was 272 million shares, reflecting share repurchase activities since the spin of about 25% of the shares outstanding.

Slide 10 shows that we had $2.1 billion of cash and approximately $6.7 billion of debt at the end of the quarter. With EBITDA of about $6.5 billion during the last 12 months, we continue to be in a very manageable debt position with about one turn of EBITDA and the debt to total capital ratio of 36%.

The strong cash generation of the business, highlighted by the $1.2 billion in the first quarter, continues to provide great flexibility as we pursue this balanced approach in our capital allocation.

Turning to slide 11, we've generated $3.5 billion in cash from operations and $1.4 billion of adjusted free cash flow during the last 12 months. Over this same period, we've returned about $2.2 billion to shareholders through dividends and share repurchases or approximately 1.6 times our adjusted free cash flow.

During the first quarter of 2015, we repurchased 2 million shares for $209 million through open market repurchases. It's our intention to continue to return capital to our shareholders that have 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 12 provides updated outlook information on key operating metrics for MPC for the second quarter.

We are expecting second quarter throughput volumes to be up about 93,000 barrels a day compared to second quarter 2014 and up about 75,000 versus first quarter 2015, due to less planned maintenance. Since we have no comparable 2014 data that includes the newly acquired Hess locations, we are continuing to provide Speedway outlook information by quarter for 2015. For the second quarter of 2015, we project Speedway's light product sales volume will be approximately 1.5 billion gallons. With that, let me turn the call back over to Geri.

Geri Ewing - *Marathon Petroleum Corporation - IR*

Thanks, Tim. As we open your call for questions, we ask that you limit yourself to one question plus a follow-up. You may reprompt for additional questions as time permits. With that, we will now open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Evan Calio, Morgan Stanley.

Evan Calio - *Morgan Stanley - Analyst*

Strong results. My first question, Gary, could you elaborate on your opening comments regarding the favorable market conditions that you referenced? And as there's always investor apprehension around early summer margin compression, do you see any industry elements that reduce margin volatility and more particularly, MPC's ability to perform better through those periods of seasonal weakness, given willingness to return cash to shareholders and generate additional proceeds the via drop downs?

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

Sure. Evan, first of all on the market conditions, yes, we had a very strong first quarter. Turnarounds in the Gulf Coast, as well in the Midwest, I think a little bit earlier in the Midwest than we've seen historically, helped us. And as we've been able illustrate and as we've talked about with investors, we do very well when you have volatility in the marketplace and being able to capture margins because of the logistics systems that we have.

However, in this first quarter, when you compare against our prior quarters, we didn't have that big other net adjustment, or I shouldn't say adjustment, but that other revenue gross margin that we have illustrated in the past because it was more of a stable quarter from crude prices. But there were some upticks in different wholesale margins.

Going forward, though, to your question, as we look here in the second quarter, Mike Palmer can get into this in more detail than I, we continue to have a very robust export market and I think the export market is going to continue to give not just Marathon, but the industry a solid performance going forward because of those export markets.

We are being very careful to watch inventories across the regions that we operate, to keep an eye on inventories because certainly, refiners want to run full out with the crack spreads that we've seen to date. But I think the ability of us being able to reach the export market and capture the margins both at the crack spread and the differentials that we're seeing in the marketplace are going to help us. Mike, do you want to add any color to the exports?

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

Gary, I think you addressed it pretty well. As you said, I think that the export market for us continues to be as good as it's been. We continue to grow volumes and we don't expect that to change. So I think looking at the second quarter, the product inventories have been pretty well behaved relative to the crude inventories that have grown a lot. So right now, the second quarter looks pretty good.

Evan Calio - *Morgan Stanley - Analyst*

Great. That's great. And the domestic market looks pretty strong, as well. My second question, can you give us an update on BP Texas City integration and how it's operating? It appears you're capturing a higher percentage of your benchmark now for several quarters. I was just wondering if you were seeing upside to your synergies since the acquisition and integration. Any comments there?

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

Rich, would you handle that please?

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

Sure. We're in the middle of some of the integration projects of tying the two plants together, in fact, pipe rack is getting ready to go across between the two plants. But we've also been able to capture some synergies on crude and storage and utilizing the gas oils and the cat crackers, so those items have all come to fruition. I don't know Mike, if you have any other comments about -- shaking his head no. But yes, we've been very pleased with the performance of Galveston Bay.

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

The other thing that I would add to that, Evan, is in my comments, I talked about the $830 million of CapEx with a $650 million of EBITDA, part of that comes from Galveston Bay. And do you recall in the first two years that we operated Galveston Bay, we really were going in and doing turnarounds and trying to get the plant operationally headed towards our method of operating and some of our operational excellence metrics.

So we're just now starting into the process of being able to capture some of these low hanging fruits that we think have outstanding returns and that's why I stated $830 million of CapEx, but $650 million of EBITDA per year, part of that is coming from Galveston Bay and, as you can recognize, those are very high returns.

Evan Calio - *Morgan Stanley - Analyst*

Great. Thanks, guys.

Operator

Ed Westlake, Credit Suisse.

Ed Westlake - *Credit Suisse - Analyst*

Also good to see the operating cost performance coming through as you run the operations more fully this year. Two questions: you give us the cornerstone update. That looks like it's moving ahead. Any updates on Sandpiper/SAX that you could share and obviously, the proposal to reverse Capline?

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

Mike, you want to take Sandpiper/SAX and I'll handle Capline?

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

Okay, Gary, that sounds fine. Yes, Ed, with regard to Sandpiper and SAX, it looks very positive for us. SAX, I think we've cleared all the permitting hurdles that we've had. Construction is going to begin this summer. We would expect to see SAX operating sometime in the fourth quarter. With regard to Sandpiper, I think, as we've talked about, we did have some permitting delays in Minnesota, but in April, the administrative law judge did basically rule in favor of the certificate of need.

He made a recommendation to the Minnesota PUC that the project go forward and the certificate of need be granted, so that was very, very positive. And we're waiting on that ruling that will take place within the next couple months and then it will go into a routing hearing as well, but things look very positive to date.

Ed Westlake - *Credit Suisse - Analyst*

Good to hear.

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

Ed, on Capline, really no news from when we spoke lastly. As I've stated before, technically, it's not very complex to reverse a pipeline like this. It just takes time and you have to have everything in order so that you can continue to move barrels from the south to the north, if you were to reverse this.

But as I've said stated before, and I gave a speech at the CERA conference last week where we had a few questions on this as well, we're still in the throes of discussing with the other owners the interest in doing so. And it's going to continue to take some time, I believe, to get all of the owners on the same page that this appears to be the right thing to do.

Ed Westlake - *Credit Suisse - Analyst*

Okay. Thanks very much, Gary.

Operator

Neil Mehta, Goldman Sachs.

Neil Mehta - *Goldman Sachs - Analyst*

First question relates to the retail business. Clearly, integration's going very well with Speedway. Gary, I wanted to get your thoughts on potential monetization of those retail assets and are there ways or other structures in which you could get the full value of those assets that might not be fully reflected in the shares right now?

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

Well, clearly, Neil, there are different structures and avenues that you can take. We have looked at those over the time or say over time and they do not make sense to us at this time to consider other types of structures. First and foremost is to get what we now call Speedway East fully transitioned, converted over into the type of operation that Tony runs, which I'm very pleased with how the progress that they're making, both in getting the stores converted and secondly, the inside sales results bump that we're starting to see. So those are the key things.

And we started an MLP back in 2012 and that has been very fruitful for starting that and we've talked about the fuels distribution. And in order to be able to do a fuels distribution piece inside our MLP, is we're counting on these volumes to be there. So I would just say that we remain flexible. We have many options that we could play down the road if we wanted to and we'll just continue to analyze.

Neil Mehta - *Goldman Sachs - Analyst*

All right, Gary. Second was more of a macro question here. LLS, Brent has looked tight here. Just you have a unique vantage point on this and potential bottlenecks between Houston and St. James. Curious on your thoughts in terms of the dynamics there and what's needed to get the spread to be able to yield?

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

Certainly a very timely question. Let me have Mike address this.

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

Okay, Neil. Yes, the LLS Brent differentials of late have been near parity back and forth. I think currently, we're at about $1 spread with LL under Brent. If you look at the forward market, the forward market suggests that it ought to be in the $3 kind of range and I think that's plausible. I do think that we still have some logistical constraints moving all of the light sweet down through Houston and of course, into the St. James area and companies are working on that continually.

But there's also, I think, a misconception in the market that we have this large overhang in Houston or somewhere of this light sweet shale crude and I guess what I would say to you is I don't think that's really the case. I think that first of all, I think that refiners have been doing a very good job of keeping up with the light sweet production that we've got in this country. We're running more than we've run in the past.

We're not saturated within our Gulf Coast plants on the amount of light sweet that we could run. And I also think that the producers have done a better job of clearing the market than maybe what many people in the trade press understand. There's a lot of this light sweet crude that is going on foreign flagships to Canada. The number's in excess of 400,000 barrels a day. We've got another 50,000 barrels a day plus that goes on Jones Act vessels into the East Coast.

That number fluctuates, depending on what the ARB is. But in addition to that we've got another roughly 50,000 barrels a day of condensate exports that are occurring under the BIS rulings. So I would argue that the producers have done a pretty good job of clearing that market. I do think that, as inventories continue to build in the Midcontinent and more of those barrels maybe go to the South, that you should see the differentials widen. And then again, that $3 level makes sense to us.

Neil Mehta - *Goldman Sachs - Analyst*

Thank you very much.

Operator

Paul Cheng, Barclays.

Paul Cheng - *Barclays Capital - Analyst*

Gary, one of your competitors when they announced a negative earnings for the first quarter, one of the reasons cited is that, given the strike at one of their recently bought facilities, in this case that would be Carson, because they didn't have enough people in the headquarter that have worked in that facility. And so as a result even though they've been able to run it, that there's a huge degradation or efficiency loss.

Wondering that, in your case, that in Galveston Bay, that you experienced any of those kind of yield degradations or efficiency loss? In other words, that when the strike is over, should we assume we could have another improvement in the operating performance?

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

Yes, Paul. First of all, I again, want to recognize our team, both Catlettsburg and Galveston Bay, but you're specifically asking about Galveston Bay here. And a gentleman who -- I went down to the plant, Rich and I went together, went down and visited the plant just a few weeks ago and I was really impressed by our Management and the shift foreman and the superintendents who were running the facility.

This is something that we train and we train diligently to be prepared. And from day one of taking over this refinery, this was our plan to make sure we always had a trained workforce, no matter what the event, that could come in and help out. So I would say, and I'll let Rich talk about it in more detail, but we've set new records on a number of process units and we've been able to get a backlog of maintenance completed and doing it all in a very, very safe manner. And Rich, you want to go into some of the details?

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

Yes, I think I hit on it. We've run both Catlettsburg and Galveston Bay, we basically ran them full-out through all this time period. We have a lot of people in the refining organization within the Company. We've got waiting lists of people to go in if need be. So we're well-equipped to staff Galveston Bay for as long as it takes. And like Gary said, we've set production rates. We lowered our -- I mean, our costs are down, our rates are up. So it's been doing a great job by the people at Galveston Bay and Catlettsburg.

Paul Cheng - *Barclays Capital - Analyst*

My second question, Gary, do you have any insight in terms of the US economy when you're looking -- even though today, you no longer do as much of the diesel sales, but when you're looking at your retail network, any insight you can provide? And also, whether you would be able to get give us what is the RIN cost to you in the first quarter?

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

Okay. I'll let Don or Mike handle the RIN costs. As far as the US economy, we're continuing to see strong diesel demand across all the PADD'S, kind of 1.3% to 1.5% increase in distillate demand, which I think is really a precursor to how the economy continues to move. And these are good increases based on last year's substantial increase, as well.

So the thing that is a bit, I wouldn't say concerning, but as we try to reconcile the numbers that come out from a number of the government agencies and other groups who put out numbers, I think the gasoline demand, I don't believe and it's just not Marathon's numbers, but I look at what other competitors are saying in their earnings calls and talking to a number of our jobbers as well, the numbers are coming out from EIA on gasoline demand did not quite sync with what we really believe the gasoline demand is looking like. I think they're a bit overstated.

But when I look back then at Tony's merchandise sales and customers in the store, we certainly are capturing increases in merchandise sales across his entire chain, which tells us that the customers are there. And I think, especially here in the first quarter, we have so many areas that were hampered by very challenging storms, both Midwest, Northeast, and then in the Southeast, mid-first quarter had a number of stores that were closed because of weather.

So I think as we get out into the second quarter, we're going to have a much better barometer on how gasoline demand is going. Here in, starting off in April's business, we're up a little bit on gasoline demand so far in the month. So I'll turn it over then, to Don, to talk about the RINs.

Don Templin - *Marathon Petroleum Corporation - EVP of Supply, Transportation, and Marketing*

Sure. RIN expense for the first quarter was $41 million, Paul.

Paul Cheng - *Barclays Capital - Analyst*

Thank you.

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

Chi Chow, Tudor, Pickering, Holt. Got a couple quick questions on the marine business. Can you give us any sort of annual EBITDA estimate for those assets? Do you -- is the business all MPC-related or do you have third-party business flowing through those assets? And any comments on the tax basis on the assets?

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

Okay. Don?

Don Templin - *Marathon Petroleum Corporation - EVP of Supply, Transportation, and Marketing*

Chi, the EBITDA, annual EBITDA is about $115 million and that is all related to MPC activity. So essentially, we also charter out, but those specific assets would be dedicated entirely too moving MPC volumes. So that's the EBITDA perspective. What was the last question, I'm sorry, Chi? The tax basis? Yes. They have a relatively low tax basis and that's not inconsistent with some of the other assets that we have that would ultimately be dropped into MPLX, but relatively low tax basis.

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

But obviously still tax efficient on the MPC level? Okay. So another question on MPLX. I don't know if I'm doing my math right here, but I believe your guidance on EBITDA run rate, coming at the tail end of 2015, is $450 million. Is that correct?

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

That's correct.

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

You also have a 29% distribution growth target, at least for this year. It seems like there's a mismatch on my numbers and it suggests that you may end up with a coverage ratio that's well above industry average. Am I doing the math right there and is that the intention?

Tim Griffith - *Marathon Petroleum Corporation - SVP & CFO*

Chi, this is Tim. I don't think your math is flawed. Ultimately, our interest was to grow the partnership pretty substantially so that it had a base of earnings and a size and scale that would allow it to pursue projects on its own. So it is possible that in the first couple years, here, that coverage would run a little higher than our 1.1 target over that time period.

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

And is there some thoughts on the pace of bringing that coverage ratio down to really drive what I'm looking at on the MPC side, the GP distributions and the IDRs?

Tim Griffith - *Marathon Petroleum Corporation - SVP & CFO*

Well, there will be a natural migration back to about 1.1 over the course of the next several years. But again, over these first couple, you could well see a coverage ratio that's well above. So for how we have dropped assets thus far and our anticipated growth for MPLX, we'll see an earnings growth that probably will outpace the distribution growth early on and then those will converge over time.

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

Okay. Great. Maybe just one final question, any update on the Garyville hydrocracker decision?

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

We still pretty much have finished all the front-end engineering. And we won't look at this again until the fourth quarter when what we are working on the budgets for next year and the years following. And Chi, as you can recognize, it is all going to revolve around where we see the overall commodity price going over the next number of years.

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

Okay. Great. Thanks, Gary.

Operator

Paul Sankey, Wolfe Research.

Paul Sankey - *Wolfe Research - Analyst*

Could we just go back to your direct operating costs for a little bit more analysis, if that's okay? On slide 6, you show that year-over-year, it's about half of the uplift that you got from refining earnings. I just was wondering, can you break out a little bit how much of that was just the volume increase that we saw in that period and whether or not you can quantify some of the other issues? And I'm thinking I guess of fuel costs as helping against any other impacts there may have been. Thanks.

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

Tim, you want to handle that?

Tim Griffith - *Marathon Petroleum Corporation - SVP & CFO*

Sure, Paul, I think the biggest piece of that $503 million that we show in direct operating costs were just, frankly, the absence of a lot of the turnaround costs that were recorded in the first quarter last year on the year-over-year walk. The volume impact on that, we'll have to come back to you on specifically, but by far the biggest driver there was just the absence of turnaround activity relative to first quarter last year.

Paul Sankey - *Wolfe Research - Analyst*

I get that. And so obviously, there's a double cost that you were running less with the additional costs and that would be the vast majority of the uplift. I was wondering, is there anything to add on? I guess particularly your sensitivity to natural gas prices, which I guess didn't change a whole lot, but also where the lower oil prices also would boost your or rather reduce your operating expenses?

Don Templin - *Marathon Petroleum Corporation - EVP of Supply, Transportation, and Marketing*

Paul, the operating or energy costs were down in Q1 2015 about $80 million.

Paul Sankey - *Wolfe Research - Analyst*

Okay. Just totally separately, thank you, totally separately the buyback, I guess it's our forecast and it's our miss, but it was behind what we were thinking. Could you just talk a bit about how you're looking at the attractiveness of buying in more stock the pace at which you're doing that and whether or not it's a competition against, for example, higher CapEx? Thank you.

Tim Griffith - *Marathon Petroleum Corporation - SVP & CFO*

Paul, I think our primary drivers around how we're feeling that is, again, how we're situated on a core liquidity perspective as our first prime mover. Core liquidity in the environment of lower prices that actually declines to some extent, but again, we'll continue to manage the cash position of the Corporation in accordance with the needs.

The slightly slower pace in first quarter is not reflective of any change in approach or belief that the shares were appropriately valued or otherwise. We still think the shares are substantially undervalued and again, we'll continue to assess our capital and cash situation as we go and make adjustments. Share repurchase certainly affords us the best lever to make those adjustments and we'll continue to use it as such.

Paul Sankey - *Wolfe Research - Analyst*

I think your debt came down a bit in the quarter, but I assume that you're very much in the range of where you want the debt ratios?

Tim Griffith - *Marathon Petroleum Corporation - SVP & CFO*

Yes. The debt was, at a static level, unchanged but with the role of LTM EBITDA, we actually had more earnings. So the debt to EBITDA declined really as a result of earnings growth as opposed to debt reduction. But Paul, we're very much in the comfort zone with regard to where we need to be on maintaining an investment grade profile and we'll continue to manage it that way.

Paul Sankey - *Wolfe Research - Analyst*

Great. Thank you very much.

Operator

Doug Terreson, Evercore ISI.

Doug Terreson - *Evercore ISI - Analyst*

Gary, just to clarify your comments on Galveston Bay, it sounds like not only has the work stoppage not led to a reduction in output, but that production and efficiency have been pretty resilient and may have increased during the work stoppage. Is that the correct way to think about that situation?

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

Yes, it is, Doug.

Doug Terreson - *Evercore ISI - Analyst*

Okay. And then also, global oil demand growth has been surprisingly strong this year and you made some comments a few minutes ago about export markets and I just wanted to see if we could get some more color on the regional demand trends that the Company is seeing? And whether or not there's any highlights or drivers in the improvement that we're seeing that you think may be at work outside of the United States?

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

Yes. In fact, if you look at some of the announcement yesterday about how Saudi Aramco is going to really going to increase their supply efforts and I think try to increase their market share into the Asian market, namely, China, there are big questions about the Yanbu refinery coming up and Jubal soon to be operating, if that's going to affect the US market. And I was over there just a few weeks ago and it's clear to me that the output from those refineries is going to head east.

They have the best economics because they have the best transportation costs to go east with that product and I think that's directionally where it is expected to go. And even though China has global markets, when you look at the global markets and specifically at China, that the demand within their economy has fallen a bit. It's still up year on year and we would love to have those types of increases here in the US of how they are achieving growth in their markets.

So if you go back to the crude side, though, and I've said this on the call we had for the fourth quarter and in several energy conferences, you still need I think, investors need to look at where the crude is moving in the world. We're continuing to see very strong markets for imports of crude into the US. You're seeing more of the medium sours coming in and of those who have the equipment to be able to run medium sour and you look at our numbers for this quarter we ran about 56% medium sour.

That's up from where we've been and the reason being every day, we're buying the best barrel in the marketplace and medium sours certainly have been a very, very attractive barrel for us. Which comes back to say that there's still, I know Marathon, I don't know about all the other refiners, but it would suggest there's still, we have a lot of opportunity to run other light sweet crudes if they are marketed competitively with these medium sours.

And therefore, these medium sours are coming in from foreign locations. So what that tells you is we believe we are going to continue to see inventory growing in Cushing, in PADD 3. And as inventory continues to grow, as you can see the Contango market out there, we're pretty close, I think, to the top end of operational capacity, Doug, in the tanks in Cushing and some other markets.

And why I say operational capacity is, as a refiner, we want to be very careful that we don't degradate a type of crude that we're buying that ends up getting blended in with other crudes if you're sharing tankage. So we're pretty close to, I would say, to the high end of operating capacity and I think then, from watch foreign imports, watch the inventory grow, and I still believe that you're going to see, here in the second quarter, spread start to widen out.

Doug Terreson - *Evercore ISI - Analyst*

Great. Thanks for all the color, Gary.

Operator

Phil Gresh, JPMorgan.

Phil Gresh - *JPMorgan - Analyst*

First question is just on the midstream side. Given your desire to be a diversified MLP in the long-term, how do you think about the opportunity for M&A at this stage? And if we think about the potential for slowing crude oil production growth, could that accelerate the M&A in this space or just how are you thinking about this over the next couple of years?

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

Pam, do you want to take that?

Pam Beall - *Marathon Petroleum Corporation - SVP of Corporate Planning, Government & Public Affairs*

Sure, happy to do that. I guess first, I would say when we saw the crude prices fall, we thought that could potentially put more midstream assets on the market that may be captive to some producers. We've seen a little bit of that, but not a lot. And I think what we have seen is, despite the fact that crude commodity prices have been volatile and crude prices have declined, there's a lot of capital out there to help support producers and help support midstream companies that may be more exposed to commodity prices.

So I, with probably a few exceptions, I wouldn't say that we are seeing any distressed selling in the marketplace today, just from that standpoint. So we continue to evaluate opportunities, M&A acquisitions opportunities, in addition to the drop downs from MPC. And we're looking across the spectrum. As I've said before, those opportunities that would benefit both MPC and MPLX will always rise to the top of our interest list, but there certainly are a lot of different avenues that we could pursue to grow MPLX through acquisition and we've got a team of people that are very actively evaluating a lot of opportunities.

Phil Gresh - *JPMorgan - Analyst*

And as you evaluate the M&A opportunities, would you likely use MPC as a source of funding or do you feel like MPLX is large enough at this point to do sizable M&A, as you think about the trade-off between drops and M&A?

Pam Beall - *Marathon Petroleum Corporation - SVP of Corporate Planning, Government & Public Affairs*

I think each opportunity really will be fact- and circumstance-based. It's hard to make that general comment. Of course, one of the reasons we are committed to accelerating the growth of MPLX is to position it so that it could take on larger opportunities directly.

Phil Gresh - *JPMorgan - Analyst*

Okay.

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

That's what's good, Phil, is that we have the optionality and the flexibility to go either way. We aren't beholden to, like some who are not, maybe do not have the balance sheet to be able to do certain acquisitions, we have that flexibility. And if you go back to the color I just answered on Doug's question, if we look at wider spreads going forward into the second quarter, there could be pressure as we go out into the second, third quarter. We'll see where crude prices go, but there could be some further pressure that may open up the M&A activity a little more.

Phil Gresh - *JPMorgan - Analyst*

I see.

Pam Beall - *Marathon Petroleum Corporation - SVP of Corporate Planning, Government & Public Affairs*

There's a lot of private equity out there chasing opportunities.

Phil Gresh - *JPMorgan - Analyst*

Understood. On the retail side, with respect to the synergy capture at Hess, Gary, maybe you could just talk a little bit about where you stand today and what you think the biggest incremental source of upside could be as you look ahead with where you're at in the process?

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

Sure, Phil, and we have Tony on the line who's operating these stores every day and so let me have Tony handle that.

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

Thanks, Gary. As commented earlier, we're very pleased with the progress we're making on the conversions to the Speedway brand and along with that, includes the implementation of our merchandise programs inside the stores, which is a real source of synergies down the road. To date in 2015, we feel very good on the progress that we're making. We're going through the best practices of both companies that we committed to and that is, in and of itself, is a good source of the synergies that we're experiencing, primarily right now, on the expense side of the business.

So as we continue to go forward, we're going to start to realize some marketing efficiencies as well. So on a full-year basis in 2015, we're right on plan with where we expect to be on the synergy capture in 2015.

Phil Gresh - *JPMorgan - Analyst*

Okay. Great. Thank you.

Operator

Brad Heffern, RBC Capital Markets.

Brad Heffern - *RBC Capital Markets - Analyst*

Staying right there, I was wondering if you could give an update for the Hess stores that have been converted? Has there been any noticeable loss of customers or going the other way, have you been able to pull in more customers from other areas in Florida?

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

Yes. I'll take that. The benefit that we have with the conversion is our loyalty program. And these are the markets, Florida in particular and as we move into the Northeast, have really not had a strong presence of a retail loyalty program. So what we're getting is a lot of good interest in customers signing up for our loyalty program, which is probably the best benchmark we have right now in terms of how we're attracting new customers.

There's a lot of dynamics in play. Retail price, as the gasoline prices come down, I think that's driving traffic as well. So we're very careful on how we're analyzing that. And we've only got a little over -- we did the deal, it's seven months old and the conversions in Florida are probably three to five months old, so we have limited data at this point, but we're getting some very, very good feedback from our customers in terms of the loyalty and the offers that we have once we convert to the Speedway brand.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay. Great. Then thinking about SAX, I was wondering if you could go through maybe the ways in which that's going to change the crude sourcing in the Midwest or is it really more providing optionality?

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

Mike?

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

Yes, Gary. Yes, Brad, it's going to have a significant impact for us. As you know, that pipeline runs from Enbridge's system in South Chicago down to Patoka, which is our hub. And today, if you look at our flexibility of bringing in either the Bakken crude or other Canadian crude, we pretty much limit that out with the logistical capability that we have today. And in SAX, even before Sandpiper is completed, it's going to give us that flexibility to increase the amount of crude that comes in from both of those sources, so it's a big deal for us. It's going to help the bottom line, certainly.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay. Great. Thank you.

Operator

Doug Leggate, Bank of America Merrill Lynch.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Gary, I don't know if I picked up on this earlier, but back to Paul Sankey's question on gas sensitivity, I was looking back at the -- it's an operating cost question -- I was looking back at the presentations from the last year and the Q1 delta last year was a negative 605 versus the prior first quarter 2013 and of course gas, was very strong last year.

And this year, obviously, you had a big operating cost benefit of over $500 million, so I don't know if I picked it up wrong but can you walk through again what your gas sensitivity is? Because obviously if gas prices remain low, then those cost benefits are probably going to be quite sticky, I'm guessing.

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

Okay. Let me turn this over to Don or Rich. I don't have any of those numbers with me here for Doug.

Don Templin - *Marathon Petroleum Corporation - EVP of Supply, Transportation, and Marketing*

Sure, Doug. Our gas sensitivity, so $1 change in the natural gas prices is around $140 million after-tax on an annual basis. And with respect to the first quarter of 2015 versus the first quarter of 2014, there was about an $80 million benefit in the other manufacturing cost line related to the lower energy costs.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Okay. I guess I don't want to labor, maybe I can take it off line but what I'm looking at is the full-year cost hit last year, looked year-over-year was about $913 million according to the presentation. So I'm trying to understand what caused the cost uplift last year because it's absolute number, not a unit number obviously, and what forced it to come back out in the first quarter is what I'm trying to understand. See how sustainable it is.

Don Templin - *Marathon Petroleum Corporation - EVP of Supply, Transportation, and Marketing*

I'm sorry. Which quarter are you comparing there, Doug, I'm sorry.

Doug Leggate - *BofA Merrill Lynch - Analyst*

For the first quarter, year-over-year, you had a little over $500 million of benefit according to the presentation. But the full year last year, the direct operating cost negative impact was $913 million, most of which was in the first quarter, which is when gas prices were $5. So I'm trying to understand what the moving parts are. Like I said, maybe I need to take it off-line, but what reversed out that gave you $913 million negative last year that gave you a $500 million positive in the first quarter, I guess, is what I'm getting at. I don't know if that's complicating the question too much.

Don Templin - *Marathon Petroleum Corporation - EVP of Supply, Transportation, and Marketing*

The big piece of it last year was all the heavy turnaround activity that we had, Doug. So we can walk through individual components, but last year, you'll recall, we had very, very heavy turnaround activity, which was a detriment to that quarter and this quarter really is the absence of all of that turnaround activity.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Right.

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

And Doug, it's both cost and volume this quarter.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Right. You do not the maintenance through CapEx is that right? You expense it?

Tim Griffith - *Marathon Petroleum Corporation - SVP & CFO*

That's correct. Maintenance goes to expense, not the CapEx.

Doug Leggate - *BofA Merrill Lynch - Analyst*

So that probably explains the bulk of it. That's really helpful. Thank you. My follow-up, Gary, is really more of a macro question, again. We're looking at you guys saying you can raise your utilization by 6% or so and obviously, the industry, as a whole, has been running pretty hard. But we're starting off with very, very high gasoline inventories I guess for the US.

And what I'm thinking, I'm somewhat concerned about is when we looked at what happened at the end of last year, gasoline margins sunk on very, very high gasoline production. I'm curious, how do you see the macro playing out? Obviously, your market is a big beneficiary of imports from other regions. So given those robust gasoline inventories, what's your prognosis on how you see things playing out in this higher utilization environment?

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

Well, as I stated I think it was on the first question, it's something that we're watching very carefully, the inventories and the product exports, still within the industry, are much more skewed to distillate than to gasoline; however, gasoline is picking up namely to Latin American countries and we see that is going to continue. But you're right and that's why when I stated earlier also, keep an eye on the EIA numbers that come out and what demand appears to be.

We're not seeing, and I still think it comes down to being able to reconcile all the exports back to within the government numbers, within their model. So you make a good point. It's something that we manage and we watch every day is to watch how the inventories continue to move. The key is going to be clearing out all the bad weather we had in the first quarter and hopefully, getting down to a clean second quarter where we really can measure what the gasoline demand is across the US.

And once I have those optics, obviously, I'm going to be able to answer your question better. But we're watching inventories very, very carefully. But also, I'm seeing very significant growth in the export market.

Doug Leggate - *BofA Merrill Lynch - Analyst*

That's helpful, Gary. Thanks very much, indeed.

Operator

Roger Read, Wells Fargo.

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

I guess I'd like to follow up a little bit on the light sweet crude. Obviously, you discussed a lot of the pipeline issues and sort of the storage issues. Previously, I think you mentioned as much as 65% of the volumes that you have at hand could be light sweet crude. Can you let us know what we need to see? Is it the wider differential? Is it more pipeline access in order to get to those volumes?

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

Mike?

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

Yes, Roger. I think what we need to see is we need to see differentials, say, versus medium sour that are more compelling than what they've been. We're constantly in the market. This is every day, trying to optimize our crude slates, and we do that on a day-to-day basis with domestic barrels. So we have this option to buy light sweet crude.

We have this option to buy medium sour crude, for example at Garyville, and so we're constantly looking at the differentials to see which makes a higher margin. And honestly, between the light sweet crude that so many think has this huge overhang in the market and therefore, you'd think it would be priced so that was compelling to bring in, that's just simply not the case.

We go back and forth between buying the medium sours versus the light sweet. So at some point, if the production rises enough and the producers don't clear it to another market, then we would see numbers that would allow us to run higher volumes of light sweet.

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

Okay. But doesn't that, by itself, sort of create the pressure for the export call? In other words, I get that you don't want to run the crude unless it's economically profitable, but if you have a differential at $7 or even $10, that puts more pressure within the system to call for the export volumes. So do you think it's a number closer to, as you mentioned with LLS, $3 or is it something that we need to see in a $5 to $7 range in order to clear the market if we have more crude on the market from the lower 48 producers?

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

Well, I think what we tend to look at, again, is this differential of LLS versus our other alternatives. So, of late, I think again, when I talk about the competition with the medium sours, we've been seeing a differential between LLS and Mars that's been in the $3 range, $3 to $4. So again, if that differential came into something less, then we would try and run more light sweet at those more economic numbers. That's primarily what we look at.

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

Okay. Thank you.

Geri Ewing - *Marathon Petroleum Corporation - IR*

Cynthia, with that we'll close the question and answer. I want to thank everyone for joining us today and thank you for your interest in Marathon Petroleum Corporation. Should you have additional questions or like clarification on the topics we've discussed this morning, Teresa Homan and I will be available to take your calls.

Operator

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