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# EDITED TRANSCRIPT

MPC - Q2 2016 Marathon Petroleum Corp Earnings Call

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**OVERVIEW:**

Co. reported 2Q16 earnings of \$801m, or \$1.51 per diluted share.



## CORPORATE PARTICIPANTS

**Lisa Wilson** *Marathon Petroleum Corporation - Director of IR*

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

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

**Don Templin** *Marathon Petroleum Corporation - EVP*

**Tony Kenney** *Speedway LLC - President*

**Ray Brooks** *Marathon Petroleum Corporation - SVP Refining*

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

## CONFERENCE CALL PARTICIPANTS

**Doug Leggate** *BofA Merrill Lynch - Analyst*

**Evan Calio** *Morgan Stanley - Analyst*

**Neil Mehta** *Goldman Sachs - Analyst*

**Ed Westlake** *Credit Suisse - Analyst*

**Brad Heffern** *RBC Capital Markets - Analyst*

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

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

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**Phil Gresh** *JPMorgan - Analyst*

**Paul Sankey** *Wolfe Research - Analyst*

**Spiro Dounis** *UBS - Analyst*

## PRESENTATION

### Operator

Welcome to the second-quarter 2016 earnings call for Marathon Petroleum Corporation. My name is Katie, and I will be operator for today's call. (Operator Instructions) Please note that this conference is being recorded. I will now turn the call to Lisa Wilson, Director of Investor Relations.

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**Lisa Wilson** - *Marathon Petroleum Corporation - Director of IR*

Thank you, Katie. Welcome to Marathon Petroleum Corporation's second-quarter 2016 earnings webcast and conference call. The synchronized slides that accompany this call can be found on our website at [Marathonpetroleum.com](http://Marathonpetroleum.com) under the investors center tab.

On the call today are Gary Hemminger, Chairman, President, and CEO; Tim Griffith, Senior Vice President and Chief Financial Officer; and other members of MPC's executive team.

We invite you to read the Safe Harbor statements on slide 2. It is a reminder that we will be making forward-looking statements during the call 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 there as well as our filings with the SEC.



Now I will turn the call over to Gary Hemminger for opening remarks and highlights.

**Gary Hemminger** - *Marathon Petroleum Corporation - Chairman, President and CEO*

Thanks, Lisa. And good morning to everyone. Thank you for joining us. If you'll please turn to slide 3.

Earlier today, we reported second-quarter earnings of \$801 million, or \$1.51 per diluted share. Earnings included net benefit of \$0.44 per share primarily related to a reversal of our lower cost of market inventory valuation reserve. All segments of the business performed well in the second quarter. Earnings benefited from improving crack spreads, robust product demand entering this summer driving and asphalt season, strong retail margins and the inclusion of Mark West in our consolidated results.

The refining and marketing segment delivered strong results despite less favorable operating and market conditions during the quarter. Our integrated seven refinery and extensive logistics network allows us to capture advantage feedstock and other raw materials as well as enhanced price realizations to our refined product distribution system. Our unique asset mix and flexibility position us to optimize operations even during disruptions such as those caused in the second quarter by the Canadian wildfires and refinery outages.

Speedway continued its outstanding performance with a record second-quarter segment income. In addition to higher light product sales volume and margins, the business delivered higher merchandise margins in the quarter. This improvement is consistent with a strategy to drive marketing enhancement opportunities. We are pleased with our progress in realizing synergies across the Speedway network earlier than originally planned and believe this will be a continuing source of value to the business.

Speedway provides significant and growing stable cash flow, complementing MPC's integrated refining and distribution network. Speedway is MPC's most ratable distribution channel, provides a solid base to enhanced overall supply reliability, and allows us to optimize our entire refining, pipeline and terminal operations.

The midstream segment, including MPLX's financial and operational results, also delivered solid performance during the quarter. MPLX remains on target to achieve its 2016 distribution growth guidance without the need for additional dropdowns from MPC during the year.

During the quarter, MPLX expanded its midstream presence in the Southwest with the completion of its Hidalgo gas processing complex in the Delaware Basin, where utilization is exceeding initial expectations. Construction of the Cornerstone Pipeline is also progressing as planned, with the completion expected in the fourth quarter.

Cornerstone Pipeline is designed to provide MPC's Canton, Ohio, refinery with a direct supply of condensate out of the Marcellus and Utica regions and to supply natural gasoline to our Midwest refineries.

As commodity prices recover, optimism is growing among MPLX's producer customers. And with world-class midstream assets located in some of the best resource plays in the country, MPLX is well-positioned to capitalize on an exceptional set of opportunities along the entire hydrocarbon value chain.

As we enter the third quarter, both heavy and light Canadian crude differentials have returned to more favorable levels as the impact of the Canadian wildfires subsided. Canadian heavy production continues to grow, and we expected good values throughout the third and fourth quarters. Additionally, we expect to continue to see spot opportunities in foreign sweet and sour cargos. The regional diversity of our refining assets also enabled us to benefit from access to the export market. We believe we have the right assets in the right locations, with 60% of our crude oil refining capacity in the Gulf Coast and 40% in the Midwest.

We also expect to complete the first phase of our multi-year STAR program at the Galveston Bay refinery in Texas City next month. This phase will revamp and expand the resid hydrocracker by 12,000 barrels per day, improving the profitability of the refinery by increasing the conversion of lower-value residual oil into gas oil. EBITDA contribution from this initial phase is expected to average approximately \$80 million per year.

During the second quarter, we returned \$221 million to shareholders through dividends and share repurchases. In addition, on July 27, our Board of Directors announced a 12.5% increase in the quarterly dividend to \$0.36 per share. The 29% compound annual growth rate and our dividend since MPC became an independent Company demonstrates our continuing confidence in the cash flow generation of the business. It also demonstrates our long-term focus on capital returns while maintaining an investment-grade credit profile and strong liquidity throughout the cycle. The efficiency and flexibility of our integrated retail, logistics and refining system drives the diversified earnings power of the business, and we remain encouraged by the long-term prospects of our business and the value proposition for our investors.

With that, let me turn the call over to Tim to walk you through the financial results for the quarter. Tim?

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

Thanks Gary. Slide 4 provides earnings on both an absolute and per-share basis. MPC's second-quarter 2016 earnings of \$801 million, or \$1.51 per diluted share, were down slightly from last year's second-quarter earnings of \$826 million. Gary referred to the \$0.44 per-share net benefit in the quarter, which included a benefit of \$0.47 per diluted share related to the reversal of the lower of cost to market inventory valuation reserve and a charge of \$0.03 per diluted share related to the impairment of one of MPLX's equity investments.

The chart on slide 5 shows by segment the change in earnings from the second quarter of last year. As mentioned, earnings were impacted during the quarter by a \$385 million pretax benefit to fully reverse our lower cost of market reserve. \$360 million of this benefit is included in the refining and marketing segment, and \$25 million is reflected in the Speedway segment. After adjusting for this benefit, earnings were down approximately \$410 million over the same quarter last year, largely attributable to lower income from our refining and marketing segment, higher interest expense resulting from the MarkWest merger, and the equity impairment I just mentioned. These negative impacts for the quarter were partially offset by higher income contributed by our midstream and Speedway segments and lower income taxes.

Turning to slide 6, our refining and marketing segment reported income from operations of almost \$1.1 billion in the second quarter, compared to the income from operations of \$1.2 billion in the same quarter last year. The decrease, after excluding the \$360 million benefit from the LCM reversal, was primarily due to weaker crack spreads in both the Gulf Coast and Chicago and narrower LSWTI differential, less favorable market structure and higher costs related to turn our activity in the second quarter. Partially offsetting these negative impacts was an improvement in the sweet/sour differential in the quarter.

The lower blended crack spread had a negative impact on earnings of approximately \$502 million. The blended crack spread was \$2.58 per barrel lower at \$7.66 per barrel in the second quarter of 2016, compared to \$10.24 per barrel in the same period last year.

R&M segment income benefited \$227 million by an approximately \$2 per-barrel widening of the sweet/sour differential as well as higher sour runs in the quarter versus last year. The LLS/WTI differential narrowed \$3.25 per barrel from \$4.99 per barrel in the second quarter of 2015 to \$1.74 per barrel in the second quarter of this year. This had a negative impact on earnings of about \$100 million based on the WTI linked crudes in our slate.

The market structure contango effect during the quarter is reflected in the \$78 million unfavorable variance on the walk and relates to the difference between the product crude prices we use for market metrics and the actual crude acquisition costs in the quarter.

The \$70 million increase year over year in direct operating costs relates primarily to higher turnaround activity in the quarter versus last year. Turnaround in major maintenance costs increased \$0.50 per barrel, or over \$80 million, compared to the second quarter of 2015. The higher turnaround activity also impacted total throughputs, which were 62,000 barrels per day lower than the second quarter last year.

Capture rate for the quarter was negatively impacted by the effect of rising crude oil prices on wholesale and secondary product margins, narrower crew differentials, and tighter differentials on feedstocks relative to crude.

Turning to our other segments, slide 7 provides a Speedway segment earnings walk versus the same quarter last year. As Gary mentioned, Speedway had a record second-quarter earnings of \$193 million, which were \$66 million higher than the second quarter 2015. Light product margin was a



significant contributor to this increase along with higher merchandise gross margin and the \$25 million reversal of Speedway's lower cost of market inventory reserves in the quarter.

Gasoline and distillate margins were about \$0.02 higher than in the second quarter last year at \$0.155 per gallon, while volumes were up 33 million gallons quarter over quarter. On a same-store basis, gasoline sales volumes increased 3/10 of a percent over the same period last year.

Merchandise gross margin was \$10 million higher than the second quarter last year due to overall higher merchandise sales and the higher margins realized on those sales. Merchandise sales in the quarter, excluding cigarettes, increased 2% on a same-store year-over-year basis, reflecting some of the progress we're making on enhancing our merchandise model across the entire business.

In July, we've seen a decrease in gasoline demand, with approximately 1% decrease in same-store gasoline sales volumes compared to last July, which you may recall was a very strong month in 2015. Speedway same-store gasoline sales growth was lower than estimated US demand growth as we continually strive to optimize total gasoline contributions between volume and margin to ensure fuel margins remain adequate.

Slide 8 provides the changes in the midstream segment income versus the second quarter last year. The \$98 million increase quarter over quarter was primarily due to the combination of MarkWest at the end of last year, which contributed \$81 million of the incremental segment income to the quarter. The remaining increase of \$17 million was primarily due to an increase in income from our equity affiliates and lower operating expenses versus last year.

Slide 9 presents the significant elements of changes in our consolidated cash position in the second quarter. Cash at the end of the quarter was nearly \$1.8 billion. Core operating cash flow was a \$1.2 billion source of cash. The \$1 billion source of working capital noted in the slide primarily relates to an increase in accounts payable and accrued liabilities partially offset by smaller increases in accounts receivable. The increases in accounts payable and receivable were primarily due to higher crude oil and refined product prices during the quarter, which led to the net source of cash given the generally longer terms in the crude payables versus refined products.

As we discussed in the first-quarter call in April, MPLX issued convertible preferred equity during the quarter, generating equity proceeds of about \$984 million. Proceeds from this private placement are broken out separately in the walk. MPLX used a portion of these funds to pay down its revolver, which is included in the \$521 million of net debt repayment on the walk.

Return of capital during the quarter included the repurchase of \$51 million worth of shares and \$170 million of dividends. Share purchase activity may vary from quarter to quarter based on our needs and the cash flow characteristics of our business in any particular period. Our commitment to continuing returning capital remains the fundamental element of our strategy and important part of the value proposition for investors.

Share count at the end of the quarter was approximately 528 million shares, reflecting repurchase activity of about \$7.4 billion, retiring approximately 28% of the outstanding shares at the time of spin. In addition, as Gary mentioned earlier, the \$0.36 per-share dividend announced by our Board yesterday represents a 12.5% increase over last quarter's dividend and contributes to a 29% compound annual growth rate in the dividend since our spin.

Slide 10 provides an overview of the capitalization and financial profile as of the end of the quarter. We had \$11.1 billion of total consolidated debt, including 4.4 billion of debt at MPLX. Total debt to book capitalization was about 36% and represented a manageable 2 times last-12-months adjusted EBITDA of over \$5.8 billion, which is pro forma for the MarkWest acquisition.

Operating cash flow for the quarter was \$1.2 billion before reflecting the \$1 billion source of cash for working capital in the quarter.

Slide 11 provides updated outlook information and key operating metrics for MPC for the third quarter. We are expecting third-quarter throughput volumes to be down slightly compared to third-quarter 2015 due to more planned maintenance. Total direct operating costs are expected to be \$7.65 per barrel on total throughput of 1.85 million barrels per day, which reflects the impact of higher expected turnaround activity in the third quarter versus our third quarter last year. Our projected third-quarter corporate and other unallocated items is expected to be about \$75 million.



With that, let me turn the call back over to Lisa for questions.

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**Lisa Wilson** - *Marathon Petroleum Corporation - Director of IR*

Thank you, Tim. As we open the call for your questions, as a courtesy to all participants, we ask that you limit yourself to one question and one follow-up. If time permits, we will re-prompt for additional questions. With that, Katie, we will now open the call to questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Doug Leggate, Bank of America Merrill Lynch.

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**Doug Leggate** - *BofA Merrill Lynch - Analyst*

Gary, there has been obviously a lot of noise in the sector about the arbitrage potential value of your retail business. And I think your comments in your prepared remarks probably underlined your thoughts. But I just wondered if I could ask you to reiterate your view that retail is -- you are happy with the current structure of Speedway and the current business, and whether you would ever consider a separation to try and exploit the arbitrage that some others were talking about.

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

Well, Doug, as you and I have talked many times, of course we look at this all the time. But, as in my remarks, we are very happy. And it illustrates when you have a down market like the refining sector has been in the last couple quarters, how important having a diversified portfolio and a diversified value chain is to a business like ours. It is not only the most ratable customer within our portfolio, it's also this and our long-term strategy to grow the midstream business as well as the retail business. Those two segments are becoming, I would say, our most ratable cash flow streams within the business. So, yes, we are happy with the structure. But, yes, we continue to analyze and analyze very critically as you call an arbitrage.

But when you look at an arbitrage, Doug, you also need to understand what the integration value is. Now, the integration value is, I would say, proprietary. I can't give out a number from a competitive reason of that integration value, but I can say it is very significant, especially when you look at downturns in the cycle. As I've mentioned several times, then you look again at the first half of this year, the EBITDA from Speedway the first half of this year clearly covers the total dividend and interest costs on our capital.

So, yes, we are happy. Yes, we continue to analyze it very carefully. But I would expect that we will continue on as we are.

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**Doug Leggate** - *BofA Merrill Lynch - Analyst*

Appreciate that answer, Gary. I realize it's not always easy to answer those kind of questions. My follow-up is really on the dividend. Obviously a nice bump last night. You're now mid-range with the peers. Going forward, what are your thoughts on the bounds in terms of distributions between buybacks and continued dividend growth? And I'll leave it there. Thanks.

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

Doug, our thinking has been, and really since the time of the spin, that we would have a focus around maintaining a regular dividend that's got a growth cycle to it that is really sort of through the cycle and has got -- what we would love to see is double-digit over an extended period of time.



So that is our primary focus to make sure that we have baselined capital turnaround -- an attractive and growing dividend that has got sustainability through cycle.

Share repurchase for us continues to be a flywheel depending on the cash needs of the business, where we sit from a core liquidity perspective and how we're viewing things. Obviously we have taken down our capital spending plans in 2016, and I think some of the reductions that we have seen on the share repurchase side have gone in parallel with really a careful look at how the year will play out and what the cash flow generation looks like. But I think it will continue to be an important source, and it will really be a function of the cash and liquidity position we find ourselves in as we move forward.

So, continued focus. I know the activity is lower in second quarter and in first quarter than it's been over the last several years. But, again, it's really just a function of what the liquidity needs of the business are at different points in time.

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

And Doug, one more point to that. As many leading analysts have already printed this morning, as MPLX now has gotten into a good rhythm within the capital structure, the balance sheet and our growth going forward, and as we expect that the yield will continue to improve within MPLX, that's going to give us that ability in the future as we have dropdowns to be able to bring that cash back in and further buy back shares. So that's a very important ingredient in our strategy as well.

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**Doug Leggate** - *BofA Merrill Lynch - Analyst*

Appreciate the answers. guys. Thank you.

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**Operator**

Evan Calio, Morgan Stanley.

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**Evan Calio** - *Morgan Stanley - Analyst*

Good morning, guys, and good results.

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

Thank you, Evan.

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**Evan Calio** - *Morgan Stanley - Analyst*

My question is a sum follow-up to Doug's first question and maybe a different way to partially monetize the value arbitrage. I know you filed the IRS letter to expand the characterization of wholesale EBITDA, which would add to your droppable inventory. Any update there, and can you dimension the potential range for expansion of what might be MLP-able out of what is currently characterized as retail? Really appreciate it.

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

Well, Evan, we continue to wait on the IRS to answer our PLR. We're expecting that soon, but I don't know if that means this quarter, next quarter or the following quarter. We filed a long time ago, but still awaiting.



The fuels distribution that we discussed earlier is really a -- I think an elegant way to consider -- Tim talked about a flywheel before. But that is an elegant way without getting caught up in a retail blocker, if you will -- a tax blocker to be able to drop down part of those -- of that value. So, we need to remain in our seats and wait for the IRS to opine on our request. But we feel confident that it will go forward. And, albeit, we give you a better range after we get that work back from the IRS.

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**Evan Calio** - *Morgan Stanley - Analyst*

Great. I appreciate that. And the second question is on midstream. Shell is now building a cracker in Pittsburgh. Want to know -- it's still five years out. It's very positive for MPC and MPLX both from volume growth and what it means for pricing and relative Northeast pricing in particular put at parity with Mount Bellevue. Can you discuss that project or how it could affect your business and maybe how you are thinking about our positioning for that today?

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**Don Templin** - *Marathon Petroleum Corporation - EVP*

Yes, Evan, this is Don. We have a leading ethane position in the Marcellus and the Utica. We've invested considerable capital in the past to be able to handle ethane recovery. And our view is that there is going to be continued production of -- and growth in ethane, which will give us an opportunity. We are estimating probably -- depending on where the forecasts and up, we've heard or seen forecasts that would suggest in the early 2020s that there would be 500,000 barrels per day of ethane production. And if you got to those kinds of volumes, we could anticipate having capital projects that would be in the \$500 million to \$1 billion range in order to be able to extract that ethane to be able to support things like the crackers, but also to support ethane needs in the Gulf Coast, and also for pipelines and other projects that are taking it to the East Coast.

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**Evan Calio** - *Morgan Stanley - Analyst*

All right. Thanks, guys.

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**Operator**

Neil Mehta, Goldman Sachs.

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**Neil Mehta** - *Goldman Sachs - Analyst*

Gary, can you comment on the state of the product market as you see it? Inventories are elevated right now. Do you think that's a function of refining supply or a demand? And how do we work our way out of this? Do you ultimately think we need to see run cuts later this year in the world? And if so, where?

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

Yes, Neil, that's a very prudent question. And especially if you look at the same period last year, when we were in a very strong refining market last year. But refiners ran full out, and that tremendous build and excess inventories is what really led to the downturn in the fourth quarter and early first quarter this year because of the rapid build of inventories and the long-term to be able to run those off.

I look at the inventories that came out yesterday, Neil -- in these PADDs where we predominantly operate, gasoline and PADD 2 is 2.9 million barrels over same period last year. So -- and we were down 2 million barrels for the week. So we are in pretty good shape. The Gulf Coast is still a bit high on inventories. But Mike Palmer pointed out to me earlier today, if you look at the turnaround schedule coming up in the Gulf Coast for PADD 3 and early into PADD 4, it appears to be a significant turnaround schedule somewhere between 700,000 to 1 million barrels are going to be down over this period of time. And then of course we're going to switch to the winter-grade gasoline before long.



On distillates, both PADD 2 and PADD 3 were fairly balanced on distillates the way I look at it across the chain -- or I should say across the industry. But the key point is, and I believe that the refining industry has shown pretty good resolve in the past, that there is no need to be running inventories up that are going to cause the degradation in margins into the future. But as I say, distillates in pretty good shape right now. Gasoline PADD 2, we're in good shape. It's just PADD 3 gasoline is a bit high.

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**Neil Mehta** - *Goldman Sachs - Analyst*

I appreciate that, Gary. I might've misheard that, but I think -- did you call out same-store gasoline sales in Speedway were down 1% in July? And do you think that's just a function of comps? And could you just speak to how you see the demand trends on the gasoline side for the balance of the year?

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

And that's what we said; you are right, Neil. Gasoline has been a real strong contributor to Speedway over the first half of the year, and I think somewhat can be timing. As you know, weather has been outstanding across most of the markets so far early in Q3 here. So, I would say it would be a bit more timing. I know Tony is on the line. Tony, would you like to add what you are seeing across the market?

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**Tony Kenney** - *Speedway LLC - President*

Yes, you're right about the weather. That is driving traffic. We are seeing some nice benefits inside the store. On the volume, though, I think the comment about the comps that were hurtling from last July, fairly significant. We were close to 2% up last year, and that's a big -- that's a -- relative to both year's performance isn't all that bad.

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**Neil Mehta** - *Goldman Sachs - Analyst*

Appreciate the comments, guys. Thank you.

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**Operator**

Ed Westlake, Credit Suisse.

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**Ed Westlake** - *Credit Suisse - Analyst*

Yes, good morning, and congrats also on the MPLX raise. We will see what -- when the market opens in the two minutes whether yield on MPLX goes. But do you think the yield at MPLX is now low enough, bearing in mind you've got the IDRs, to get on the front foot for growing projects at this cost of capital assuming that the upstream customers are there to do it? And also to start dropping down for cash?

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

That's kind of a softball question to add on whether I think the yield's where it should be. No, I think the yield should be much lower than where it is based on the tremendous suite of assets, both drop-down assets and organic assets.

Then the other thing that we pointed out in the release this morning is we've indicated a double-digit growth in 2017, and we have not talked about that previously. So, I think that with the increase we just had in MPLX, with the expectations of growth in 2017, with the success that we've had and what we believe will be growing volumes in our base business --.

And the other key to watch within MPLX as well, that is -- if you look at our capacity utilization, as commodity prices improve, we have a tremendous amount of basically free space to be able to fill up some of the capacity that we already have invested in that will fall directly to the bottom line.

So, we're expecting that our yield is going to continue to improve with this solid performance, again, that we've had. Our balance sheet is in good order. But in order to be able to make a real step improvement in being able to drop down more at favorable multiples, we expect to be more competitive in the yield going forward.

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**Ed Westlake** - *Credit Suisse - Analyst*

Yeah. I guess I was just trying to get to the point that obviously there's been an improvement in cash this quarter. Obviously part of it is the preferred and the working capital release. But if you can start dropping down for cash, you can start to build cash at MPC level, drive the LP DCF per unit up, and also then obviously buy back stock. So just trying to get a sense of when that process might start, in your opinion.

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

Yes, you are absolutely right. As we stated earlier, we are in very good shape. We don't need to have another drop here in 2016. But we will continue to see how the markets perform, and we can always pivot if we need to. But I think we are in very good shape, as we said.

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**Ed Westlake** - *Credit Suisse - Analyst*

And my follow-up is just on the synergy capital progress. Obviously that's a big chunk of potential future EBITDA -- \$6 billion to \$9 billion. Obviously, the industry is not on the front foot yet, but I'm sure you're doing a lot of work in the background. So maybe just give us a bit of color on -- I guess you have got nine projects. How those projects -- maybe not each one, but how those projects in aggregate are coming on.

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**Don Templin** - *Marathon Petroleum Corporation - EVP*

Yes, this is Don. We are very focused on progressing a number of those projects. And as we think about the ones that we have prioritized, the first priority is to help move NGLs to the East Coast. So, we think about our producer customers. They are seeing some optimism in terms of NGL pricing and improvement in NGL pricing. But the flat price isn't the only issue for our producer customers in the Utica Marcellus in that basin. It's been the deferral that they have been experiencing to -- like Mount Bellevue pricing.

So, very focused on moving NGLs to the East Coast, and I can say that that project is probably the one that is furthest ahead in terms of an in-service date and getting a solution.

We are also looking at moving NGLs to the Gulf Coast and have been in regular discussion with our partner Enterprise on Centennial and evaluating the feasibility of a reversal of Centennial.

Then the third major project that we've been spending a lot of time on is a project to a butane-to-alkylate project that would likely be positioned somewhere near our processing facilities in the Utica Marcella's and that will allow us to convert butane to alkylate and allow our producer customers to see an uplift in their overall valuation.

But that's a big project. That's a multi-year -- would be a multi-year project. And we are in, I would say, the heavy part of the engineering right now in terms of evaluating that.

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**Ed Westlake** - *Credit Suisse - Analyst*

Thanks.



**Operator**

Brad Heffern, RBC Capital Markets.

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**Brad Heffern** - RBC Capital Markets - Analyst

Gary -- or maybe for Tim. Circling back on repurchases for this quarter, obviously there is the big working capital benefit, and the cash balance was up pretty significantly on a sequential basis. Can you talk about why there weren't more repurchases? Is it a matter of that working capital potentially reversing next quarter?

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

Well, again, I think anytime we're making decisions on the liquidity position and where we are positioned, it also incorporates how we see things playing out from a forecast basis over the coming months and quarters. So I think we are mindful of that. The working capital benefit obviously is a big function of where absolute crude prices are at and how quickly they move.

So, a lot of what -- and frankly, a lot of what was done from a cash basis was done as really sort of a pre-funding for capital spend we would have expected at MPLX over the course of the year. So the -- that capital raise was less about trying to build into a big capital -- big cash position that could be spent, and more about really taking care of the needs of the partnership over the back half of the year. We did pay down some of the debt, again, just to open up some capacity. But it really is -- I would say most of the proceeds that were brought in are sort of spoken for this point, and probably would not go back and perform a share repurchase.

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**Brad Heffern** - RBC Capital Markets - Analyst

Okay, understood. Then in the prepared comments, you talked about the phase 1 of the STAR project coming online and the \$80 million in EBITDA. I'm curious, is that all EBITDA that comes online when you guys flip the switch on that, or has some of that been seen in previous quarters? And additionally, what's the underlying assumption for that \$80 million in EBITDA? Is that at current cracks or is that some sort of five-year average number?

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**Ray Brooks** - Marathon Petroleum Corporation - SVP Refining

Yes, this is Ray Brooks. I'll take a shot at answering that question. The \$80 million of EBITDA is on an annualized basis. So, as Gary mentioned, we're bringing on phase 1 of STAR this year, which is actually two parts of that. One part that we did a few months ago where we resid the asphaltting unit. We essentially did a project to turn that into its original purpose to be asphalt resid. And then, as Gary said, by the end of next month, we will have the rest of that project completed, but we are actually expanded by 12,000 barrels a day.

So, those two parts together lead to a combined EBITDA contribution of \$80 million a year. And we continue to look at this -- the economics on a point-forward basis, and we're still good based on the assumptions here that it's in that range.

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**Brad Heffern** - RBC Capital Markets - Analyst

Okay. Thank you.

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**Operator**

Jeff Dietert, Simmons.

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**Jeff Dietert** - *Simmons & Company International - Analyst*

Question on -- as you look at your linear program models with the current margin environment, it looks to continue to drive relatively strong throughput per your guidance. How is the LP evolving? Still maximizing summer-grade gasoline? Is there any -- are there any regions where you are shifting to a more distillate-based yield? And there's been some commentary of that shifting to winter-grade gasoline production. Could you talk about how the current pricing is shaping up for you?

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**Ray Brooks** - *Marathon Petroleum Corporation - SVP Refining*

Sure. This is Ray Brooks, and I will take a shot at that question, too. You asked a couple different things here.

First regarding the LP model, yes, we do run the LP model on a weekly basis, and we look at our crude avails and our product mix and determine what we're going to make and at what rate. And we will only run to what's economic for us -- makes economic sense to us.

Regarding distillate and gasoline and winter-grade production, right now we are producing summer grade, and we have about two months before we can legally sell -- start selling higher vapor pressure gasoline to our customers. So we're still in that mode.

Now as far as distillate to gasoline, as you know, the economics there change frequently. And right now predominantly we are pointed towards diesel. And just to give you a little flavor, we have about a 10% swing that we have the ability to swing back and forth on our swing strings between gasoline and diesel.

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**Jeff Dietert** - *Simmons & Company International - Analyst*

Great. And secondly, product exports have been an important part of your strategy. Could you talk about what you saw on second-quarter product exports and perhaps give a view on early 3Q outlook on exporting product?

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

Yes, Jeff, it's Mike Palmer. I'd be happy to talk a little bit about exports.

If you look at the second quarter of 2016, we have exports of 325,000 barrels a day. So, exports were strong. Things look very good for us in the second quarter.

When we look around the market, most of the strength was in Latin America, although -- and obviously you know we are well-situated to supply Latin America due to the proximity. But we are also finding that we've had diesel cargos that are making its way over to Europe. So that ARB has been more difficult but still works under certain circumstances.

So, we see the exports being strong. We have no reason to believe that will change at all in the third quarter. The first quarter was a little light due to supply, really, due to turnaround activity. But things continue to go very well.

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**Jeff Dietert** - *Simmons & Company International - Analyst*

Thank you for your comments.

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**Operator**

Chi Chow, Tudor, Pickering, Holt.

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

Just a couple questions -- I guess one on the crude slate. It looks like you ran a really high percentage of WTI-based crudes in the Gulf Coast in Q2 relative to recent history. That's a bit surprising given the TI spread. Can you talk about that?

And also, it looks like that heavy and medium sour crude differentials have narrowed recently, particularly on a percentage basis. What is your outlook there on the dynamics on the heavier crude markets going forward?

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

Yes, Chi, Mike Palmer again. You know, with regard to your second question first, I guess, with regard to sour crude, we are finding a lot of opportunities in the sour crude right now. Not only in the Gulf of Mexico where, if you look at those spreads over the last six months, Mars has been discounted to LLS in the range of \$5 to \$6. It's been pretty stable. We see that continuing. The sour crudes in the Gulf are still growing, and we see really good value there.

With the ARB coming in, we are also seeing some really good opportunities worldwide. We are bringing in more spot sour cargos than typically we have been able to find value in. And because Galveston Bay and Garyville have the ability to run the heavy, more difficult crudes high-TAN crudes, that's what we tend to focus on because that's where we get the discount. So we see that continuing to go forward.

In terms of the additional WTI-based crudes, that's going to shift back and forth depending upon what's happening at the plants, what crudes we are really optimizing on a daily basis between the WTI and the LLS-based crudes. So I don't think there's anything structural in the market there. It's just part of the overall optimization.

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

Chi, it was the right question. If you look at our slate -- as we talked about at this same time last year, last year we were running about 55% sour. This year we ran a little over 61%. So we have the ability to swing back and forth due to the composition of our refineries and take advantage wherever the best margins are in the market. So, 61% is one of the highest percentages of sour we've run for some time. I just want to give you those parameters.

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

Yes, thanks. That's really high. But are you seeing Canadian barrels back to normal levels of availability at this point? And I guess on the Gulf Coast, just from the Latin American barrels, any concerns about the steep production climbs we are seeing -- Mexico, Colombia, Venezuela -- on the heavier crude availability out of those regions?

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

You know, it's -- we've had a hard time trying to make sense of a lot of the Venezuelan crudes for some time there. They are not very dependable and they have been declining. So, I don't -- I would say that we really haven't had a big focus on much of the Latin American crudes. There are some out of Columbia that have made a lot of sense for us. But it's not -- we don't really see that as a big deal. We have seen more interest in, for example, some of the Middle Eastern heavy crudes.

With regard to Canadian, yes, the wildfire situation is behind us now. And we've seen the Canadian spreads return back to normal. They look a lot more attractive to us than they did before. And, as you know, the Canadian heavy with these projects that were sanctioned prior to this fall in crude prices, those projects continue. So, the Canadian heavy continues to grow. And we see a lot of value in the Canadian heavy.

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

Okay, great. Thanks, Mike. Then one question on the potential drop of the fuels distribution margin. When you look at that, I guess what happens to the RIN if hypothetically you do drop that -- the fuels distribution margin down? Does the RIN go with it or does the RIN stay at the MPC level?

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

No, the RIN would -- we would expect, Chi, that the RIN would still be controlled by MPC.

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

Okay. Even though you've got the wholesale piece going? Structurally --

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

Yes, but where we are looking at the fuels distribution, it would be after the RIN or after the blending would have taken place. So, I would expect that we would not be putting any RIN volatility inside of MPLX.

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

Yes, and Chi, I think the other important piece of that for how we have thought about this and the potential for structuring it, we are really looking at it as a sort of service arrangement as opposed to the transfer of inventory necessarily. So the -- I don't think we would expect any change to the -- where the RINs are resident and where the benefit resides.

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

Great. That's helpful. Thanks. Appreciate it.

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**Operator**

Roger Read, Wells Fargo.

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

Guess I would like to catch up a little more and try to -- how to think about the share repurchases and how they will fit in. I understand a little early to lay out 2017 CapEx, but you did improve the balance sheet year to date. It sounds like in every which way, MPLX is on much firmer footing and a solid growth outlook. Refining, probably better in 2017 than it is right now. So, as you get free cash flow, how should we think about it between consistent raising of the dividend, further balance sheet repair if need be and then the share repurchases?

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

Well, again, I think, again, the focus around capital return and how we do that is going to continue in the business for as long as we can imagine. How we balance that -- I think the key part, Roger, is maybe as you allude to a little bit that this is really going to be a balanced approach. I think we're not inclined to go all in on full investment. We're not inclined to go all in on full share purchase. It's really going to be finding that balance that's in the business based on what the earnings look like, what the cash flow generation could be and exactly where we find ourselves financially at each point in time.

Again, as I referenced earlier, this really becomes sort of a flywheel as we evaluate exactly how we want to position the business from a capital allocation perspective. We expect a level of activity will be there and could vary in different periods in time, but will be an important part of our balanced approach on the capital allocation side.

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

Okay. Thanks. And as a follow-up to that, Gary, certainly Marathon has been an acquisitive Company. I understand you may be in more of a digested phase right now. But as you do free up more capital, whether from a retail, wholesale drop-down or further growth inside of MPLX, what else looks interesting on the M&A front? Is there a desire to expand the refining, or should we think about it as a midstream retail growth really only at this point?

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

When you look at the valuation metrics of refining today, I think we are -- we have a very good platform and a good footprint in refining of where we want -- where we like being today. Doesn't say that we won't look at the other opportunities that may come about; we will. On the retail and midstream side, of course, we are very interested in continuing to build out within our footprint.

The retail side -- we have the platform, the ability and, as Tony's team has been able to certainly illustrate, the expertise to be able to step outside of our footprint and perform very well. So we will continue to be interested in retail. I think retail and midstream probably give us higher returns. But I would say where our share prices are, as Tim just alluded to, buying back shares will be the top of mind as well.

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

Okay. That's great. Thank you.

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**Operator**

Paul Cheng, Barclays.

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**Paul Cheng** - *Barclays Capital - Analyst*

Gary, with MPLX sort of stabilized, do you believe that this point and going forward, whatever is the new investment opportunity, whether it is building out more NGL distribution business over there, I think it would be all self-funded that the need for the parent operation -- any support we need just (inaudible) behind and you are not going to consider going forward? Or that this is -- may have opportunity that at some point it would be so great from MPLX that you would still consider support from the parent?



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

Well -- and you are right, Paul; it just depends on the situation. As Don just mentioned, we have -- he was speaking to some of the big organic projects we talked about. And some of those can be hefty because of the size of the projects. And we will see what the carry might be, if any.

But we have stabilized the balance sheet. I think that the business -- the base business is picking up. As commodity prices improve, the coverage should continue to improve. So I believe that it can stand on its own into 2017, and we will see at that point. But I don't see anything over the next few quarters that MPC would need to step in and support their balance sheet.

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**Paul Cheng** - *Barclays Capital - Analyst*

I know it's early. Any (inaudible) CapEx for 2017, even from a direction standpoint, you can share given the recent weaknesses in the refunding margins? Should we assume that CapEx is going to be somewhat similar to this year or that you think it's going to be down or going to be up?

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

Well, Paul, I would say that when we come to your conference during September, we're going to be able to have a pretty good idea of where we're looking at CapEx going forward. We are in that phase right now. I wouldn't expect it to be up from where we are in 2016, but we are just in an initial phase of looking at the capital for 2017 and beyond.

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**Paul Cheng** - *Barclays Capital - Analyst*

A final one, and maybe this is for Mike -- Sandpiper. With a number of the major projects our region from getting oil out from Bakken, are we going to have enough oil from Bakken to fill that line?

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

Yes, Mike will take that. Mike?

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

You know, that really depends -- I guess, Paul -- on what happens with crude prices, and we think that things are rebalancing quickly now. We think that oil prices will be up, and we do believe that North Dakota production is a big resource. We believe that North Dakota production will go up as well. So there will be oil into the future to feed the various pipelines.

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**Paul Cheng** - *Barclays Capital - Analyst*

Okay. All right. Thank you.

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**Operator**

Phil Gresh, JPMorgan.

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**Phil Gresh** - *JPMorgan - Analyst*

Perhaps just as a follow-up to Ed's question on the drop potential, how do you think about the deal pace of drops moving forward in terms of maybe on an annualized basis, what you think MPC you can get back from jobs that can be reallocated?

And then also in terms of value-unlock opportunities, how are you thinking about the GP here? Do you think it's at a mature enough state to consider unlocking some value there, or do you think you would need more time?

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

Well, I would say, Phil, the -- we don't look at it as what can we hurry up and drop. We look at it as what is the growth rate that we're trying to achieve and what are the mechanisms that we use to achieve that growth rate. And as we stated in our release this morning that we expect double-digit growth rate, we are on target, first of all, to meet that parameter that we set out of 12% to 15% this year, and then a double-digit growth next year. So, that is directionally how we look at it, Phil.

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**Phil Gresh** - *JPMorgan - Analyst*

Okay, and on the GP?

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

The GP -- when you were out visiting with us, we still believe that the GP is -- this is a -- it has to mature more to consider that. This clearly isn't the market to try to float a GP IPO.

And the other thing that as -- we certainly have recognized in the market with some changes in structure is that it appears that simplification is better. But we continue to analyze, and we will continue down that path.

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**Phil Gresh** - *JPMorgan - Analyst*

Got it. Okay. Then my follow-up is just around the level of maintenance spending that we're seeing this year in the refining side. As we look ahead, would you say this is above normal in terms of maintenance this year? Or how might you suggest we think about the normal level of maintenance spending moving forward?

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**Ray Brooks** - *Marathon Petroleum Corporation - SVP Refining*

Well, this year was definitely a step up on the maintenance side from the standpoint -- it was a heavy turnaround year. So -- but it was definitely a step up. But our goal in refining is what do we have to do year in, year out to level that spend as much as possible. Take care of our turnarounds, but try to keep things as constant as possible.

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**Phil Gresh** - *JPMorgan - Analyst*

Is there a specific number you might think about that you would get back next year just from having fewer turnarounds?

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**Ray Brooks** - *Marathon Petroleum Corporation - SVP Refining*

Yes, I don't think I can talk forward in forward numbers at this time.

**Phil Gresh** - *JPMorgan - Analyst*

Okay. Thanks.

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**Operator**

Paul Sankey, Wolfe Research.

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**Paul Sankey** - *Wolfe Research - Analyst*

Back to these terrible RINs, Gary, I'm afraid. I don't know if you listened at all to what (inaudible) was saying yesterday about a lawsuit or if you saw Jack Lipinski's comments this morning, which were very aggressive, about essentially the idea that third-party traders and speculators are driving up the price of RINs.

My question to you, Gary, knowing how involved you are in Washington is what is your stance, first, on what you think should happen? And what do you guys actually want as Marathon Petroleum? What do you feel is in your best interest as regard to RINs? Thank you.

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

Sure. While clearly we need to have our best interest, which we continue to strive for, is full repeal of the renewable fuel standard. But knowing that that is a heavy lift, there has been a bill that's been introduced on the floor known as the Flores bill that would limit blending at 9.7%, which really takes into account the neat gasoline that's in the market as well. We think that that needs to be supported with tremendous amount of support already inside the House on this bill, and we need to get others on schedule as well.

The RIN prices, you're right. Upwards of \$0.95, \$0.98. I know they've hit \$1 over the last couple weeks. And it's a -- and I think -- I don't think, I know the reason is because the market is understanding that we're going to be very close and probably will tip over the 10% ethanol blend wall this year. Therefore, RINs are going to be at a -- the demand for RINs are going to outpace the supply. The steps that we've taken over the years, as illustrated as well in this morning's comments, is that we are in very good shape and we are fairly balanced on the RIN side. But nevertheless, we want a significant amendment or repeal of the renewable fuel standard and are working very hard towards that -- or in that direction.

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**Paul Sankey** - *Wolfe Research - Analyst*

Very clear, Gary. Thank you very much. It's 10 o'clock, I will leave it there.

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

Go ahead, Paul.

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**Paul Sankey** - *Wolfe Research - Analyst*

No, that's great. I've got to run. But thanks for your answer. Appreciate it.

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**Operator**

Spiro Dounis, UBS.

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**Spiro Dounis** - UBS - Analyst

Just one really quick one for me. Hopefully -- on M&A. And I know the question was asked earlier, but maybe just from a different perspective. Just in terms of the opportunity set out there and maybe quarter over quarter, it seems like things are pretty dire in the first quarter and gradually improved. And I'm wondering if you saw maybe a lot of fire sales come out of the market or if you still see a lot of opportunity out there in terms of what is available to pick up in whether it be retail, refining or midstream?

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

I think for the most part -- except on the midstream side, for the most part, R&M and retail has really ridden the wave here to the fourth quarter and first quarter. There is nothing pending on the refining side of the slate. There are rumors on different things that might be available. But I think the refining side still would be fairly pricey, and be pricey versus the multiples that are achieved in the marketplace today.

But beyond that, I would say there is some -- there has been some movement in the retail space. And Don can mention here on the midstream side what he is seeing across the midstream space.

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**Don Templin** - Marathon Petroleum Corporation - EVP

Yes, Spiro, we haven't really seen any significant change. I think the people that were really in a desperate situation at the end of the fourth quarter going into the first was primarily on the E&P side. Clearly, the cost of capital was increasing for the midstream producers -- or midstream players. But I just haven't seen a dramatic change one way or the other. The folks that would be potentially in play in the first quarter are still in play, and we haven't seen any big pullback in terms of opportunities.

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**Spiro Dounis** - UBS - Analyst

Got it. That makes sense. Really appreciate the color. Thanks, guys.

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**Operator**

And with that, I will turn the call back to Lisa.

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**Lisa Wilson** - Marathon Petroleum Corporation - Director of IR

Thank you, Katie, and thank all of you for joining us today and your interest in Marathon Petroleum Corporation. Should you have additional questions or would like clarification on topics discussed this morning, Teresa, Holman and I will be available to take your calls. Thank you.

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**Operator**

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

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