MARATHON OIL CORP
Form 10-Q
May 08, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended March 31, 2006

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 1-5153

Marathon Oil Corporation

(Exact name of registrant as specified in its charter)

Delaware	**25-0996816**
(State of Incorporation)	(I.R.S. Employer Identification No.)

5555 San Felipe Road, Houston, TX 77056-2723

(Address of principal executive offices)

(713) 629-6600

(Registrant s telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ **Accelerated filer o** **Non-accelerated filer o**

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

There were 362,436,024 shares of Marathon Oil Corporation common stock outstanding as of April 30, 2006.

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Unless the context otherwise indicates, references in this Form 10-Q to Marathon, we, our, or us are references to Marathon Oil Corporation, including its wholly-owned and majority-owned subsidiaries, and its ownership interests in equity method investees (corporate entities, partnerships, limited liability companies and other ventures over which

Marathon exerts significant influence by virtue of its ownership interest, typically between 20 and 50 percent).
Effective September 1, 2005, Marathon Ashland Petroleum LLC changed its name to Marathon Petroleum Company LLC. In this Form 10-Q, references to Marathon Petroleum Company LLC (MPC) are references to the entity formerly known as Marathon Ashland Petroleum LLC.

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Part I Financial Information
Item 1. Financial Statements

MARATHON OIL CORPORATION
Consolidated Statements of Income (Unaudited)

(Dollars in millions, except per share data)	First Quarter Ended March 31, 2006	2005
Revenues and other income:		
Sales and other operating revenues (including consumer excise taxes)	$ 12,998	$ 9,840
Revenues from matching buy/sell transactions	3,206	2,809
Sales to related parties	312	283
Income from equity method investments	92	40
Net gains on disposal of assets	11	11
Other income	19	27
Total revenues and other income	16,638	13,010
Costs and expenses:		
Cost of revenues (excludes items below)	9,769	7,692
Purchases related to matching buy/sell transactions	3,233	2,832
Purchases from related parties	51	56
Consumer excise taxes	1,165	1,084
Depreciation, depletion and amortization	415	323
Selling, general and administrative expenses	287	260
Other taxes	149	105
Exploration expenses	71	34
Total costs and expenses	15,140	12,386
Income from operations	1,498	624
Net interest and other financing costs	24	32
Minority interests in income (loss) of:		
Marathon Petroleum Company LLC		70
Equatorial Guinea LNG Holdings Limited	(3)	(1)
Income before income taxes	1,477	523
Provision for income taxes	693	199
Net income	$ 784	$ 324
Per share information:		

Net income per share basic	$ 2.15	$ 0.94
Net income per share diluted	$ 2.13	$ 0.93
Dividends paid per share	$ 0.33	$ 0.28

The accompanying notes are an integral part of these consolidated financial statements.

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MARATHON OIL CORPORATION
Consolidated Balance Sheets (Unaudited)

(Dollars in millions, except per share data)	March 31, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	$ 1,269	$ 2,617
Receivables, less allowance for doubtful accounts of $3 and $3	3,614	3,476
Receivables from United States Steel	20	20
Receivables from related parties	55	38
Inventories	3,409	3,041
Other current assets	218	191
Total current assets	8,585	9,383
Investments and long-term receivables, less allowance for doubtful accounts of $9 and $10	1,841	1,864
Receivables from United States Steel	529	532
Property, plant and equipment, less accumulated depreciation, depletion and amortization of $12,746 and $12,384	15,186	15,011
Goodwill	1,307	1,307
Intangible assets, less accumulated amortization of $63 and $58	196	200
Other noncurrent assets	160	201
Total assets	$ 27,804	$ 28,498
Liabilities		
Current liabilities:		
Accounts payable	$ 5,194	$ 5,353
Consideration payable under Libya re-entry agreement	212	732
Payables to related parties	108	82
Payroll and benefits payable	286	344
Accrued taxes	846	782
Deferred income taxes	466	450
Accrued interest	49	96
Long-term debt due within one year	15	315
Total current liabilities	7,176	8,154
Long-term debt	3,687	3,698
Deferred income taxes	2,033	2,030
Employee benefits obligations	1,221	1,321
Asset retirement obligations	750	711

Payable to United States Steel	6	6
Deferred credits and other liabilities	295	438
Total liabilities	15,168	16,358
Minority interests in Equatorial Guinea LNG Holdings Limited	471	435
Commitments and contingencies		
Stockholders Equity		
Common stock issued 367,280,367 and 366,925,852 shares (par value $1 per share, 550,000,000 shares authorized)	367	367
Common stock held in treasury, at cost 3,457,472 and 179,977 shares	(245)	(8)
Additional paid-in capital	5,116	5,111
Retained earnings	7,068	6,406
Accumulated other comprehensive loss	(141)	(151)
Unearned compensation		(20)
Total stockholders equity	12,165	11,705
Total liabilities and stockholders equity	$ 27,804	$ 28,498

The accompanying notes are an integral part of these consolidated financial statements.

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MARATHON OIL CORPORATION
Consolidated Statements of Cash Flows (Unaudited)

(Dollars in millions)	First Quarter Ended March 31, 2006	2005
Increase (decrease) in cash and cash equivalents		
Operating activities:		
Net income	$ 784	$ 324
Adjustments to reconcile to net cash provided from operating activities:		
Deferred income taxes	41	3
Minority interests in income (loss) of subsidiaries	(3)	69
Depreciation, depletion and amortization	415	323
Pension and other postretirement benefits, net	(92)	47
Exploratory dry well costs and unproved property impairments	34	12
Net gains on disposal of assets	(11)	(11)
Changes in the fair value of long-term U.K. natural gas contracts	(78)	57
Equity method investments, net	(59)	(2)
Changes in:		
Current receivables	(192)	2
Inventories	(366)	(277)
Current accounts payable and accrued expenses	(173)	(137)
All other, net	(60)	(53)
Net cash provided from operating activities	240	357
Investing activities:		
Capital expenditures	(599)	(556)
Acquisitions	(527)	
Disposal of assets	38	36
Investments loans and advances		(30)
repayments of loans and advances	87	
All other, net	14	6
Net cash used in investing activities	(987)	(544)
Financing activities:		
Debt repayments	(302)	(2)
Issuance of common stock	8	39
Purchases of common stock	(229)	
Excess tax benefits from stock-based compensation arrangements	10	
Dividends paid	(121)	(97)

Contributions from minority shareholders of Equatorial Guinea LNG Holdings Limited		30		73
Net cash provided from (used in) financing activities		(604)		13
Effect of exchange rate changes on cash		3		(4)
Net decrease in cash and cash equivalents		(1,348)		(178)
Cash and cash equivalents at beginning of period		2,617		3,369
Cash and cash equivalents at end of period	$	1,269	$	3,191

The accompanying notes are an integral part of these consolidated financial statements.

MARATHON OIL CORPORATION
Notes to Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

These consolidated financial statements are unaudited but, in the opinion of management, reflect all adjustments necessary for a fair presentation of the results for the periods reported. All such adjustments are of a normal recurring nature unless disclosed otherwise. These consolidated financial statements, including selected notes, have been prepared in accordance with the applicable rules of the Securities and Exchange Commission and do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. Certain reclassifications of prior year data have been made to conform to 2006 classifications. These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Marathon Oil Corporation (Marathon or the Company) 2005 Annual Report on Form 10-K.

2. New Accounting Standards

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (Revised 2004), Share-Based Payment, (SFAS No. 123(R)) as a revision of SFAS No. 123, Accounting for Stock-Based Compensation. This statement requires entities to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award on the grant date. That cost is recognized over the period during which an employee is required to provide service in exchange for the award, usually the vesting period. In addition, awards classified as liabilities are remeasured at fair value each reporting period. Marathon had previously adopted the fair value method under SFAS No. 123 for grants made, modified or settled on or after January 1, 2003.

Marathon adopted SFAS No. 123(R) as of January 1, 2006, for all awards granted, modified or cancelled after adoption, and for the unvested portion of awards outstanding at January 1, 2006. At the date of adoption, SFAS No. 123(R) requires that an assumed forfeiture rate be applied to any unvested awards and that awards classified as liabilities be measured at fair value. Prior to adopting SFAS No. 123(R), Marathon recognized forfeitures as they occurred and applied the intrinsic value method to awards classified as liabilities. The adoption did not have a significant impact on Marathon s consolidated results of operations, financial position or cash flows.

SFAS No. 123(R) also requires a company to calculate the pool of excess tax benefits (the APIC Pool) available to absorb tax deficiencies recognized subsequent to adopting the statement. In November 2005, the FASB issued FASB Staff Position No. 123R-3, Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards, to provide an alternative transition election (the short cut method) to account for the tax effects of share-based payment awards to employees. Marathon has elected the long-form method to determine its APIC Pool as of January 1, 2006. See Note 3 for the disclosures regarding share-based payments required by SFAS No. 123(R).

Effective January 1, 2006, Marathon adopted SFAS No. 151, Inventory Costs an amendment of ARB No. 43, Chapter 4. This statement requires that items such as idle facility expense, excessive spoilage, double freight and re-handling costs be recognized as a current-period charge. The adoption did not have a significant effect on Marathon s consolidated results of operations, financial position or cash flows.

Effective January 1, 2006, Marathon adopted SFAS No. 154, Accounting Changes and Error Corrections A Replacement of APB Opinion No. 20 and FASB Statement No. 3. SFAS No. 154 requires companies to recognize (1) voluntary changes in accounting principle and (2) changes required by a new accounting pronouncement, when the pronouncement does not include specific transition provisions, retrospectively to prior periods financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change.

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3. Stock-Based Compensation Arrangements

Description of the Plans

The Marathon Oil Corporation 2003 Incentive Compensation Plan (the Plan) authorizes the Compensation Committee of the Board of Directors of Marathon to grant stock options, stock appreciation rights, stock awards, cash awards and performance awards to employees. The Plan also allows Marathon to provide equity compensation to its non-employee directors. No more than 20,000,000 shares of common stock may be issued under the Plan, and no more than 8,500,000 of those shares may be used for awards other than stock options or stock appreciation rights. Shares subject to awards that are forfeited, terminated, expire unexercised, settled in cash, exchanged for other awards, tendered to satisfy the purchase price of an award, withheld to satisfy tax obligations or otherwise lapse become available for future grants. Shares issued as a result of stock option exercises and restricted stock grants are generally funded out of common stock held in treasury, except to the extent there are insufficient treasury shares, in which case new common shares are issued.

The Plan replaced the 1990 Stock Plan, the Non-Officer Restricted Stock Plan, the Non-Employee Director Stock Plan, the deferred stock benefit provision of the Deferred Compensation Plan for Non-Employee Directors, the Senior Executive Officer Annual Incentive Compensation Plan and the Annual Incentive Compensation Plan (collectively, the Prior Plans). No new grants will be made from the Prior Plans. Any awards previously granted under the Prior Plans shall continue to vest and/or be exercisable in accordance with their original terms and conditions.

Stock-Based Awards Under the Plans

Marathon s stock options represent the right to purchase shares of common stock at the fair market value of the common stock on the date of grant. Through 2004, certain options were granted with a tandem stock appreciation right, which allows the recipient to instead elect to receive cash and/or common stock equal to the excess of the fair market value of shares of common stock, as determined in accordance with the Plan, over the option price of the shares. Most stock options granted under the Plan vest ratably over a three-year period and all expire ten years from the date they are granted.

Similar to stock options, stock appreciation rights (SARs) represent the right to receive a payment equal to the excess of the fair market value of shares of common stock on the date the right is exercised over the exercise price. In general, SARs that have been granted under the Plan are settled in shares of stock, vest ratably over a three-year period and have a maximum term of ten years from the date they are granted.

In 2003 and 2004, the Compensation Committee granted stock-based performance awards to Marathon s and MPC s officers under the Plan. The stock-based performance awards represent shares of common stock that are subject to forfeiture provisions and restrictions on transfer. Those restrictions may be removed if certain pre-established performance measures are met. The stock-based performance awards granted under the Plan generally vest at the end of a 36-month performance period if the performance targets are achieved and the recipient remains employed by Marathon at that date.

In 2005, the Compensation Committee granted time-based restricted stock to the officers under the Plan. The restricted stock awards vest three years from the date of grant, contingent on the recipient s continued employment. Prior to vesting, the restricted stock recipients have the right to vote such stock and receive dividends thereon. The nonvested shares are not transferable and are retained by Marathon until they vest.

Marathon also grants restricted stock to certain non-officer employees and phantom stock units to certain international employees under the Plan (restricted stock awards) based on their performance within certain guidelines and for retention purposes. The restricted stock awards generally vest in one-third increments over a three-year period, contingent on the recipient s continued employment. Prior to vesting, the restricted stock recipients have the right to vote such stock and receive dividends thereon. The nonvested shares are not transferable and are retained by Marathon until they vest.

Marathon maintains an equity compensation program for its non-employee directors under the Plan. Prior to January 1, 2006, pursuant to the program, non-employee directors were required to defer 50 percent of their annual retainers in the form of common stock units. In addition, each non-employee director receives an annual grant of non-retainer common stock units under the Plan. The program also provided each non-employee director with a matching grant of up to 1,000 shares of common stock on his or her initial election to the Board if he or she purchased an equivalent number of shares within 60 days of joining the Board. Effective January 1, 2006, non-employee directors are no longer required to defer 50 percent of their annual retainers in the form of common stock units and the matching grant program was discontinued.

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Stock-Based Compensation Expense

The fair values of stock options, stock options with tandem SARs and stock-settled SARs (stock option awards) are estimated on the date of grant using the Black-Scholes option pricing model. The model employs various assumptions, based on management s best estimates at the time of grant, which impact the fair value calculated and ultimately, the expense that is recognized over the life of the stock option award. Of the required assumptions, the expected life of the stock option award and the expected volatility of the Company s stock price have the most significant impact on the fair value calculation. Marathon has utilized historical data and analyzed current information which reasonably support these assumptions.

The fair value of Marathon s restricted stock awards is determined based on the fair market value of the Company s common stock on the date of grant. Prior to adoption of SFAS No. 123(R) on January 1, 2006, the fair values of Marathon s stock-based performance awards were determined in the same manner as restricted stock awards. Under SFAS No. 123(R), on a prospective basis, these awards are required to be valued utilizing an option pricing model. No stock-based performance awards have been granted since May 2004.

Effective January 1, 2006, Marathon s stock-based compensation expense is recognized based on management s best estimate of the awards that are expected to vest, using the straight-line attribution method for all service-based awards with a graded vesting feature. If actual forfeiture results are different than expected, adjustments to recognized compensation expense may be required in future periods. Unearned stock-based compensation is charged to stockholders equity when restricted stock awards and stock-based performance awards are granted. Compensation expense is recognized over the balance of the vesting period and is adjusted if conditions of the restricted stock award or stock-based performance award are not met. Options with tandem SARs are classified as a liability and are remeasured at fair value each reporting period until settlement.

Prior to January 1, 2006, Marathon recorded stock-based compensation expense over the stated vesting period for stock option awards that are subject to specific vesting conditions and specify (1) that an employee vests in the award upon becoming retirement eligible or (2) that the employee will continue to vest in the award after retirement without providing any additional service. Under SFAS No. 123(R), from the date of adoption, such compensation cost is recognized immediately for awards granted to retirement-eligible employees or over the period from the grant date to the retirement eligibility date if retirement eligibility will be reached during the stated vesting period. No stock option awards were granted during the quarter ended March 31, 2006, and therefore awards with such vesting terms did not impact stock-based compensation expense for the quarter. Marathon previously determined that the compensation expense determined under the current and previous approaches did not differ materially.

During the quarters ended March 31, 2006 and 2005, total employee stock-based compensation expense was $23 million and $42 million. The total related income tax benefits were $9 million and $16 million. During the first quarter 2006, cash received upon exercise of stock option awards was $8 million. Tax benefits realized for deductions during the first quarter 2006 that were in excess of the stock-based compensation expense recorded for options exercised and other stock-based awards vested during the quarter totaled $10 million. No stock option awards were settled in cash during the first quarter 2006.

Outstanding Stock-Based Awards

The following is a summary of stock option award activity for the quarter ended March 31, 2006:

	Shares	Price [(a)]

Outstanding at December 31, 2005	6,007,954	$36.51
Granted		
Exercised	(357,265)	$30.04
Canceled	(27,848)	$44.58
Outstanding at March 31, 2006 [b]	5,622,841	$36.88

(a) Weighted-average exercise price.

(b) Of the stock option awards outstanding as of March 31, 2006, 4,732,234 and 890,607 were outstanding under the 2003 Incentive Compensation Plan and 1990 Stock Plan, including 913,902 options with tandem SARs.

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The following table presents information on stock option awards at March 31, 2006:

	Outstanding			Exercisable	
Range of Exercise Prices	Number of Shares Under Option	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number of Shares Under Option	Weighted-Average Exercise Price
$22.38 25.52	1,189,837	6.8	$ 25.50	670,209	$ 25.49
$26.91 30.88	510,538	5.7	$ 28.38	498,872	$ 28.37
$32.52 34.00	2,062,246	7.5	$ 33.49	759,603	$ 33.29
$47.65 51.67	1,860,220	9.2	$ 50.25	13,600	$ 47.65
Total	5,622,841	7.7	$ 36.88	1,942,284	$ 29.43

As of March 31, 2006 the aggregate intrinsic value of stock option awards outstanding was $221 million. The aggregate intrinisic value and weighted average remaining contractual life of stock option awards currently exercisable were $91 million and 6.4 years. As of March 31, 2006, the number of fully vested stock option awards and stock option awards expected to vest was 5,394,081. The weighted average exercise price and weighted average remaining contractual life of these stock option awards were $36.46 and 7.7 years and the aggregate intrinsic value was $214 million.

No stock option awards were granted during the quarters ended March 31, 2006 and 2005. The total intrinsic value of stock option awards exercised during each of these quarters was $16 million. Of these amounts, $7 million in the first quarter 2006 and $11 million in the first quarter 2005 was related to options with tandem SARs. As of March 31, 2006, unrecognized compensation cost related to stock option awards was $16 million, which is expected to be recognized over a weighted average period of 1.4 years.

The following is a summary of stock-based performance award and restricted stock award activity for the quarter ended March 31, 2006:

	Stock-Based Performance Awards	Weighted Average Grant Date Fair Value	Restricted Stock and Units	Weighted Average Grant Date Fair Value
Unvested at December 31, 2005	448,600	$ 29.93	985,556	$ 47.94
Granted	67,848	$ 76.82	35,020	$ 76.68
Vested	(273,448)	$ 38.30	(123,626)	$ 37.96
Forfeited			(11,950)	$ 52.20
Unvested at March 31, 2006	243,000	$ 33.61	885,000	$ 50.61

During the quarters ended March 31, 2006 and 2005, the weighted average grant date fair value of restricted stock awards was $76.68 and $46.86. The total vesting date fair value of restricted stock awards that vested during the quarters ended March 31, 2006 and 2005 was $32 million and $6 million. Of these amounts, $21 million related to the vesting of the officer stock-based performance awards during the first quarter of 2006. As of March 31, 2006, there was $33 million of unrecognized compensation cost related to restricted stock awards which is expected to be recognized over a weighted average period of 2 years.

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4. Computation of Income per Share

Basic net income per share is based on the weighted average number of common shares outstanding. Diluted net income per share assumes exercise of stock options, provided the effect is not antidilutive.

	First Quarter Ended March 31,			
	2006		2005	
(Dollars in millions, except per share data)	Basic	Diluted	Basic	Diluted
Net income	$ 784	$ 784	$ 324	$ 324
Shares of common stock outstanding (thousands):				
Average number of common shares outstanding	365,110	365,110	346,006	346,006
Effect of dilutive securities		3,270		2,639
Average common shares including dilutive effect	365,110	368,380	346,006	348,645
Per share:				
Net income per share	$ 2.15	$ 2.13	$ 0.94	$ 0.93

5. Segment Information

Marathon s operations consist of three reportable operating segments:

1) Exploration and Production (E&P) explores for, produces and markets crude oil and natural gas on a worldwide basis;

2) Refining, Marketing and Transportation (RM&T) refines, markets and transports crude oil and petroleum products, primarily in the Midwest, the upper Great Plains and southeastern United States; and

3) Integrated Gas (IG) markets and transports products manufactured from natural gas, such as liquid natural gas (LNG) and methanol, on a worldwide basis, and is developing other projects to link stranded natural gas resources with key demand areas.

Effective January 1, 2006, Marathon revised its measure of segment income to include the effects of minority interests and income taxes related to the segments to facilitate comparison of segment results with Marathon s peers. Income taxes were allocated to the segments using estimated effective rates for each segment. In addition, the results of activities primarily associated with the marketing of the Company s equity natural gas production, which had been presented as part of the Integrated Gas segment prior to 2006, are now included in the Exploration and Production segment as those activities are better aligned with E&P operations. Segment income amounts for all periods presented reflect these changes.

(Dollars in millions)	E&P	RM&T	IG	Total Segments
First Quarter Ended March 31, 2006				
Revenues:				
Customer	$ 2,206	$ 13,890	$ 30	$ 16,126
Intersegment [(a)]	190	13		203
Related parties	3	309		312
Segment revenues	2,399	14,212	30	16,641

Elimination of intersegment revenues	(190)	(13)		(203)
Gain on long-term U.K. natural gas contracts	78			78
Total revenues	$ 2,287	$ 14,199	$ 30	$ 16,516
Segment income	$ 477	$ 319	$ 8	$ 804
Income from equity method investments	53	26	13	92
Depreciation, depletion and amortization [(b)]	251	133	2	386
Minority interests in income (loss) of subsidiaries [(b)]			(3)	(3)
Provision for income taxes [(b)]	489	204	5	698
Capital expenditures [(c)]	384	104	94	582

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(Dollars in millions)	E&P	RM&T	IG	Total Segments
First Quarter Ended March 31, 2005				
Revenues:				
Customer	$ 1,572	$ 11,073	$ 61	$ 12,706
Intersegment [(a)]	144	42		186
Related parties	2	281		283
Segment revenues	1,718	11,396	61	13,175
Elimination of intersegment revenues	(144)	(42)		(186)
Loss on long-term U.K. natural gas contracts	(57)			(57)
Total revenues	$ 1,517	$ 11,354	$ 61	$ 12,932
Segment income	$ 334	$ 74	$ 22	$ 430
Income from equity method investments	5	17	18	40
Depreciation, depletion and amortization [(b)]	210	104	2	316
Minority interests in income (loss) of subsidiaries [(b)]		67	(1)	66
Provision for income taxes [(b)]	212	68	(5)	275
Capital expenditures [(c)]	294	136	125	555

(a) Management believes intersegment transactions were conducted under terms comparable to those with unrelated parties.

(b) Differences between segment totals and Marathon totals represent amounts related to corporate administrative activities and other unallocated items and are included in Items not allocated to segments, net of income taxes in the reconciliation below.

(c) Differences between segment totals and Marathon totals represent amounts related to corporate administrative activities.

The following reconciles segment income to net income as reported in Marathon s consolidated statements of income:

	First Quarter Ended March 31,	
(Dollars in millions)	2006	2005
Segment income	$ 804	$ 430
Items not allocated to segments, net of income taxes:		
Gain (loss) on long-term U.K. natural gas contracts	45	(33)
Corporate and other unallocated items	(65)	(73)
Net income	$ 784	$ 324

6. Pensions and Other Postretirement Benefits

The following summarizes the components of net periodic benefit costs:

	First Quarter Ended March 31,			
	Pension Benefits		Other Benefits	
(Dollars in millions)	2006	2005	2006	2005
Service cost	$ 34	$ 31	$ 6	$ 5
Interest cost	32	27	10	10
Expected return on plan assets	(26)	(23)		
Amortization:				
net transition gain		(1)		
prior service costs (credits)	1	1	(3)	(3)
actuarial loss	13	15	2	2
Net periodic benefit cost	$ 54	$ 50	$ 15	$ 14

During the quarter ended March 31, 2006, Marathon made contributions of $148 million to its funded pension plans. Of this amount, $6 million related to foreign pension plans. Contributions made from the general assets of Marathon to cover current benefit payments related to unfunded pension and other postretirement benefit plans were $3 million and $9 million during the quarter. Marathon expects to make additional contributions to its funded pension plans of between $125 million and $195 million over the remainder of 2006.

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7. Income Taxes

The provision for income taxes for interim periods is based on management s best estimate of the effective income tax rate expected to be applicable for the current year plus any adjustments arising from a change in the estimated amount of taxes related to prior periods. The effective income tax rate for the first quarter 2006 was 47 percent compared to 38 percent for first quarter 2005. The following is an analysis of the effective income tax rate for the periods presented:

	First Quarter Ended March 31,	
	2006	2005
Statutory U.S. income tax rate	35%	35%
Effects of foreign operations	11	
State and local income taxes after federal income tax effects	2	5
Other tax effects	(1)	(2)
Effective income tax rate	47%	38%

8. Comprehensive Income

The following sets forth Marathon s comprehensive income for the periods indicated:

	First Quarter Ended March 31,	
(Dollars in millions)	2006	2005
Net income	$ 784	$ 324
Other comprehensive income (loss), net of taxes:		
Minimum pension liability adjustments	10	
Change in fair value of derivative instruments		(6)
Total Comprehensive income	$ 794	$ 318

9. Inventories

Inventories are carried at the lower of cost or market. The cost of inventories of crude oil, refined products and merchandise is determined primarily under the last-in, first-out (LIFO) method.

(Dollars in millions)	March 31, 2006	December 31, 2005
Liquid hydrocarbons and natural gas	$ 1,435	$ 1,093
Refined products and merchandise	1,810	1,763
Supplies and sundry items	164	185
Total, at cost	$ 3,409	$ 3,041

10. Property, Plant and Equipment

Exploratory well costs capitalized greater than one year after completion of drilling as of March 31, 2006 were $99 million, including $40 million added to this category during the first quarter 2006 for wells in Equatorial Guinea (Corona, Bococo and Gardenia), where Marathon is evaluating various development scenarios for the discoveries around the Alba Field, including plans that would integrate the resources into the Company s long-term LNG supply.

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11. Commitments and Contingencies

Marathon is the subject of, or party to, a number of pending or threatened legal actions, contingencies and commitments involving a variety of matters, including laws and regulations relating to the environment. Certain of these commitments are discussed below. The ultimate resolution of these contingencies could, individually or in the aggregate, be material to Marathon s consolidated financial statements. However, management believes that Marathon will remain a viable and competitive enterprise even though it is possible that these contingencies could be resolved unfavorably.

Contract commitments At March 31, 2006 and December 31, 2005, Marathon s contract commitments to acquire property, plant and equipment totaled $724 million and $668 million, respectively. During the first quarter of 2006, additional contract commitments were made related to the potential expansion of the Garyville, Louisiana refinery while the commitments related to the Equatorial Guinea LNG plant and the Alvheim project in Norway declined due to the continued construction progress on both projects.

12. Stock Repurchase Program

On January 29, 2006, Marathon s Board of Directors authorized the repurchase of up to $2 billion of common stock over a period of two years. Such purchases will be made during this period as Marathon s financial condition and market conditions warrant. Any purchases under the program may be in either open market transactions, including block purchases, or in privately negotiated transactions. The repurchase program does not include specific price targets or timetables, and is subject to termination prior to completion. Marathon will use cash on hand, cash generated from operations or cash from available borrowings to acquire shares. During the quarter ended March 31, 2006, Marathon acquired approximately 3.2 million common shares, at an acquisition cost of $229 million, which were recorded as common stock held in treasury in the consolidated balance sheet.

13. Supplemental Cash Flow Information

	First Quarter Ended March 31,	
(Dollars in millions)	2006	2005
Net cash provided from operating activities included:		
Interest and other financing costs paid (net of amounts capitalized)	$ 74	$ 91
Income taxes paid to taxing authorities (excluding excess tax benefits on stock-based compensation in 2006)	601	194
Commercial paper and revolving credit arrangements, net:		
Borrowings	$ 197	$
Repayments	(197)	

14. MPC Receivables Purchase and Sale Facility

On July 1, 2005, MPC entered into a $200 million, three-year Receivables Purchase and Sale Agreement with certain purchasers. The program was structured to allow MPC to periodically sell a participating interest in pools of eligible accounts receivable. During the term of the agreement MPC was obligated to pay a facility fee of 0.12%. In the first quarter of 2006, the facility was terminated. No receivables were sold under the agreement during its term.

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15. Accounting Standards Not Yet Adopted

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets An Amendment of FASB Statement No. 140. This statement amends SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, with respect to the accounting for separately recognized servicing assets and servicing liabilities. Adoption of SFAS No. 156 is required as of the beginning of an entity s first fiscal year that begins after September 15, 2006. Marathon does not expect adoption of this statement to have a significant effect on its consolidated results of operations, financial position or cash flows.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments An Amendment of FASB Statements No. 133 and 140. SFAS No. 155 simplifies the accounting for certain hybrid financial instruments, eliminates the interim FASB guidance which provides that beneficial interests in securitized financial assets are not subject to the provisions of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and eliminates the restriction on the passive derivative instruments that a qualifying special-purpose entity may hold. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. Marathon is currently studying the provisions of this Statement to determine the impact on its consolidated financial statements.

In September 2005, the FASB ratified the consensus reached by the Emerging Issues Task Force (EITF) on Issue No. 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty. The issue defines when a purchase and a sale of inventory with the same party that operates in the same line of business is recorded at fair value or considered a single non-monetary transaction subject to the fair value exception of APB Opinion No. 29. The purchase and sale transactions may be pursuant to a single contractual arrangement or separate contractual arrangements and the inventory purchased or sold may be in the form of raw materials, work-in-process, or finished goods. In general, two or more transactions with the same party are treated as one if they are entered into in contemplation of each other. The rules apply to new arrangements entered into in reporting periods beginning after March 15, 2006. The accounting for certain of the transactions that Marathon considers as matching buy/sell transactions will be affected by this consensus and therefore, upon adoption, these transactions will no longer be recorded on a gross basis. Management does not believe any impact on net income would be material. There will be no impact on cash flows from operations as a result of adoption.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Marathon Oil Corporation is engaged in worldwide exploration and production of crude oil and natural gas; domestic refining, marketing and transportation of crude oil and petroleum products primarily in the Midwest, the upper Great Plains and southeastern United States; and worldwide marketing and transportation of products manufactured from natural gas, such as LNG and methanol, and development of other projects to link stranded natural gas resources with key demand areas. Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements and Selected Notes to Consolidated Financial Statements, the Supplemental Statistics and our 2005 Annual Report on Form 10-K.

Certain sections of Management s Discussion and Analysis of Financial Condition and Results of Operations include forward-looking statements concerning trends or events potentially affecting our business. These statements typically contain words such as anticipates, believes, estimates, expects, targets, plans, projects, could, would or similar words indicating that future outcomes are uncertain. In accordance with safe harbor provisions of the Private Securities Litigation Reform Act of 1995, these statements are accompanied by cautionary language identifying important factors, though not necessarily all such factors, which could cause future outcomes to differ materially from those set forth in the forward-looking statements. For additional risk factors affecting our business, see Item 1A. Risk Factors in our 2005 Annual Report on Form 10-K.

We acquired the 38 percent interest in MPC previously held by Ashland Inc. on June 30, 2005. Unless specifically noted as being after minority interests, amounts for the Refining, Marketing and Transportation segment include amounts related to the 38 percent interest held by Ashland prior to June 30, 2005.

Marathon holds a 60 percent interest in Equatorial Guinea LNG Holdings Limited. The remaining interests are held by a company controlled by the government of Equatorial Guinea (25 percent interest), Mitsui & Co., Ltd. (8.5 percent interest) and a subsidiary of Marubeni Corporation (6.5 percent interest). Unless specifically noted as being after minority interests, amounts for the Integrated Gas segment include amounts related to the minority interests.

Overview and Outlook

Exploration and Production (E&P)

Production available for sale during the first quarter of 2006 averaged 418,600 barrels of oil equivalent per day (boepd). Reported liquid hydrocarbon and natural gas sales during the quarter averaged 376,800 boepd. This period s variance between production available for sale and actual sales volumes is primarily attributable to the timing of liquid hydrocarbon liftings from our operations in Libya, Equatorial Guinea and the U.K.

We resumed our operations in the Waha concessions of Libya and achieved our first crude oil liftings there during the first quarter 2006. Our production available for sale for this quarter was consistent with our expectations when we re-entered these operations at the end of 2005. During 2006, we will work with our partners to define growth plans for this major asset.

We continue to advance our major E&P projects. In Norway, the Alvheim project is 53 percent complete as of March 31, 2006, and is progressing on schedule with first production projected for the first quarter of 2007. As part of this project, the hull modifications to the Alvheim Floating Production Storage Offloading Vessel (FPSO) have been completed and the vessel sailed from Singapore to Norway where it will undergo topside installation work. Development drilling is scheduled to begin in May 2006. Also, the Neptune development in the Gulf of Mexico is 22 percent complete as of March 31, 2006, and is expected to deliver production by early 2008, with development drilling scheduled to begin in May 2006.

We recently completed leasehold acquisitions totaling approximately 200,000 acres in the Bakken Shale resource play. The majority of the acreage is located in North Dakota with the remainder in eastern Montana. We now own a substantial position in the Bakken Shale with approximately 300 locations to be drilled over the next four to five years, with additional infill potential likely.

During the first quarter 2006, we announced two exploration/appraisal successes. Offshore Norway, we participated in a successful appraisal well on the Gudrun prospect. Two zones were tested at an aggregate rate of over 10,000 barrels of oil per day and 30 million cubic feet of natural gas per day (mmcfpd). Marathon holds a 28 percent non-operated interest in Gudrun. Future activities will primarily be focused on evaluating development scenarios. Offshore Angola, we participated in a discovery well on the Mostarda prospect in Block 32. This discovery is the thirteenth discovery in Marathon s deepwater Angola exploration program on Blocks 31 and 32 in which the Company holds a 10 percent and 30 percent interest, respectively. The Mostarda discovery is located near the previously announced Gindungo, Canela and Gengibre discoveries. In Block 31 we also participated in a successful appraisal well in the northeast part of the block and a dry hole in the southeast portion of the block. The Urano well reached total depth and its results will be reported upon government approval.

We continue to estimate our 2006 production available for sale will average between 365,000 and 395,000 boepd, excluding the effect of any acquisitions or dispositions. Reported volumes are based upon sales volumes which may vary from production available for sale primarily due to the timing of liftings from certain of our international locations.

The above discussion includes forward-looking statements with respect to the timing and levels of our worldwide liquid hydrocarbon, natural gas and condensate production, the development of the Alvheim field, the Neptune development, the Gudrun prospect and anticipated future drilling activity in the Bakken Shale resource play. Some factors that could potentially affect these forward-looking statements include pricing, supply and demand for petroleum products, amount of capital available for exploration and development, acquisitions or dispositions of oil and natural gas properties, regulatory constraints, timing of commencing production from new wells, drilling rig availability, inability or delay in obtaining necessary government and third-party approvals and permits, unforeseen hazards such as weather conditions, acts of war or terrorist acts and the governmental or military response and other geological, operating and economic considerations. The foregoing factors (among others) could cause actual results to differ materially from those set forth in the forward-looking statements.

Refining, Marketing and Transportation (RM&T)

In the first quarter 2006, our RM&T operations benefited from refining margins (crack spreads) in the Midwest (Chicago) and Gulf Coast that were stronger than the comparable period of 2005. As a result of these strong margins and favorable sweet/sour crude oil differentials, our refining and wholesale marketing gross margin averaged 11.37 cents per gallon in the first quarter 2006 versus 6.85 cents per gallon in the first quarter 2005. In addition, during the first quarter of 2006, our total refinery throughput was approximately five percent higher than the same quarter in 2005. We continue to expect that our 2006 average crude oil throughput will exceed our record throughput for 2005. Also during the first quarter of 2006, we blended approximately 30 thousand barrels per day (mbpd) of ethanol into gasoline, approximately 13 percent more than we blended in the first quarter of 2005. The expansion or contraction of our ethanol blending program will be driven by the economics of the ethanol supply. In addition, we are on schedule to comply with the Federal Environmental Protection Agency regulations which require ultra low sulfur diesel fuel production beginning June 1, 2006.

Speedway SuperAmerica LLC continued to realize strong same store merchandise sales with an increase of approximately 10.2 percent, while same store gasoline sales volume increased 3.3 percent when compared to the first quarter of 2005.

The above discussion includes forward-looking statements with respect to projections of crude oil throughput that could be affected by planned and unplanned refinery maintenance projects, the levels of refining margins and other operating considerations. These factors (among others) could cause actual results to differ materially from those set forth in the forward-looking statements.

Integrated Gas (IG)

Our integrated gas activities during the first quarter 2006 were marked by continued progress in constructing the LNG plant in Equatorial Guinea. The project is approximately 73 percent complete on an engineering, procurement and construction basis as of March 31, 2006. Construction remains on schedule for first shipments of LNG in the third quarter of 2007.

The above discussion contains forward-looking statements with respect to the estimated construction and startup dates of a LNG project which could be affected by unforeseen problems arising from construction, inability or delay in obtaining necessary government and third-party approvals, unanticipated changes in market demand or supply, environmental issues, availability or construction of sufficient LNG vessels, and unforeseen hazards such as weather conditions. The foregoing factors (among others) could cause actual results to differ materially from those set forth in the forward-looking statements.

Corporate

Historically, we have maintained insurance coverage for physical damage and resulting business interruption to our major onshore and offshore facilities. Higher margins and commodity prices have increased our exposure to business interruptions. Due to recent hurricane activity, the availability of insurance coverage for windstorms in the Gulf of Mexico region has been reduced or, in many instances, it is prohibitively expensive. As a result, our exposure to losses from future windstorm activity in the Gulf of Mexico region has increased.

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Critical Accounting Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the consolidated financial statements and the reported amounts of revenues and expenses during the respective reporting periods. Actual results could differ from the estimates and assumptions used.

Certain accounting estimates are considered to be critical if (1) the nature of the estimates and assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and (2) the impact of the estimates and assumptions on financial condition or operating performance is material.

There have been no significant changes to our critical accounting estimates subsequent to December 31, 2005.

Results of Operations

Consolidated Results

Revenues for the first quarters of 2006 and 2005 are summarized by segment in the following table:

	First Quarter Ended March 31,	
(Dollars in millions)	2006	2005
E&P	$ 2,399	$ 1,718
RM&T	14,212	11,396
IG	30	61
Segment revenues	16,641	13,175
Elimination of intersegment revenues	(203)	(186)
Gain (loss) on long-term U.K. natural gas contracts	78	(57)
Total revenues	$ 16,516	$ 12,932
Items included in both revenues and costs and expenses:		
Consumer excise taxes on petroleum products and merchandise	1,165	1,084
Matching crude oil and refined product buy/sell transactions settled in cash:		
E&P	11	36
RM&T	3,195	2,773
Total buy/sell transactions included in revenues	$ 3,206	$ 2,809

E&P segment revenues increased by $681 million in the first quarter of 2006 from the comparable prior-year period. The increase was primarily due to increased net liquid hydrocarbon sales volumes and higher prices for both liquid hydrocarbons and natural gas in all regions. The first crude oil liftings from Libya occurred this quarter, contributing to the net sales volume increase. In addition, net liquid hydrocarbon sales volumes benefited from a full quarter of production in the first quarter of 2006 from the Petronius field in the Gulf of Mexico that was down during the first quarter of 2005 due to hurricane damage.

Excluded from E&P segment revenues are a gain of $78 million for the first quarter of 2006 and a loss of $57 million for the first quarter of 2005 on long-term natural gas contracts in the United Kingdom that are accounted for as derivative instruments.

RM&T segment revenues increased by $2.816 billion, including an increase from matching buy/sell transactions of $422 million, in the first quarter of 2006 from the comparable prior-year period. The increases primarily reflected higher refined product and crude oil prices as well as increased refined product volumes, partially offset by lower crude oil volumes.

For additional information on segment results, see Segment Income.

Income from equity method investments for the first quarter 2006 increased $52 million from the comparable prior-year period primarily due to the liquefied petroleum gas expansion in Equatorial Guinea which ramped up to full production in the third quarter of 2005.

Cost of revenues for the first quarter 2006 increased by $2.077 billion from the comparable prior-year period. The increases are primarily in the RM&T segment and resulted mainly from higher acquisition costs for crude oil, other refinery charge and blend stocks, and refined products. Additionally, we experienced higher manufacturing expenses, primarily a result of higher purchased energy and maintenance costs.

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Depreciation, depletion and amortization for the first quarter of 2006, increased by $92 million compared to the same period of 2005. RM&T segment depreciation expense increased primarily as a result of the asset value increase recorded for the minority interest acquisition in the second quarter of 2005 and the Detroit refinery expansion completed in the fourth quarter of 2005. Included in first quarter 2006 for the E&P segment was a $20 million impairment of capitalized costs related to the Camden Hills field in the Gulf of Mexico and the associated Canyon Express pipeline. Natural gas production from the Camden Hills field ended during the first quarter 2006 as a result of increased water production from the well. Depreciation, depletion and amortization for the first quarter 2006 was also impacted by increased E&P volumes.

Selling, general and administrative expenses for the first quarter 2006 increased by $27 million compared to the first quarter 2005. This increase reflects engineering costs for various RM&T projects, the cost to study the feasibility of adding a second natural gas liquefaction unit (or train) to our LNG plant in Equatorial Guinea and increased costs for outside professional services, partially offset by lower stock-based compensation expense.

Exploration expenses were $71 million in the first quarter of 2006 compared to $34 million in the first quarter of 2005. Exploration expenses related to dry wells in the first quarter of 2006 totaled $30 million and primarily included costs related to the Davan well in the U.K. and the Soulandaka well in Gabon.

Minority interest in income of MPC decreased $70 million in the first quarter of 2006 from the comparable 2005 period due to the completion of our acquisition of Ashland Inc. s 38 percent interest in MPC on June 30, 2005.

Provision for income taxes in the first quarter of 2006 increased by $494 million compared to the first quarter 2005 primarily due to increased income before income taxes as discussed above. Our effective income tax rate for 2006 was 47 percent compared to 38 percent for 2005 and the increase is primarily a result of the income taxes related to our Libyan operations, where the statutory income tax rate is in excess of 90 percent. The following is an analysis of the effective tax rates for the periods presented:

	First Quarter Ended March 31,	
	2006	2005
Statutory U.S. income tax rate	35%	35%
Effects of foreign operations	11	
State and local income taxes after federal income tax effects	2	5
Other tax effects	(1)	(2)
Effective income tax rate	47%	38%

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Segment Results

Segment income for the first quarter of 2006 and 2005 is summarized in the following table. Effective January 1, 2006, we revised our measure of segment income to include the effects of minority interests and income taxes related to the segments. In addition, the results of activities primarily associated with the marketing of our equity natural gas production, which had been presented as part of the Integrated Gas segment prior to 2006, are now included in the Exploration and Production segment. Segment results for all periods presented reflect these changes.

	First Quarter Ended March 31,	
(Dollars in millions)	2006	2005
E&P:		
United States	$ 245	$ 177
International	232	157
E&P segment	477	334
RM&T	319	74
IG	8	22
Segment income	804	430
Items not allocated to segments, net of income taxes:		
Gain (loss) on long-term U.K. natural gas contracts	45	(33)
Corporate and other unallocated items	(65)	(73)
Net income	$ 784	$ 324

United States E&P income in the first quarter of 2006 increased $68 million compared to the first quarter of 2005. Pretax income increased $95 million and the effective income tax rate declined from 40 percent in the first quarter of 2005 to 37 percent in the first quarter of 2006.

The increase in pretax income was primarily the result of an increase in revenues from higher product prices and liquid hydrocarbon sales volumes. Our domestic average realized liquid hydrocarbon price was $49.30 per barrel (bbl) compared with $38.47 per bbl in the comparable prior-year period. The average realized natural gas price of $6.66 per thousand cubic feet (mcf) was an increase from the $4.95 per mcf in the corresponding 2005 period. Domestic net liquid hydrocarbon sales volumes were 80 mbpd, an increase of 12 percent compared to the first quarter of 2005, primarily because of the resumption of production from the Petronius field in the Gulf of Mexico that was down in 2005 due to hurricane damage. Net natural gas sales volumes of 561 million cubic feet per day (mmcfd) were down nearly 2 percent from the first quarter of 2005.

This revenue increase was partially offset by higher variable costs, including depreciation, depletion and amortization expense.

International E&P income in the first quarter of 2006 increased $75 million from the first quarter of 2005. Pretax income increased $325 million and the effective income tax rate increased from 37 percent in the first quarter of 2005 to 60 percent in the first quarter of 2006. The 23 percentage point increase in the effective income tax rate was primarily a result of the income taxes related to our Libyan operations, where the statutory income tax rate is in excess of 90 percent.

The increase in pretax income was primarily the result of an increase in revenues from higher product prices and higher net liquid hydrocarbon sales volumes. Additionally, income from equity method investments for the first quarter of 2006 benefited from a full quarter of operations from the liquefied petroleum gas expansion in Equatorial Guinea, which ramped up to full production in the third quarter of 2005.

Our international average realized liquid hydrocarbon price was $50.68 per bbl in the first quarter of 2006 compared with $39.10 per bbl in the comparable prior-year period. The average realized natural gas price of $6.16 per mcf in the first quarter of 2006 was an increase from the $4.17 per mcf in the corresponding 2005 period. International net liquid hydrocarbon sales volumes were 131 mbpd in the first quarter of 2006 as compared to 91 mbpd in the first quarter of 2005 primarily due to our resumption of production in Libya. The increase also reflects the effect of the Equatorial Guinea condensate expansion project. Net natural gas sales volumes averaged 435 mmcfd, down 4 percent from the 2005 comparable period.

These increases in pretax income were partially offset by higher variable costs and dry hole costs in the first quarter of 2006.

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RM&T segment income in the first quarter of 2006 increased by $245 million from the first quarter of 2005. Segment income in the first quarter of 2006 benefited from the 38 percent minority interest in MPC that we acquired on June 30, 2005. In the first quarter of 2005, the pretax earnings reduction related to the minority interest was $76 million. A key driver of the increase in RM&T pretax income was our refining and wholesale marketing gross margin, which averaged 11.37 cents per gallon in the first quarter of 2006 compared to 6.85 cents per gallon in the first quarter of 2005. This margin improvement reflected favorable sweet/sour crude oil differentials in the first quarter of 2006 and was consistent with the relevant indicators (crack spreads) in the Midwest (Chicago) and Gulf Coast markets.

Derivative losses related to non-trading activities (which are included in the refining and wholesale marketing gross margin) were $11 million in the first quarter of 2006 as compared to losses of $172 million in the first quarter of 2005. Included in first quarter 2005 derivative losses was a $73 million charge for crack spread derivative contracts, $61 million of which related to mark-to-market losses on crack spread derivative contracts primarily related to No. 2 high sulfur fuel oil crack spreads that expired over the remainder of 2005. Derivative gains related to trading activities were $5 million in the first quarter of 2006 as compared to losses of $31 million in the comparable prior-year period. See Quantitative and Qualitative Disclosures About Market Risk RM&T Segment for further details of derivative results.

The 9 percentage point decrease in the effective income tax rate from 48 percent in the first quarter of 2005 to 39 percent in the first quarter of 2006 is primarily the result of the effect of the 2005 Kentucky tax increase on deferred tax balances at the beginning of that quarter.

IG segment income in the first quarter of 2006 decreased by $14 million from the first quarter of 2005 primarily as a result of a $10 million increase in the provision for income taxes. This increase is primarily a result of providing for U.S. deferred income taxes on foreign income in 2006. No provision for U.S. deferred income taxes was made in 2005 because we permanently reinvested such income in those foreign operations.

Cash Flows and Liquidity

Cash Flows

Net cash provided from operating activities totaled $240 million in the first quarter of 2006, compared with $357 million in the first quarter of 2005. The $117 million decrease mainly reflects contributions of $148 million to our pension plans and various working capital changes during the quarter.

Net cash used in investing activities totaled $987 million in the first quarter of 2006. Capital expenditures were $599 million compared with $556 million for the comparable prior-year period. E&P spending increased $90 million, partially offset by decreases in RM&T and IG spending as a result of major projects being completed, such as the Detroit refinery expansion in the RM&T segment, or nearing completion, such as the LNG plant in the IG segment. E&P spending in the first quarter of 2006 reflected higher expenditures related to the Alvheim development offshore Norway and the Neptune development in the Gulf of Mexico. For information regarding capital expenditures by segment, refer to Supplemental Statistics. Cash paid for acquisitions totaled $527 million, primarily related to the initial $520 million payment associated with our re-entry into Libya.

Net cash used in financing activities was $604 million in the first quarter of 2006, compared to net cash provided from financing activities of $13 million in the first quarter 2005. Significant uses of cash in financing activities during the first quarter of 2006 included the repayment of our $300 million 6.65% notes that matured during the quarter, stock repurchases of $229 million under a previously announced plan discussed under Liquidity and Capital Resources below and dividend payments of $121 million.

Dividends to Stockholders

On April 26, 2006, our Board of Directors declared a dividend of 40 cents per share, payable June 12, 2006, to stockholders of record at the close of business on May 17, 2006. This was a seven cent, or 21 percent, increase in our quarterly dividend.

Derivative Instruments

See Quantitative and Qualitative Disclosures About Market Risk for a discussion of derivative instruments and associated market risk.

Liquidity and Capital Resources

Our main sources of liquidity and capital resources are internally generated cash flow from operations, committed and uncommitted credit facilities, and access to both the debt and equity capital markets. Our ability to access the debt capital market is supported by our investment grade credit ratings. Our senior unsecured debt is currently rated investment grade by Standard and Poor s Corporation, Moody s Investor Services, Inc. and Fitch Ratings with ratings of BBB+, Baa1 and BBB+, respectively. Because of the liquidity and capital resource alternatives available to us, including internally generated cash flow, we believe that our short-term and long-term liquidity is adequate to fund operations, including our capital spending programs, stock repurchase program, repayment of debt maturities for the years 2006, 2007 and 2008, and any amounts that may ultimately be paid in connection with contingencies.

During the first quarter 2006, we had a committed $1.5 billion five-year revolving credit facility with third-party financial institutions terminating in May 2009. At March 31, 2006, there were no borrowings against this facility and we had no commercial paper outstanding under the U.S. commercial paper program backed by the five-year revolving credit facility.

During the first quarter 2006, MPC had a committed $500 million five-year revolving credit facility with third-party financial institutions terminating in May 2009. At March 31, 2006, there were no borrowings against this facility.

Effective May 4, 2006, we entered into an amendment to our $1.5 billion five-year revolving credit agreement, expanding the size of our credit facility to $2.0 billion and extending the termination date to May 2011. The MPC revolving credit facility has been terminated.

As a condition of the closing agreements for our acquisition of Ashland s minority interest in MPC, we are required to maintain MPC on a stand-alone basis financially for a two-year period. During this period of time, capital contributions into MPC are prohibited and MPC is prohibited from incurring additional debt, except for borrowings under an existing intercompany loan facility to fund the expansion project at our Detroit refinery and in the event of limited extraordinary circumstances. MPC was permitted to use its revolving credit facility only for short-term working capital requirements in a manner consistent with past practices. There are no restrictions against MPC making intercompany loans or declaring dividends to its parent. We believe MPC s existing cash balances and cash provided from MPC s operations will be adequate to meet its liquidity requirements.

During the first quarter of 2006 we entered into a loan agreement which allows borrowings up to an amount of $525 million from the Norwegian export credit agency based upon the amount of qualifying purchases by Marathon of goods and services from Norwegian suppliers. The loan agreement provides for either a fixed or floating interest rate option at the time of the initial drawdown. Should we elect to borrow under the agreement, the initial drawdown can only occur in June 2007.

As of March 31, 2006, $1.7 billion aggregate amount of common stock, preferred stock and other equity securities, debt securities, trust preferred securities or other securities, including securities convertible into or exchangeable for other equity or debt securities were available to be issued under our $2.7 billion universal shelf registration statement filed in 2002.

Our cash-adjusted debt-to-capital ratio (total debt-minus-cash to total debt-plus-equity-minus-cash) was 17 percent at March 31, 2006, compared to 11 percent at year-end 2005 as shown below. This includes $549 million of debt that is serviced by United States Steel Corporation (United States Steel). We continually monitor our spending levels, market conditions and related interest rates to maintain what we perceive to be reasonable debt levels.

(Dollars in millions)	March 31, 2006	December 31, 2005
Long-term debt due within one year	$ 15	$ 315
Long-term debt	3,687	3,698
Total debt	$ 3,702	$ 4,013
Cash	$ 1,269	$ 2,617
Equity	$ 12,165	$ 11,705

Calculation:		
Total debt	$ 3,702	$ 4,013
Minus cash	1,269	2,617
Total debt minus cash	2,433	1,396
Total debt	3,702	4,013
Plus equity	12,165	11,705
Minus cash	1,269	2,617
Total debt plus equity minus cash	$ 14,598	$ 13,101
Cash-adjusted debt-to-capital ratio	17%	11%

Our opinions concerning liquidity and our ability to avail ourselves in the future of the financing options mentioned in the above forward-looking statements are based on currently available information. If this information proves to be inaccurate, future availability of financing may be adversely affected. Factors that affect the availability of financing include our performance (as measured by various factors including cash provided from operating activities), the state of worldwide debt and equity markets, investor perceptions and expectations of past and future performance, the global financial climate, and, in