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MPC - Q4 2016 Marathon Petroleum Corp Earnings Call

EVENT DATE/TIME: FEBRUARY 01, 2017 / 2:00PM GMT

OVERVIEW:

Co. reported 4Q16 earnings of \$227m and diluted EPS of \$0.43.



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PRESENTATION

Operator

Welcome to the MPC earnings call. My name is Jason and I will be your operator.

(Operator Instructions)

And please note this conference is being recorded.

I will now turn the call over to Lisa Wilson. Lisa, you may begin.

Lisa Wilson - Marathon Petroleum Corporation - Director IR

Thank you, Jason. Welcome to Marathon Petroleum Corporation's fourth-quarter and full-year 2016 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, 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 in our filings with the SEC.

Now I'll turn the call over to Gary Heminger for opening remarks and highlights.

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Thank you, Lisa, and good morning to everyone. If you would please turn to slide 3. This morning we reported fourth-quarter earnings of \$227 million, or \$0.43 per diluted share, and full-year earnings of \$1.17 billion, or \$2.21 per diluted share. We were pleased with the results for the quarter across all areas of the business despite a 2016 that proved to be challenging from a commodity price and margin perspective. We were also enthusiastic about MPLX's 2016 results, one year into the combination of MPLX and MarkWest, and remain very encouraged by the growth opportunities in front of the partnership which will continue to be a source of long-term value for our investors.

Moving to the Company-owned retail business in 2016, Speedway set all-time records for the year, while continuing to maintain its disciplined approach to cost control. Speedway surpassed segment all-time highs in income from operations, light product gallons sold, merchandise sales, and merchandise gross margin on both the percentage of sales and absolute dollar basis. Speedway continues to exceed expectations by driving marketing enhancement opportunities and continuing to realize acquisition synergies across the network.

Turning to Refining and Marketing, Garyville successfully completed the largest turnaround in its history during the quarter. As part of the turnaround, we completed an FCC/Alky upgrade project, increasing Garyville's production capacity at high-value alkylate and light products. We also completed the Galveston Bay refinery export capacity expansion, increasing Galveston Bay's export capacity by 30,000 barrels per day, increasing our total export capacity from both the Galveston Bay and Garyville refineries to nearly 400,000 barrels per day.

This morning we also announced our 2017 capital investment plans for both MPC and MPLX which remain focused on strengthening the sustained earnings power of our business through growth and margin-enhancement projects as well as expanding our more stable cash flow of businesses. We are discussing these capital plans separately as the funding will be managed independently, and we think the consolidated totals will be less useful going forward.

Our capital investment plan for MPC for 2017, excluding the MPLX, is \$1.7 billion. This plan spending for MPC is roughly in line with MPC's capital spending and investments in 2016 and includes nearly \$1.2 billion for Refining and Marketing, \$380 million for Speedway, \$90 million for Midstream investments at MPC, and \$100 million to support corporate activities.

The Refining and Marketing segment includes \$325 million for margin-enhancing investments including the Garyville distillate maximization projects, the Galveston Bay export capacity expansion, and approximately \$85 million for the South Texas asset repositioning project. This morning we also announced a \$500 million reduction in the total plan investment for the STAR project. We now plan to spend a total of \$1.5 billion for STAR through 2021, while principally maintaining the project's scope and projected return.

The high-return staged investments planned for STAR are designed to enhance profitability and reliability while integrating Galveston Bay and Texas City refineries, creating the second-largest refining complex in the United States. We expect to invest about \$380 million in Speedway, primarily to build new stores and to remodel and rebuild existing retail locations in its core markets, driving continued growth and opportunities in merchandise across the platform. This morning, MPLX also announced its 2017 capital spending and investment plan of \$1.4 billion to \$1.7 billion organic growth, plus approximately \$100 million for maintenance capital.



About 75% of these growth investments are directed to the development of natural gas and gas liquids infrastructure expansion to support MPLX's producer/customer demand, primarily in the Marcellus region. The remaining growth capital will be for the Utica infrastructure buildout in connection with the recently completed Cornerstone Pipeline, a butane cavern in Robinson, Illinois, and a tank farm expansion in Texas City, Texas.

Additionally, we are executing the strategic actions announced on January 3 to enhance shareholder value. We plan to significantly accelerate the dropdowns of MLP qualifying assets, generating approximately \$1.4 billion of annual EBITDA to MPLX as soon as practicable, and now planned for 2017. A proposed transaction representing approximately \$250 million of this annual EBITDA is already under review by the conflicts committee on the MPLX board, and is expected to close by the end of the first quarter.

Work related to the remaining plan dropdowns is on schedule, and we were pleased to see the qualifying income regulations finally released. We are currently reviewing the amended regulations and pursuing all actions to get comfort around the qualifying income treatment for our proposed fuels-distribution model which will likely involve a private letter ruling on the structure given the substantial differences to precedent transactions. In conjunction with the completion of the plan dropdowns, MPC also expects to exchange its economic interest in the general partner, including incentive distribution rights for newly issued MPLX common units. We expect this exchange will capture the under-appreciated value of our general partner interest and optimize the cost of capital for the partnership.

Similarly to our long-term intent to maintain an investment-grade credit profile, cash proceeds from the dropdowns and ongoing LP distributions to MPC are expected to fund a substantial ongoing return of capital to shareholders. Importantly, all transactions are subsequent to requisite approvals, including the independent conflicts committee of the MPLX board and will be subject to market and other conditions, including tax and other regulatory clearances. Additionally, a special committee of the board has been formed and has selected an independent financial advisor to assist in the full and thorough review of Speedway to ensure optimum value is delivered to shareholders over the long term. We expect to provide an update on the review by mid-2017.

As we start the new year, I also wanted to provide some observations on the macro environment we are expecting in 2017. From a commodity and oil price perspective, we are encouraged by OPEC's resolve around production levels and think the prospects for a more balanced supply-and-demand environment should be supportive of higher crude prices throughout the year. This bodes well for a number of important differentials on the refining side as well as helping to continue to generate meaningful midstream development opportunities for MPLX. We think the US macro picture remains solid. And although we have seen unusual weakness in refined products demand in January, we expect that solid economic growth will continue to support good, underlying demand for refined products as inventory levels are worked down over the course of the year.

We are also encouraged by the early tone set around energy policy by the new administration. Although the ultimate changes remain to be seen, it appears we may have a legitimate opportunity to walk back some of the regulatory burdens that the industry has had to deal with over the last several years, including excessive delays on important and needed pipelines, a potential revisit of the requirements on the renewable fuel standard, as well as much-needed reform on taxes. The execution of our strategic plan, strengthening commodity prices, recovering refinery spreads, and an improved regulatory environment all contribute to what we expect will be a strong 2017 and believe we are well positioned to deliver long-term sustainable value to our shareholders.

Before I turn the call over to Tim, as we announced last Friday, MPC looks forward to welcoming Mike Stice to our Board later this month. Mike comes to us with more than 35 years in the upstream and midstream gas businesses, including as Chief Executive Officer of Access Midstream Partners where he had one of the largest gathering and processing MLPs. On behalf of the whole MPC Board, it's a pleasure to have Mike joining our ranks as we embark on an exciting year. With that, let me turn the call over to Tim to walk you through the fourth-quarter and the full-year 2016 financial results. Tim?

Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

Thanks, Gary. Slide 4 provides earnings on both an absolute and per-share basis for the fourth-quarter and full-year 2016. MPC's fourth-quarter earnings of \$227 million, or \$0.43 per diluted share, were up from last year's \$187 million, or \$0.35 per diluted share. For the full-year 2016, earnings were nearly \$1.2 billion, or \$2.21 per diluted share, down from \$2.9 billion, or \$5.26 per diluted share in 2015.



The chart on slide 5 shows the change in earnings over the fourth quarter last year. It is important to note that the \$187 million of fourth-quarter 2015 earnings included a \$370 million pretax lower-of-cost or market inventory evaluation charge. \$345 million of this prior-year charge is reported in the Refining and Marketing segment and \$25 million was in the Speedway segment, with the related tax benefit reflected in income taxes. There were no LCM adjustments in the fourth quarter of 2016 resulting in a favorable year-over-year effects for both of these segments and an unfavorable quarter-over-quarter change for income taxes.

The quarter-over-quarter comparison also reflects several impacts related to the MarkWest merger in multiple bars on the walk. Midstream segment results increased as we had a full quarter of MarkWest results this year compared to less than one month in 2015. The walk also highlights an increased interest expense resulting from the assumed MarkWest debt and an increased allocation of MPLX earnings to the publicly held units in the partnership, shown here as noncontrolling interest.

Turning to slide 6, our Refining and Marketing segment reported income from operations of \$219 million in the fourth quarter of 2016, compared to \$179 million in the same quarter last year. Looking at our key market metrics, an increase in LLS-based blended crack spread had \$105 million favorable impact to segment results as an increase from the Gulf Coast crack more than offset the effects of a decrease in the Chicago crack. The blended crack increased from \$6.65 per barrel in 2015 to \$7.39 per barrel in 2016. We also benefited by \$47 million on the sweet/sour differential as a higher percentage of sour crude in the slate more than offset a slightly narrower sweet/sour differential.

Offsetting much of these favorable impacts was an unfavorable other gross margin effect of \$397 million, primarily due to two factors. First, we experienced weaker asphalt price product realizations compared to fourth quarter 2015. Asphalt realizations were exceptionally strong in the fourth quarter of 2015 and did not increase at the same rate as the rise in the price of crude in the fourth quarter of 2016. Second, we experienced weaker gasoline product price realizations versus the LLS-based crack spread reported on our market metric for the quarter.

Segment results also reflected an unfavorable impact from direct operating costs of \$70 million, primarily related to turn-around activity in the quarter. Turn-around and major maintenance costs were \$0.45 per barrel higher in the fourth quarter of 2016 as compared to the fourth quarter of 2015.

Turning to slide 7, we've also provided a sequential comparison of the Refining and Marketing segment results for the fourth quarter of 2016 as compared to the third quarter of 2016. A decrease in the LLS-based blended crack had a \$201 million unfavorable impact to segment results as an increase in the Chicago crack spread was only partially offset by an increase in the Gulf Coast crack. The blended crack spread decreased from \$8.08 per barrel in the third quarter to \$7.39 per barrel in the fourth quarter. Direct operating costs were \$70 million higher than the third quarter, primarily related to turn-around activity at our Garyville refinery.

A favorable other gross margin effect of \$257 million almost completely offset these unfavorable effects. The change in other gross margin was primarily due to two factors. First, we experienced stronger product price realizations versus spot market prices used in the LLS-based crack spread reported on our market metrics. Second, crude and feed stock acquisition costs, compared to the market indicators, were more favorable fourth quarter compared to third quarter.

Slide 8 provides the drivers for the change in Refining and Marketing segment income for the full year versus 2015. Income from operations was \$1.5 billion in 2016, compared to \$4.1 billion in 2015. The LLS 6-3-2-1 blended crack spread had nearly a \$2 billion unfavorable impact on the full-year segment results, with lower crack spreads in both the Gulf Coast and Chicago markets over the full year. The blended crack spread for the full year decreased from \$9.70 barrel in 2015 to \$6.96 per barrel in 2016. We had a \$334 million improvement from the sweet/sour differential as a \$0.42 wider differential combined with about a 5% higher crude oil throughput over the full year.

The primary contributor to the nearly \$1.1 billion unfavorable other gross margin variance in this walk was narrower gasoline and diesel price realizations versus the LLS-based crack spread in 2016 compared to last year. Finally, the value of refinery volumetric gains continues to be lower than last year due to the absolute lower refined products price environment in 2016. The \$407 million increase in direct operating costs over 2015 was related to the higher refinery turn-around activity in 2016 versus prior year.



Turn-around and major maintenance costs increased \$0.70 per barrel compared to 2015, with significant turn-around activity occurring at Garyville, Galveston Bay, and Robinson in 2016, compared to a fairly light schedule turn-around activity in 2015. In addition, year-over-year results reflect the favorable effect to 2016 full-year segment results caused by the \$345 million LCM charge in 2015 and the subsequent reversal of inventory valuation reserve as refined product prices increased in 2016.

Moving to our other segments, slide 9 provides the Speedway segment results for the fourth quarter and full year. Speedway segment income was \$165 million in the fourth quarter of 2016, compared to \$135 million in the same period 2015. The increase in segment income was primarily due to lower operating costs, the increased merchandise margin, and the absence of an LCM adjustment in 2016 compared to the 2015 LCM charge of \$25 million. These favorable impacts were substantially offset by lower light product margins which decreased from \$0.1823 per gallon in the fourth quarter of 2015 to \$0.1617 per gallon in the fourth quarter of 2016.

Speedway's income from operations for full-year 2016 was a record \$734 million, compared to \$673 million in 2015. The increase in segment income was a result of record merchandise margin, gains from asset sales, and the effects of LCM adjustments mentioned earlier. The favorable impacts were partially offset by lower light product margins which decreased from \$0.1823 per gallon in 2015 to \$0.1656 per gallon in 2016.

So far this year we've seen a roughly 3.8% decrease in same-store gasoline volumes when comparing January 2017 to January last year, due to lower demand seen across our marketing area in addition to impacts from the ice storms in the Southeast. For the same period, US gasoline demand decreased approximately 6.5%. As Gary mentioned earlier, despite the seasonal weakness in demand, we continue to expect gasoline demand to rebound to levels comparable to 2016.

Slide 10 provides changes in the Midstream segment income of \$151 million quarter over quarter and \$491 million year over year. The increases were primarily due to the combination with MarkWest in December 4 of last year and from the results of new pipeline and marine equity investments during 2016.

From a cash flow perspective, slide 11 presents elements of changes to our consolidated cash position for the fourth quarter. Cash at the end of year was just over \$187 million. Core operating cash flow, before changes to working capital, was an \$896 million source of cash. Working capital was a \$95 source of cash for the quarter as the price impact on crude payables more than offset inventory impacts in the quarter.

Cash flow for the quarter also reflects opportunistic equity issuances by MPLX to its ATM program during the quarter, with net proceeds of \$277 million. Return of capital to shareholders, by way of dividends and share purchases, was \$210 million during the quarter. Going forward, we intend to maintain our focus on disciplined and balanced approach to capital allocation, including careful investment in the business and continued return of capital to shareholders. As Gary mentioned earlier, we expect cash proceeds from dropdowns and ongoing LP distributions to fund the substantial ongoing return of capital to shareholders, all conducted with continued focus on maintaining an investment-grade credit profile at both MPC and MPLX.

Slide 12 provides an overview of our capitalization and financial profile of the business at the end of the year. We had \$10.6 billion of total consolidated debt, including \$4.4 billion of debt at MPLX. Total debt-to-book capitalization was 33% and represented 2.5 times last 12-months adjusted EBITDA on a consolidated basis, or about 1.9 times if we exclude MPLX. We continue to show the metric without MPLX because we think it's more useful to show the bifurcated capital structure, given the effect of the relatively higher leverage of the growing partnership on consolidated metrics.

Slide 13 provides updated outlook information on key operating metrics for MPC for the first quarter of 2017. We are expecting the first-quarter throughput volumes to be down slightly compared to the first quarter of 2016 due to more planned maintenance during the quarter. Total direct operating costs are expected to be \$10.05 per barrel on a total throughput of about 1.68 million barrels per day. The increased operating costs quarter over quarter is primarily attributed to planned maintenance, mainly in the Gulf Coast where turnarounds will occur at all three refineries. Gulf Coast crude throughput is estimated at 800,000 barrels per day.

Included in the first quarter planned maintenance is the first turnaround of process units from Garyville's 2009 major expansion. While costs are higher than first quarter last year, we expect the full-year planned maintenance cost to be similar to 2016 levels. Manufacturing costs on a per-barrel basis are also expected to be higher due to higher forecasted natural gas prices combined with lower throughput volumes.



We expect to continue to see an advantage from processing sour crude, as reflected in our expectation, that will make up about 64% of crude oil throughput in the first quarter. Estimated percentage of WI type -- priced crude (sic - see slide 13 "WTI-priced crude") is 15%. Our projected first-quarter Corporate and Other unallocated items are estimated at \$80 million. With that, let me turn the call back over to Lisa. Lisa?

Lisa Wilson - Marathon Petroleum Corporation - Director IR

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Brad Heffern, RBC Capital Markets.

Brad Heffern - RBC Capital Markets - Analyst

Good morning, everyone. Gary, I was just wondering if you could talk a little bit about the border adjustment tax. If it happens, how would it affect MPC's behavior, how it would affect product markets in general and maybe the likelihood you think that it would get past"

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Let me start -- in the event that it were to be past, Brad, the refiners is going to have to be able to pass any incremental costs on to the consumer. And I am very confident that we will be able to do that just as we did when crude prices were \$100 to \$147, we passed the price on to the consumer. Now the calculus is really a political calculus on do I think it will be passed. Because that is going to be the concern.

Trying to pass something through Congress that really is going to increase domestic crude prices at the benefit of domestic producers, to the detriment of the consumer, I think is something that is going to be difficult. But if it were to pass, we'll be able to be flexible. We'll be able to move the price onto the consumer. I've had a lot of questions, Brad — what do I think will happen with incremental exports? The companies who have their refineries in the Gulf Coast have the infrastructure and logistics to be able to export. We'll be the one's who will still be the most likely to export because we will have the lowest cost.

So as we stated, we were a little over 300,000 barrels per day of exports in this quarter. We now have the infrastructure set that we can go around 400,000 and moving up to 500,000 barrels per day. So we are in a very, very good position. And even if border adjustments were to happen, I think Marathon is in one of the best positions because of our logistics, infrastructure, our optimization between PADD II, PADD III refining that I think we will be in good shape if it were to happen.

Brad Heffern - RBC Capital Markets - Analyst

Okay. Thanks for that color, Gary. And then shifting over to the OPEC cut, I was curious if you have seen any impact on your volumes. Because of that cut, one of your peers said that they were getting prorated. And has there been any meaningful impact on the system overall?



Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Let me have Mike Palmer cover that.

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

Certainly we've seen the OPEC cuts. We have seen that there has been a tightening in some of the sour foreign opportunities that we have seen in past quarters. We at MPC -- we have got very strong relationships in contrast with Middle East suppliers. So far we -- of course in January and February we've had turnarounds. So there has been really no impact on us. Our demand's been down.

But as I say, we've got very strong relationships. We don't think that there is going to be a big impact. We are already in the market buying March and April crude oil for the system. And we've continued to see some real values in sour crude opportunities. So I don't think it's going to have a big impact on us.

Brad Heffern - RBC Capital Markets - Analyst

Okay. Thanks, guys.

Operator

Phil Gresh, JPMorgan.

Phil Gresh - JPMorgan - Analyst

Good morning. First question is just to follow up on some of the demand commentary. Gary, just curious what you're seeing on the demand front. Why the data has been as weak as it has to start the year and what makes you confident that it will get back to a stable outlook as progress through the year.

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

First of all, Phil, I'll take you back to the same time last year. We didn't have a winter, if you recall. So last year demand in January was strong plus we were on the rebound after the rapid decline in crude prices and, therefore, gasoline prices. And you couple that with really no upsets in the weather patterns over the same period last year led us two very, very strong first quarter volume.

Now we've had a couple big storm cells have come through mainly in the Southeast here earlier in the year. That has caused a pretty big upheaval. And then secondly, a lot of fog in and around the Gulf Coast regions, the Houston ship channel, all the way through to Florida that has caused really some supply and demand issues. But I think we'll get beyond this and everything seems to have really gone back into a different pace right now. And what we are seeing though secondly is as you see crude prices increase, what you are going to see in many of our markets, Tony Kenney's Speedway operations in many of the markets -- he has to lead the price up in order to be able get the incremental costs to the street.

That will have some short-term hit on demand. But I believe as long as crude prices continue to have a methodical pace upwards, I believe will be able to get that price to the street and not be too big of a hit on volume.

Phil Gresh - JPMorgan - Analyst

Okay. Got it. And my second question is just on the maintenance -- obviously a very high first quarter level for you was well as for your peers. How do you think about maintenance for the full year in the MPC system relative to what we saw last year? And are you anticipating the whole industry



-- based on what we've heard from a couple, it feels like the whole industry is going to have pretty heavy maintenance February through April. Is that consistent with your view?

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Let me have Ray Brooks first handle our maintenance.

Ray Brooks - Marathon Petroleum Corporation - SVP, Refining

Okay. As Tim stated earlier, our maintenance for the first quarter is up substantially because in the Gulf Coast we have significant turnaround activity at all three of our refineries. So we are up for the quarter. But for the year we look at it being flat with 2016 -- where we actually ended up in 2016. And I will say in 2016 we were very aggressive about bringing our spend levels down. So we are projecting to hold even with that for the year.

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

And, Phil, as we look across the entire industry, I think we see both where we have our refining PADD II, PADD III to be about equal to the total maintenance of last year -- maybe just a little bit of an uptick in the Gulf Coast. Some of the concerns we have been -- the work we've done already here in January has been just a little bit ahead of schedule and under budget.

So we have been doing very well. There have been some concerns in the industry though about the labor force. But I don't think at the end of the day that it is going to have a substantial impact on the refining industry. But that's something I would say to keep an eye on. But we're in very, very good shape in all of our turnarounds.

Phil Gresh - JPMorgan - Analyst

Okay. Thanks.

Operator

Ed Westlake, Credit Suisse.

Johannes Van Der Tuin - Credit Suisse - Analyst

Hi. It's actually Johannes here pinch hitting for Ed. Thank you for taking my question. First and foremost, just a quick question on it's really the logistics side of the house. It seems like there was a bit of a bump in MPLX EBITDA guidance. How much of that is throughput utilization in the Northeast kind of low capital intensive improvements?

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Don, do you want to take that?



Don Templin - Marathon Petroleum Corporation - EVP

I don't think any of it was related to that. We are just seeing stronger demand as we especially are moving into 2017. We feel great about the growth opportunities that we have. The logistics and storage business is performing really, really solidly. And we have some very good potential growth opportunities on the gathering and processing side.

Johannes Van Der Tuin - Credit Suisse - Analyst

Okay. Are there any regional differences or specific drivers you would like to highlight?

Don Templin - Marathon Petroleum Corporation - EVP

I would like to say that from our perspective Marcellus probably has some very strong opportunities for us. And we are seeing good volumes there. Our major producer customer such as Antero and Range and EQT have been very bullish on volumes going into 2017. And then we see a lot of optimism and opportunities for us in the Southwest. Our capital budget probably will spend more money in the Southwest this year than we do in the Utica region.

Johannes Van Der Tuin - Credit Suisse - Analyst

Okay. That's very helpful. And then circling back to the border adjustment tax very quickly, out of curiosity, do have a sense as to either for yourselves or the industry as a whole what percentage of WCS is on long-term contract?

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

I don't. Mike, do have any sense on WCS?

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

Well on long-term contract, again, going back to WCS, WCS is -- really it refers to the heavy Canadian. WCS is a particular grade but there are many heavy Canadian grades. Most of that crude oil coming out of Canada is either sold spot month-to-month or on 30 or 60 day kind of evergreen contracts. So it can be turn around fairly quickly. I think that regardless of the border tax, the Canadian crude -- the heavy Canadian continues to grow and that crude will flow into the US. Does that answer your question?

Johannes Van Der Tuin - Credit Suisse - Analyst

I think it does more or less. So most of it is at the outside as kind of a 60 day contract?

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

Yes.

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

The way you really have to look at this is that there may be shippers who have long-term shipping commitments but they are fulfilling that buying through the 30 or 60 day evergreen window. So typically we do not have a long-term shipping contract like some of those that are going to the Gulf Coast. But the requirements are fulfilled either on a spot or 30 to 60 day window.



Johannes Van Der Tuin - Credit Suisse - Analyst

Okay. Thank you very much.

Operator

Doug Leggate, Bank of America.

Doug Leggate - BofA Merrill Lynch - Analyst

Gary, I realize that the process around Speedway is still ongoing. But I wonder if I could ask you to frame your latest thoughts on the viability of a separate retail business while still pursuing the fuels distribution drop. I know control and influence over fuels distribution is important to the refining business so I was wondering if you could talk about the viability at a very high level, albeit we're still waiting on the result of the outcome of the review by mid year.

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Sure, Doug. As we said and I said on the January 3 call, and to be very specific, the viability will be one of the scenarios that we look at. But we are doing a full and thorough review over all the scenarios that we really can consider at this time. You have to look at counterparty risk. You have to look at the balance sheet of MPC after you drop into the fuels distribution.

You have to look at the credit profile. So we're going to look at all the different scenarios. And I'm not going to lean one way or another. Our statement that we made on January 3 is just that. There will be a full comprehensive review and then we will determine by midyear what the outcome is.

Doug Leggate - BofA Merrill Lynch - Analyst

Okay. I thought it was worth a try but we will have to be patient. Gary, my second -- my follow-up question if I may is unfortunately also on tax. So a slightly different question though in terms of how you are preparing or planning internally. And what I'm driving at is you guys are obviously a fairly large cash tax payer. What scenarios are you running in terms of the current corporate tax potential changes -- the Brady Bill versus a 15% corporate rate and obviously the offsets from depreciation and so on?

How are you trying to frame? And it at the end of the day, if the tax rate fell, would you expect to see a material improvement or reduction in your cash tax payment. That's really what I'm trying to get out. I'll leave it there. Thank you.

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Sure, Doug. Tim, do you want to take that?

Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

Sure. Doug, the picture is still a little bit murky in terms of how all the potential reforms play out. Certainly the reduction in the proposed change in the corporate tax rate either under the Republican blueprint or the Trump plan that potentially 20% or 15% -- obviously very helpful but it could dramatically lower the cash tax burden of the Company. There is also obviously a proposal to eliminate interest expense as the deduction.



There is a part of the proposal that incorporates immediate expensing of capital and then obviously the border tax adjustment. There is really a pretty complicated set of potential changes that come out. And we're trying to look at them as clarity is offered in terms of what the net impact could be on the business and sort of where it plays out. A think a little bit tough to handicap exactly what form it takes but certainly there are elements to the tax reform that we think are extraordinarily positive.

The lowering of the tax rate and the immediate expensing are two areas that we're very supportive of. And what the offset from some of the other provisions could be, I think remain to be seen at this point. It would be tough to handicap or indicate exactly where that's going to come up but we're going to look at it pretty carefully. We certainly are entirely supportive of the notion of tax rates going down to make the US more competitive on the global stage. And we think those are very productive discussions and could be fantastic if implemented. But it's tough to say at this point what the net impacts on the cash tax base for us could be.

Operator

Paul Cheng, Barclays.

Paul Cheng - Barclays Capital - Analyst

I think the first question is for Tim. Tim, explaining that the quarter -- you were talking about the outer margin improvement sequentially due to two factors. One is there are stronger price realization than what the screens say and the other one is the true and the fiscal purchase call and small favor at both end of the benchmark. When you are looking at so far in the quarter, if those trends continue and getting more favorable or about the same or just getting less favorable?

Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

We wouldn't give guidance necessarily on the trending into the first quarter. I think we would highlight that third quarter from a product price realization on a number of fronts was what we thought to be unusually low from a product price realization. A lot of those impacts did not occur again in fourth quarter. And I think less likely we would see those as we go forward.

But we really would not provide guidance necessarily on how that will shake out in the first quarter. We will see what the product markets look like, as Gary indicated. In environments where prices are rising, there's generally a little bit of a lag in terms of the catch up on street prices which will have a product price realization impact. Again, I think we would probably characterize third quarter as a little bit unusual relative to the realizations that we've seen over the last several years.

Paul Cheng - Barclays Capital - Analyst

Tim, in the fourth quarter do you have any sales of inventory?

Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

I'm sorry, Paul.

Paul Cheng - Barclays Capital - Analyst

In the fourth quarter did you sell any inventory? Did you sell down anything from the inventory?



Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

No. We actually had a slight inventory build into the fourth quarter. So there was no net liquidation of inventory in the fourth quarter.

Paul Cheng - Barclays Capital - Analyst

The second question is that, Gary, should we assume the MPLX \$1.7 billion in the CapEx this year is going to be fully funded? It's not going to acquire any support from MPC? And also that the -- wondering is there any additional color in terms of the drop-down pace for this year? Are we going to do the \$1.4 billion totally in this year -- \$250 million in the first quarter. Should we assume the order remaining or get dropped down in the fourth quarter?

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Well I'll take the last part of that first. As you know, we've already turned over to the conflicts committee approximately \$250 million. Then we are working on what the optimum pace is for the balance of the year. That has not been -- we've not turned anything else over to the conflicts committee yet.

But I would expect that you would see something -- maybe I wouldn't necessarily call it ratable, Paul. But maybe another chunk some time in the third quarter or so just to spread it out a little bit over the year. Let me have Don take the budget and how he is going to fund that.

Don Templin - Marathon Petroleum Corporation - EVP

Yes, Paul, on the \$1.7 billion we would expect to fund that all with MPLX without any support from the parent. You will recall that in 2016 there was a real focus on capital preservation. The balance sheet and the leverage metrics at MPLX were higher than we wanted them to be and what we were targeting. So we started out with about 4.7 times leverage at the beginning of 2016. We're down to 3.4 times by the end of 2016 and we are in a very comfortable position to be able to fund our organic growth through a combination of equity and debt.

Paul Cheng - Barclays Capital - Analyst

Thank you. Gary, just want to make one comment about the retail. Given the pretty aggressive drop-down and also the change of the GP, we just hope that maybe that -- maybe I'm wrong but personally I think it is probably far better off for you to keep Speedway (inaudible) spin it off. Thank you.

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Thank you, Paul. I appreciate your comments. I always appreciate your comments.

Operator

Chi Chow, Tudor Pickering Holt.

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

Good morning. Regarding the acceleration of the midstream drops, does the commitment to contribute all the assets this year suggest that you may forgo the private letter ruling on field distribution? And I suppose by extension, did the recent IRS regulation give enough comfort on dropping that field distribution business down as qualifying income?



Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Sure. Tim?

Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

Chi, the regulations that are issued were we think positive. We don't see anything in them at our initial review that is suggestive of anything that would be a gating item to field distribution. Nonetheless, we still think it's likely that we will pursue a PLR just given the size of the earnings that represents and the impact it could have on the partnership. So we are certainly, as Gary said, pleased to see them finally issued. We are working through them now. And, again, think it's still likely that we would pursue a PLR just to make sure we have got a high level of comfort that we're not putting something in the partnership that would not be qualifying in nature and potentially threaten the partnership's QI treatment.

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

Given your drop down guidance, do you expect that PLR then soon, I would think? Sometime this year then? Is that what you're suggesting then with the guidance?

Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

Again, you never know exactly what the timing would be. And there could be a little bit of a backlog on some of the PLRs. But we will -- again, we are working through it now. And, again, with the likeliness -- likelihood of a PLR, expect that we would be submitting that in the near term. And then, again, would wait for guidance back from treasury around that. And, again, I think we are still hoping that all of these events could unfold in 2017. But that's probably a wildcard.

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

Okay. Thanks. Second question -- can you give us your thoughts on the potential change in the RIN obligation from refiners to blenders and what potential impact that might have on Marathon?

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Chi, if you look at how RIN prices have already come down from a little bit over \$1 in the -- early in the fourth quarter to \$0.47 today and that is not caused necessarily by concerns over the change in the point of obligation. I think it's really caused from the new administration taking over and stating that they do not like this RIN requirement and the renewable volume application requirements. As we've always said, the market can be balanced at just a little bit under 10% in ethanol. And refiners and blenders -- we need the ethanol in order to be able to meet our optimum requirements.

So I don't think it's a volume obligation versus RIN cost scenario. I think it's -- really we need to step back and look at does this renewable fuel standard makes sense in any way going forward? My answer would be no. That the way it is set today, on an absolute volume basis, it needs to be changed to a percentage base. And if that happens, that will take care of the RIN cost.

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

Okay. Thanks. Gary, one other follow-up. If I read the IRS regulations correctly -- and I might not be able to, that was a hard document to get through -- but it appears that they are ruling that the sale of RIN is considered a qualifying event. Does that change your thinking at all on possibly dropping RINs it they're still around into MPLX down the road?



Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

One of the things that we've always said is we don't see that RINs are affordable. So it would be very difficult to separate RINs and have a steady revenue stream from RINs. It's our belief that the RINs are in the crack spread. And, Mike, I will turn it over to you to see if you see any different.

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

No, Gary. I wouldn't answer the question any differently than you just did.

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

Okay great. Thanks for your thoughts.

Operator

Neil Mehta, Goldman Sachs.

Neil Mehta - Goldman Sachs - Analyst

This is related to Speedway and retail. What drives the pickup in capital spending here in 2017 versus 2016 at Speedwell? And then, Gary, can you talk about how you think about the outlook for retail margins next year? Especially if you're right that crude prices continue to grind higher?

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

I will take the latter part. It's crude prices -- and, again, it is the rate or the pace that crude prices would change, Neil. If there is a slow and steady climb -- at your conference I outline that we expect 2017 will end somewhere in the \$60 to \$65 range. That's where we expect. So if it's a slow, steady climb into that level, you'll be able to move the price to the street and really not affect demand much.

I think at your conference I stated that if you look at the elasticity for an increase at the retail price, you're looking at about every \$0.50 increase in retail price, you may have somewhere 1.5% to 2% change in demand. That may vary over regions. But I don't think it will have that much of an effect. We're expecting gasoline for the full-year to be flat and diesel to be up a couple of percents for the year. And I will let Tony talk about his capital budget for the year.

Tony Kenney - Marathon Petroleum Corporation - President, Speedway LLC

Yes. The biggest change in our capital is we had a provision in our capital for 2017 to be able to comply with the euro pay MasterCard Visa requirements at her dispensers at 2,700 locations. As you know, that date has changed. We have a capital in there.

It's not going to go away ultimately. Sooner or later the US is going to have to comply with the ability to take chip cards at our retail locations. So we are currently evaluating how we want to approach along the changed timeline -- our investment and the changes that will make it retail. So most of that change is in regard to how we are going to go forward with the investments we need to make in accepting chip cards at our locations.



Neil Mehta - Goldman Sachs - Analyst

I appreciate the comments. And the second is on Dakota Access. Can you just talk about where we are with in terms of the Dakota Access Pipeline and when you ultimately expect crude to start flowing?

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Okay. Don, do you want to take that?

Don Templin - Marathon Petroleum Corporation - EVP

Sure. Neil, we are optimistic that especially with recent communications coming out of the administration around that pipeline, we are optimistic that that pipeline gets completed and gets completed quickly. And from a MPLX perspective, we are prepared to make our investment in that pipeline when the conditions to close are met. So with respect to their -- I think it's probably not our place to talk about first oil and whatnot but in terms of the transaction or the pipeline being completed, we are optimistic that will happen in the near future and we are well prepared for it.

Neil Mehta - Goldman Sachs - Analyst

Thanks, guys.

Operator

Roger Read, Wells Fargo.

Roger Read - Wells Fargo Securities, LLC - Analyst

Gary, maybe just to come back to some of the retail questions here. You mentioned on the January 3 call, I think, in response to a question that you felt that most of the RINs expense is in the crack. If that's the case, then as we think about retails EBITDA generation down the line, should we think about it as sands RINs price? And that it's maybe a little lower performer than what we've been used too?

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

No. I don't think so, Roger. We don't have -- we aren't showing any value at the Speedway side for RINs. We -- Marathon is the blender of record for a lot of our volume that goes into Speedway. But I don't think you are going to see any change in Speedway due to possible change in RINs. Tim, do you see it any different?

Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

No. I think that's right, Gary. Ultimately it's -- Marathon is ultimately the blender which is where this is getting picked up. So, Roger, there is really nothing with regard to Speedway segment earnings that has RIN component. Obviously the RINs reflected in pricing gets factored into the transfer pricing that we look at within the business. But there's nothing really that would change even if there were some separation in the future, which obviously will remain to be seen.

Roger Read - Wells Fargo Securities, LLC - Analyst

Okay. So there is not an allocation risk, like you said, on the transfer pricing or anything?



Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

Nο

Roger Read - Wells Fargo Securities, LLC - Analyst

Okay. Perfect. And then, Gary, can you give us a little more detail on exactly who's doing the evaluation of Speedway for the spin and maybe what Marathon management's input is on that directly?

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Yes, Roger. As I stated, we've already have -- the board has appointed a special committee. And they are going down the path of their work with a financial advisor. We want to keep this as a very independent, confidential study between the committee. So we are not going to announced at this time who the financial advisor is. We will over time.

And management's job -- I am not on the special committee. This is -- I've felt it was important to keep this totally independent. And we have five board members making up the special committee. All members of the board but I am not part of that. Now management will prepare a lot of the data that the committee and the advisors that are working on this -- management will compile a lot of data for the advisors to work on. But that's management's job is just to compile data and to turn that over.

Roger Read - Wells Fargo Securities, LLC - Analyst

Okay. Thank you.

Operator

Jeff Dietert, Simmons.

Jeff Dietert - Simmons & Company International - Analyst

We've tracked about 10 Bcf a day of new pipelines coming on in the Marcellus this year and another 10 Bcf a day in 2018. I was wondering if you could talk about how you expect this infrastructure to impact Northeast natural gas prices and opportunities for you in the Marcellus?

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Don?

Don Templin - Marathon Petroleum Corporation - EVP

Sure, Jeff. We are also tracking those individual projects and we are confident that many of those projects will ultimately be completed. From our perspective right now I think the last sort of year has been -- we were very focused on supporting our producer customers in allowing them or providing them opportunities to move NGLs out of the Utica Marcellus.

I would say from my perspective, and I think based upon our discussions with producer customers, residue gas movements out of the Utica Marcellus are an important part of their consideration around growth going forward. We would expect that over time, when you get those particular projects



in place, that the differential would probably come from -- get down to maybe a \$0.50 differential which would really be a transportation cost differential. And you well know, Jeff, that in the summertime and other parts of the year, that differential has been probably as much as \$1.50. So we would be improving the differential for our producer customers by \$1 probably.

Jeff Dietert - Simmons & Company International - Analyst

Great. You've previously guided to about \$7.5 billion of organic spending between 2016 and 2020. It sounds like your 2017 guidance is kind of in that fairway. Any biased higher or lower on your long-term organic spending outlook?

Don Templin - Marathon Petroleum Corporation - EVP

I think we are really confident about and optimistic about the opportunity to identify and to deliver on organic growth projects, Jeff. So I would say that if I had a bias, it would be on the higher side of that, not on the lower side of that.

Jeff Dietert - Simmons & Company International - Analyst

Thanks for your comments.

Operator

Benny Wong, Morgan Stanley.

Benny Wong - Morgan Stanley - Analyst

Just wondering if you can give us an update on how you're thinking about your return of capital program this year and how you guys balance the pace of your buybacks stock with the visibility you might have with your drop-down plan.

Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

Sure. Again, if we sort of look bad at 2016, obviously the buyback activity is always a function of where we see operating cash flow in the business. I think with the plans that are announced with regard to the drops and, again, the prospects and at least the potential for the full \$1.4 billion to be dropped into MPLX in 2017 -- they're, again, subject to our maintaining and investment grade credit profile and any adjustments we may need to make to make the capital structure to support that, the primary source of those funds is going to be in return of capital.

So that will come in the form of potential consideration around the dividend and certainly for share buybacks which we think are the most efficient way to get capital back. So I think our expectation is based on what's laid in front of us for 2017 is that capital return will be a much larger source of activity in 2017. And, again, outside of any adjustment we make to debt will be the primary use of the cash.

Benny Wong - Morgan Stanley - Analyst

Great. Thanks for that, Just a follow-up on unrelated -- can you give us some color around the scale back of the capital at the STAR program? Is there items that you are no longer investing in or did you figure out some work around where you're able to obtain the same result without spending the money? Just trying to get a better understanding of the change there.



Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Ray, do you want to talk about what the reduction entails?

Ray Brooks - Marathon Petroleum Corporation - SVP, Refining

Sure. The STAR program -- we continue to progress that. And as Gary stated earlier, that's now viewed as a \$1.5 billion project. It still looks really good. Just a little bit of color on that is the STAR program actually has several components across the Galveston Bay TRD complex that we've looked at. And the first part of that we actually pulled in 2016 when we looked at a resid de-asphalting unit. And we did a repurposed unit to actually run resid and then expanded it.

And that had a phenomenal return. It exceeded our expectations. And so has generated more EBITDA than we previously projected. And then there are three other components of that going forward -- looking at our sour crude unit and revamping that, expanding our resid hydro-cracker and then also looking at a diesel hydrotreater. At this point, we are going to progress engineering on two phases of that -- the crude unit revamp and resid hydrocracker revamp.

And at this point not progress any further on the engineering with a diesel hydrotreater. And that is simply based on looking at all of the components on a standalone basis for their return and two projects exceed our refining hurdle rate while under the 20% where the diesel hydrotreater did not. So that's just a little bit more detail on that project going forward.

Benny Wong - Morgan Stanley - Analyst

Awesome. Thanks for the color, guys.

Gary Heminger - Marathon Petroleum Corporation - Chairman, President & CEO

Benny, what Ray was talking about there -- our expectation for 2016, the asphalting unit that was completed, we'd expected about \$80 million of EBITDA. And now we are projecting that to be north of \$100 million. So a very, very strong increase due to the performance of the unit.

Benny Wong - Morgan Stanley - Analyst

Great. Thanks, guys.

Operator

Corey Goldman, Jefferies.

Corey Goldman - Jefferies & Co. - Analyst

A quick follow up to Johannes' question on MPLX guidance. Don, can you comment what's included for DAPL in 2017 in the guidance?

Don Templin - Marathon Petroleum Corporation - EVP

There is nothing included for DAPL in guidance.



Corey Goldman - Jefferies & Co. - Analyst

Okay. And if I remember correctly, you guys already pre-funded to CapEx for DAPL? Is that right?

Don Templin - Marathon Petroleum Corporation - EVP

We have about \$2.7 billion of liquidity currently. So we are in with almost \$300 million in cash. So we are in a very good position sitting here in anticipation of that.

Corey Goldman - Jefferies & Co. - Analyst

Okay. That's helpful. And then a quick follow up. I'm assuming you guys have been in communication with rating agencies as it relates to some of the pro forma debt to EBITDA metrics following the dropdowns. Can you give us some commentary on what we can expect it would take to retain IG for both levels there?

Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

Sure. We've had dialogues and even with the negative outlooks that Moody's and Fitch put out more recently, we've talked to them even beyond that. But I think we feel very comfortable that anything that we do with regard to capital structure will be supportive for both entities. For MPLX what we have indicated is that about a four times debt to EBITDA. Over the course of time we think makes sense and is an appropriate amount of leverage for partnerships that's investment grade rated.

You may have seen even yesterday S&P published that MPLX on a standalone basis is investment-grade. That initial rating was based on the rating of appearance so we think it's very encouraged. Again, on the MPC side, we'll continue to look at and evaluate. I think the initial reaction to the announcements was some concern about the increase in leverage. And, again, what we've indicated is that we will take actions and adjust the capital structure as we need to to support that profile overtime.

Even with all of the actions we are taking here, I think it's worth reminding everyone that the amount of cash distributions that come back to MPC, even once we work through a GP buy-in, are going to be substantial. And that will afford us a tremendous amount of financial flexibility to make adjustments as we need to as well as continue to return capital. So I think we're very comfortable that the investment grade credit profile for both entities is something that we will be able to maintain and we'll take action to support that over time.

Corey Goldman - Jefferies & Co. - Analyst

Okay. Any commentary on what appropriate cap structure could look like at MPC in terms of like an absolute number?

Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

I think if we look on sort of a net MPC basis, which also has been an important part of the dialogue with the agencies and with fixed income investors, we think that probably the two times debt to EBITDA is probably in our comfort zone and would probably look to maintain things at or around those levels as we go forward.

Corey Goldman - Jefferies & Co. - Analyst

Okay. That's very helpful. Thanks, guys.



Operator

Spiro Dounis, UBS Securities.

Spiro Dounis - UBS - Analyst

I thought I took myself out of the line -- most answered at this point. But to reach deep in the bag here, since I'm on anyway, I just wanted to ask you on your decision to repay or prepay some debt last quarter, I'm just wondering where you're thinking about going forward? Did you make the decision again and could we see you scale that down over the next quarter? Thanks.

Tim Griffith - Marathon Petroleum Corporation - SVP & CFO

Spiro, it's Tim. I think the consideration around the debt pay -- and third quarter, again, was just based on where we saw the full-year earnings coming out for refining and just making sure that, again, we are calibrating the capital structure for the underlined earnings. Again, any further adjustments to capital structure would really be based on sort of what were doing with the drops and what things will look like in terms of the new debt taken out at MPLX and what that could mean for the consolidated fixture.

So it is something we will look at. I don't think there's anything that compels us at this point. Again, it will really be a function of the drops and what the pro forma capital structures look like once his activity is completed. So something we will continue to monitor. No specific guidance that we provide right now other than we're going to continue to watch very carefully and adjust the leverage situation at MPC as we think appropriate.

Spiro Dounis - UBS - Analyst

Got it. Understood. Thanks, Tim.

Operator

Thank you. We have no further questions at this time. I will now turn the call back to Lisa Wilson.

Lisa Wilson - Marathon Petroleum Corporation - Director IR

Thank you, Jason. And thank you for your interest in Marathon Petroleum Corporation. Should you have additional questions or would like clarification on topics discussed this morning, Denise Myers, Doug [Wentz] and I will be available to take your calls. Thank you for joining us this morning.

Operator

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



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