MARATHON OIL CORP
Form 10-Q
August 08, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2008

OR

[ ] 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 or other jurisdiction of incorporation or organization)	(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, including area code)

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 √ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer Ö Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No √

There were 705,551,204 shares of Marathon Oil Corporation common stock outstanding as of July 31, 2008.

MARATHON OIL CORPORATION

Form 10-Q

Quarter Ended June 30, 2008

INDEX

	Page
PART I - FINANCIAL INFORMATION	
Item 1. Financial Statements:	
Consolidated Statements of Income (Unaudited)	2
Consolidated Balance Sheets (Unaudited)	3
Consolidated Statements of Cash Flows (Unaudited)	4
Notes to Consolidated Financial Statements (Unaudited)	5
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	17
Item 3. Quantitative and Qualitative Disclosures About Market Risk	28
Item 4. Controls and Procedures	31
Supplemental Statistics	32
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings	34
Item 1A. Risk Factors	34
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	34
Item 4. Submission of Matters to a Vote of Security Holders	35
Item 6. Exhibits	36
Signatures	37

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).

Part I - Financial Information

Item 1. Financial Statements

MARATHON OIL CORPORATION
Consolidated Statements of Income (Unaudited)

(In millions, except per share data)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Revenues and other income:				
Sales and other operating revenues (including consumer excise taxes)	$ 21,226	$ 16,325	$ 38,506	$ 28,874
Sales to related parties	686	411	1,228	731
Income from equity method investments	256	117	465	224
Net gain on disposal of assets	12	7	22	18
Other income	45	27	104	42
Total revenues and other income	22,225	16,887	40,325	29,889
Costs and expenses:				
Cost of revenues (excludes items below)	17,988	11,804	32,440	21,407
Purchases from related parties	226	89	365	136
Consumer excise taxes	1,295	1,307	2,511	2,504
Depreciation, depletion and amortization	504	396	955	789
Selling, general and administrative expenses	361	327	661	614
Other taxes	127	93	250	191
Exploration expenses	130	115	259	176
Total costs and expenses	20,631	14,131	37,441	25,817
Income from operations	1,594	2,756	2,884	4,072
Net interest and other financing income (costs)	(10)	20	(1)	39
Loss on early extinguishment of debt	-	(1)	-	(3)
Minority interests in loss of Equatorial Guinea LNG Holdings Limited	-	1	-	3
Income from continuing operations before income taxes	1,584	2,776	2,883	4,111
Provision for income taxes	810	1,234	1,378	1,852
Income from continuing operations	774	1,542	1,505	2,259

Discontinued operations		-		8		-		8
Net income	$	774	$	1,550	$	1,505	$	2,267
Per Share Data								
Basic:								
Income from continuing operations	$	1.09	$	2.26	$	2.11	$	3.29
Discontinued operations	$	-	$	0.01	$	-	$	0.01
Net income	$	1.09	$	2.27	$	2.11	$	3.30
Diluted:								
Income from continuing operations	$	1.08	$	2.24	$	2.10	$	3.27
Discontinued operations	$	-	$	0.01	$	-	$	0.01
Net income	$	1.08	$	2.25	$	2.10	$	3.28
Dividends paid	$	0.24	$	0.24	$	0.48	$	0.44

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

MARATHON OIL CORPORATION

Consolidated Balance Sheets (Unaudited)

(In millions, except per share data)	June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 1,270	$ 1,199
Receivables, less allowance for doubtful accounts of $3 and $3	7,467	5,818
Receivables from United States Steel	23	22
Receivables from related parties	134	79
Inventories	5,015	3,277
Other current assets	145	192
Total current assets	14,054	10,587
Equity method investments	2,825	2,630
Receivables from United States Steel	473	485
Property, plant and equipment, less accumulated depreciation, depletion and amortization of $15,778 and $14,857	27,071	24,675
Goodwill	2,887	2,899
Intangible assets, less accumulated amortization of $88 and $80	282	288
Other noncurrent assets	1,098	1,182
Total assets	$ 48,690	$ 42,746
Liabilities		
Current liabilities:		
Commercial paper	$ 981	$ -
Accounts payable	12,136	8,281
Payables to related parties	79	44
Payroll and benefits payable	320	417
Accrued taxes	733	712
Deferred income taxes	367	547
Accrued interest	124	128
Long-term debt due within one year	87	1,131
Total current liabilities	14,827	11,260
Long-term debt	7,059	6,084
Deferred income taxes	3,768	3,389
Defined benefit postretirement plan obligations	1,170	1,092
Asset retirement obligations	1,173	1,131
Payable to United States Steel	5	5
Deferred credits and other liabilities	579	562
Total liabilities	28,581	23,523
Commitments and contingencies		
Stockholders' Equity		
Preferred stock – 5 million shares issued, 4 million and 5 million shares		

outstanding, (no par value, 6 million shares authorized)		-		-
Common stock:				
Issued – 767 million and 765 million shares (par value $1 per share,				
1.1 billion shares authorized)		767		765
Securities exchangeable into common stock – 5 million shares issued,				
3 million and 5 million shares outstanding (no par value, unlimited				
shares authorized)		-		-
Held in treasury, at cost – 60 million and 55 million shares		(2,660)		(2,384)
Additional paid-in capital		6,697		6,679
Retained earnings		15,575		14,412
Accumulated other comprehensive loss		(270)		(249)
Total stockholders' equity		20,109		19,223
Total liabilities and stockholders' equity	$	48,690	$	42,746

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

MARATHON OIL CORPORATION
Consolidated Statements of Cash Flows (Unaudited)

	Six Months Ended June 30,	
(In millions)	2008	2007
Increase (decrease) in cash and cash equivalents		
Operating activities:		
Net income	$ 1,505	$ 2,267
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on early extinguishment of debt	-	3
Income from discontinued operations	-	(8)
Deferred income taxes	16	122
Minority interests in loss of Equatorial Guinea LNG Holdings Limited	-	(3)
Depreciation, depletion and amortization	955	789
Pension and other postretirement benefits, net	71	20
Exploratory dry well costs and unproved property impairments	114	75
Net gain on disposal of assets	(22)	(18)
Equity method investments, net	(149)	(78)
Changes in the fair value of U.K. natural gas contracts	235	(12)
Changes in:		
Current receivables	(1,677)	(639)
Inventories	(1,739)	(1,150)
Current accounts payable and accrued expenses	3,500	1,037
All other, net	146	(39)
Net cash provided by operating activities	2,955	2,366
Investing activities:		
Capital expenditures	(3,382)	(1,699)
Disposal of assets	24	48
Trusteed funds - withdrawals	258	-
Investments - loans and advances	(60)	(64)
Investments - repayments of loans and return of capital	8	34
Deconsolidation of Equatorial Guinea LNG Holdings Limited	-	(37)
All other, net	(6)	(10)
Net cash used in investing activities	(3,158)	(1,728)
Financing activities:		
Commercial paper and other revolving credit arrangements, net	384	-
Borrowings	999	578
Debt issuance costs	(7)	(8)
Debt repayments	(486)	(469)
Issuance of common stock	6	18
Purchases of common stock	(295)	(776)
Excess tax benefits from stock-based compensation arrangements	7	24
Dividends paid	(342)	(302)
Contributions from minority shareholders of Equatorial Guinea LNG Holdings Limited	-	39
Net cash provided by (used in) financing activities	266	(896)
Effect of exchange rate changes on cash	8	4

Net increase (decrease) in cash and cash equivalents		71		(254)
Cash and cash equivalents at beginning of period		1,199		2,585
Cash and cash equivalents at end of period	$	1,270	$	2,331

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 statement of the results for the periods reported. All such adjustments are of a normal recurring nature unless disclosed otherwise. These consolidated financial statements, including 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 2008 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") 2007 Annual Report on Form 10-K.

2. New Accounting Standards

In April 2007, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position on FASB Interpretation No. 39, "Offsetting of Amounts Related to Certain Contracts" ("FSP FIN No. 39-1"), which allows a party to a master netting agreement to offset the fair value amounts related to the right to reclaim collateral against the fair value amounts recognized for derivative instruments. Such treatment was consistent with Marathon's accounting policy; therefore, adoption of FSP FIN No. 39-1 effective January 1, 2008, did not have any effect on Marathon's consolidated financial position.

In February 2007, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." This statement permits entities to choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. It requires that unrealized gains and losses on items for which the fair value option has been elected be recorded in net income. The statement also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. Marathon did not elect the fair value option when this standard became effective on January 1, 2008.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 does not require any new fair value measurements but may require some entities to change their measurement practices. In February 2008, the FASB issued FSP FAS 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13," which removes certain leasing transactions from the scope of SFAS No. 157, and FSP FAS 157-2, "Effective Date of FASB Statement No. 157," which defers the effective date of SFAS No. 157 for one year for certain nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. Effective January 1, 2008, Marathon adopted SFAS No. 157, except for measurements of those nonfinancial assets and liabilities subject to the one-year deferral, which for Marathon include impairments of goodwill, intangible assets and other long-lived assets, and initial measurement of asset retirement obligations, asset exchanges, business combinations and partial sales of proved properties. Adoption did not have a significant effect on

Marathon's consolidated results of operations or financial position. The additional disclosures regarding assets and liabilities recorded at fair value and measured under SFAS No. 157 are presented in Note 11.

Notes to Consolidated Financial Statements (Unaudited)

3. Income per Common Share

Basic income per share is based on the weighted average number of common shares outstanding, including securities exchangeable into common shares. Diluted income per share includes exercise of stock options and restricted shares, provided the effect is not antidilutive.

	Three Months Ended June 30,			
	2008		2007	
(In millions, except per share data)	Basic	Diluted	Basic	Diluted
Income from continuing operations	$ 774	$ 774	$ 1,542	$ 1,542
Discontinued operations	-	-	8	8
Net income	$ 774	$ 774	$ 1,550	$ 1,550
Weighted average common shares outstanding	710	710	683	683
Effect of dilutive securities	-	4	-	6
Weighted average common shares, including dilutive effect	710	714	683	689
Per share:				
Income from continuing operations	$ 1.09	$ 1.08	$ 2.26	$ 2.24
Discontinued operations	$ -	$ -	$ 0.01	$ 0.01
Net income	$ 1.09	$ 1.08	$ 2.27	$ 2.25

	Six Months Ended June 30,			
	2008		2007	
(In millions, except per share data)	Basic	Diluted	Basic	Diluted
Income from continuing operations	$ 1,505	$ 1,505	$ 2,259	$ 2,259
Discontinued operations	-	-	8	8
Net income	$ 1,505	$ 1,505	$ 2,267	$ 2,267
Weighted average common shares outstanding	711	711	686	686
Effect of dilutive securities	-	5	-	5
Weighted average common shares, including dilutive effect	711	716	686	691
Per share:				

Income from continuing operations	$	2.11	$	2.10	$	3.29	$	3.27
Discontinued operations	$	-	$	-	$	0.01	$	0.01
Net income	$	2.11	$	2.10	$	3.30	$	3.28

The per share calculations above exclude 5.5 million stock options for the second quarter and the first six months of 2008 and 3.0 million stock options for the second quarter and the first six months of 2007, as they were antidilutive.

4. Acquisition

On October 18, 2007, Marathon completed the acquisition of all the outstanding shares of Western Oil Sands Inc. ("Western") for cash and securities of $5,833 million. Subsequent to the transaction, Western's name was changed to Marathon Oil Canada Corporation. The acquisition was accounted for under the purchase method of accounting and, as such, Marathon's results of operations include Western's results from October 18, 2007. Western's oil sands mining and bitumen upgrading operations are reported as a separate Oil Sands Mining segment, while its ownership interests in leases where in-situ recovery techniques are expected to be utilized are included in the E&P segment.

Notes to Consolidated Financial Statements (Unaudited)

The following unaudited pro forma data is as if the acquisition of Western had been consummated at the beginning of each period presented. The pro forma data is based on historical information and does not reflect the actual results that would have occurred nor is it indicative of future results of operations.

(In millions, except per share amounts)	Three Months Ended June 30, 2007	Six Months Ended June 30, 2007
Revenues and other income	$ 17,175	$ 30,424
Income from continuing operations	1,372	2,015
Net income	1,380	2,023
Per share data:		
Income from continuing operations - basic	$ 1.91	$ 2.80
Income from continuing operations - diluted	$ 1.90	$ 2.78
Net income - basic	$ 1.92	$ 2.81
Net income - diluted	$ 1.91	$ 2.79

5. Segment Information

Marathon's operations consist of four reportable operating segments:

1) Exploration and Production ("E&P") – explores for, produces and markets liquid hydrocarbons and natural gas on a worldwide basis;

2) Oil Sands Mining ("OSM") – mines, extracts and transports bitumen from oil sands deposits in Alberta, Canada, and upgrades the bitumen to produce and market synthetic crude oil and by-products;

3) Refining, Marketing and Transportation ("RM&T") – refines, markets and transports crude oil and petroleum products, primarily in the Midwest, upper Great Plains, Gulf Coast and southeastern regions of the United States; and

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

(In millions)	E&P	OSM	RM&T	IG	Total
Three Months Ended June 30, 2008					
Revenues:					
Customer	$ 3,183	$ (80)	$ 18,267	$ 21	$ 21,391
Intersegment (a)	226	96	37	-	359
Related parties	15	-	671	-	686
Segment revenues	3,424	16	18,975	21	22,436

Elimination of intersegment revenues	(226)	(96)	(37)	-	(359)
Loss on U.K. natural gas contracts	(165)	-	-	-	(165)
Total revenues	$ 3,033	$ (80)	$ 18,938	$ 21	$ 21,912
Segment income (loss)	$ 828	$ (157)	$ 158	$ 102	$ 931
Income from equity method investments	77	-	43	136	256
Depreciation, depletion and amortization (b)	311	33	150	1	495
Income tax provision (benefit) (b)	854	(54)	108	36	944
Capital expenditures (c)(d)	874	262	702	-	1,838

7

(In millions)	E&P	OSM	RM&T	IG	Total
Three Months Ended June 30, 2007					
Revenues:					
Customer	$ 2,018	$ -	$ 14,248	$ 68	$ 16,334
Intersegment (a)	116	-	83	-	199
Related parties	7	-	404	-	411
Segment revenues	2,141	-	14,735	68	16,944
Elimination of intersegment revenues	(116)	-	(83)	-	(199)
Loss on U.K. natural gas contracts	(9)	-	-	-	(9)
Total revenues	$ 2,016	$ -	$ 14,652	$ 68	$ 16,736
Segment income	$ 400	$ -	$ 1,246	$ 12	$ 1,658
Income from equity method investments	64	-	31	22	117
Depreciation, depletion and amortization (b)	237	-	149	3	389
Minority interest in loss of subsidiary	-	-	-	1	1
Income tax provision(b)	480	-	721	4	1,205
Capital expenditures (c)(d)	580	-	334	34	948

(In millions)	E&P	OSM	RM&T	IG	Total
Six Months Ended June 30, 2008					
Revenues:					
Customer	$ 6,002	$ 99	$ 32,600	$ 40	$ 38,741
Intersegment (a)	385	116	202	-	703
Related parties	29	-	1,199	-	1,228
Segment revenues	6,416	215	34,001	40	40,672
Elimination of intersegment revenues	(385)	(116)	(202)	-	(703)
Loss on U.K. natural gas contracts	(235)	-	-	-	(235)
Total revenues	$ 5,796	$ 99	$ 33,799	$ 40	$ 39,734
Segment income (loss)	$ 1,512	$ (130)	$ 83	$ 201	$ 1,666
Income from equity method investments	139	-	71	255	465
Depreciation, depletion and amortization (b)	570	67	298	2	937
Income tax provision (benefit)(b)	1,541	(45)	63	84	1,643
Capital expenditures (c)(d)	1,649	510	1,213	1	3,373

Notes to Consolidated Financial Statements (Unaudited)

(In millions)	E&P	OSM	RM&T	IG	Total
Six Months Ended June 30, 2007					
Revenues:					
Customer	$ 3,723	$ -	$ 25,015	$ 124	$ 28,862
Intersegment (a)	256	-	84	-	340
Related parties	11	-	720	-	731
Segment revenues	3,990	-	25,819	124	29,933
Elimination of intersegment revenues	(256)	-	(84)	-	(340)
Gain on U.K. natural gas contracts	12	-	-	-	12
Total revenues	$ 3,746	$ -	$ 25,735	$ 124	$ 29,605
Segment income	$ 785	$ -	$ 1,591	$ 31	$ 2,407
Income from equity method investments	105	-	72	47	224
Depreciation, depletion and amortization (b)	479	-	290	4	773
Minority interest in loss of subsidiary	-	-	-	3	3
Income tax provision (b)	894	-	919	12	1,825
Capital expenditures (c)(d)	1,041	-	551	91	1,683

(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 reconciliation below.

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

(d) Through April 2007, Integrated Gas segment capital expenditures include Equatorial Guinea LNG Holdings Limited ("EGHoldings") at 100 percent. Effective May 1, 2007, Marathon no longer consolidates EGHoldings and its investment in EGHoldings is accounted for under the equity method of accounting; therefore, EGHoldings' capital expenditures subsequent to April 2007 are not included in Marathon's capital expenditures.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(In millions)	2008	2007	2008	2007
Segment income	$ 931	$ 1,658	$ 1,666	$ 2,407
Items not allocated to segments, net of income taxes:				
Corporate and other unallocated items	(73)	(111)	(41)	(154)

Gain (loss) on U.K. natural gas contracts		(84)		(5)		(120)		6
Discontinued operations(a)		-		8		-		8
Net income	$	774	$	1,550	$	1,505	$	2,267

(a) The Russian businesses sold in June 2006 were accounted for as discontinued operations. Adjustments to the sales price were completed in 2007 and an additional gain on the sale of $8 million ($13 million before income taxes) was recognized. See Marathon's 2007 Form 10-K for further information.

The following reconciles total revenues to sales and other operating revenues (including consumer excise taxes) as reported in the consolidated statements of income.

	Three Months Ended June 30,				Six Months Ended June 30,			
(In millions)		2008		2007		2008		2007
Total revenues	$	21,912	$	16,736	$	39,734	$	29,605
Less: Sales to related parties		686		411		1,228		731
Sales and other operating revenues (including consumer excise taxes)	$	21,226	$	16,325	$	38,506	$	28,874

Notes to Consolidated Financial Statements (Unaudited)

6. Defined Benefit Postretirement Plans

The following summarizes the components of net periodic benefit cost:

	Three Months Ended June 30,			
	Pension Benefits		Other Benefits	
(In millions)	2008	2007	2008	2007
Service cost	$ 39	$ 37	$ 4	$ 6
Interest cost	41	37	10	11
Expected return on plan assets	(42)	(39)	-	-
Amortization:				
– prior service cost (credit)	4	4	(2)	(3)
– actuarial loss	11	13	-	2
Net periodic benefit cost	$ 53	$ 52	$ 12	$ 16

	Six Months Ended June 30,			
	Pension Benefits		Other Benefits	
(In millions)	2008	2007	2008	2007
Service cost	$ 73	$ 70	$ 9	$ 11
Interest cost	80	71	22	22
Expected return on plan assets	(84)	(77)	-	-
Amortization:				
– prior service cost (credit)	7	7	(4)	(5)
– actuarial loss	15	18	1	4
Net periodic benefit cost	$ 91	$ 89	$ 28	$ 32

During the first six months of 2008, Marathon made contributions of $33 million to its funded international pension plans. Marathon expects to make additional contributions of approximately $7 million to its funded pension plans over the remainder of 2008. Contributions made from the general assets of Marathon to cover current benefit payments related to unfunded pension and other postretirement benefit plans were $9 million and $16 million during the first six months of 2008.

7. Income Taxes

The following is an analysis of the effective income tax rates for the periods presented:

	Six Months Ended June 30,	
	2008	2007
Statutory U.S. income tax rate	35 %	35 %
Effects of foreign operations, including foreign tax credits	14	9
State and local income taxes, net of federal income tax effects	1	2
Other tax effects	(2)	(1)
Effective income tax rate for continuing operations	48 %	45 %

The geographic sources of income and related tax expense contributed to the increase in the effective income tax rate in the first six months of 2008 when compared to the same period in 2007. The estimated 2008 effective tax rate includes the utilization of Norwegian net operating loss carryforwards for which a valuation allowance had been previously provided.

Notes to Consolidated Financial Statements (Unaudited)

Marathon is continuously undergoing examination of its U.S. federal income tax returns by the Internal Revenue Service. Such audits have been completed through the 2005 tax year. Marathon believes it has made adequate provision for federal income taxes and interest which may become payable for years not yet settled. Further, Marathon is routinely involved in U.S. state and local income tax audits and foreign jurisdiction tax audits. Marathon believes all other audits will be resolved within the amounts paid and/or provided for these liabilities. As of June 30, 2008, Marathon's income tax returns remain subject to examination in the following major tax jurisdictions for the tax years indicated.

United States (a)	2000 - 2007
Canada	2000 - 2007
Equatorial Guinea	2006 - 2007
Libya	2006 - 2007
United Kingdom	2005 - 2007

(a) Includes federal, state and local jurisdictions.

8. Comprehensive Income

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

(In millions)	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Net income	$ 774	$ 1,550	$ 1,505	$ 2,267
Other comprehensive income, net of taxes:				
Defined benefit postretirement plans (a)	(30)	(81)	(20)	(37)
Other	1	1	(1)	3
Comprehensive income	$ 745	$ 1,470	$ 1,484	$ 2,233

(a) During the first six months of 2008 and 2007, changes were made to the estimates used to measure certain assumptions necessary in determining the funded status of Marathon's postretirement benefit plans as of December 31, 2007 and 2006.

9. Inventories

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

(In millions)	June 30, 2008	December 31, 2007
Liquid hydrocarbons, natural gas and bitumen	$ 2,476	$ 1,203

Refined products and merchandise		2,245		1,792
Supplies and sundry items		294		282
Total, at cost	$	5,015	$	3,277

10. Property, Plant and Equipment

Exploratory well costs capitalized greater than one year after completion of drilling were $62 million as of June 30, 2008, a decrease of $38 million from December 31, 2007, primarily due to the transfer of the Ozona prospect exploratory wells in progress. A well on the Ozona prospect was re-entered and production casing was set in the second quarter of 2008.

11. Fair Value Measurements

As defined in SFAS No. 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 describes three approaches to measuring the fair value of assets and liabilities: the market approach, the income approach

Notes to Consolidated Financial Statements (Unaudited)

and the cost approach, each of which include multiple valuation techniques. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. The income approach uses valuation techniques to measure fair value by converting future amounts, such as cash flows or earnings, into a single present value amount using current market expectations about those future amounts. The cost approach is based on the amount that would currently be required to replace the service capacity of an asset. This is often referred to as current replacement cost. The cost approach assumes that the fair value would not exceed what it would cost a market participant to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence.

SFAS No. 157 does not prescribe which valuation technique should be used when measuring fair value and does not prioritize among the techniques. SFAS No. 157 establishes a fair value hierarchy that prioritized the inputs used in applying the various valuation techniques. Inputs broadly refer to the assumptions that market participants use to make pricing decisions, including assumptions about risk. Level 1 inputs are given the highest priority in the fair value hierarchy while Level 3 inputs are given the lowest priority. The three levels of the fair value hierarchy are as follows.

· Level 1 – Observable inputs that reflect unadjusted quoted prices for identical assets or liabilities in active markets as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

· Level 2 – Observable market-based inputs or unobservable inputs that are corroborated by market data. These are inputs other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date.

· Level 3 – Unobservable inputs that are not corroborated by market data and may be used with internally developed methodologies that result in management’s best estimate of fair value.

Marathon uses a market or income approach for its recurring fair value measurements and endeavors to use the best information available. Accordingly, valuation techniques that maximize the use of observable inputs are favored. Financial assets and liabilities are classified in their entirety based on the lowest priority level of input that is significant to the fair value measurement. The assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the placement of assets and liabilities within the levels of the fair value hierarchy.

The following table presents net financial assets (liabilities) accounted for at fair value on a recurring basis as of June 30, 2008:

(In millions)	Level 1	Level 2	Level 3	Total
Derivative Instruments:				
Commodity	$ 63	$ (2)	$ (988)	$ (927)
Interest rate	-	-	(1)	(1)
Foreign currency	-	14	1	15
Net derivative instruments	$ 63	$ 12	$ (988)	$ (913)

Other assets	15	-	-	15
Total at fair value	$ 78	$ 12	$ (988)	$ (898)

Deposits of $75 million in broker accounts covered by master netting agreements are netted against the value to arrive at the fair values of commodity derivatives. Derivatives in Level 1 are exchange-traded contracts for crude oil, natural gas, refined products and ethanol measured at fair value with a market approach using the close-of-day settlement prices for the market. Derivatives in Level 2 are measured at fair value with a market approach using broker quotes or third-party pricing services, which have been corroborated with market data. Level 3 derivatives are measured at fair value using either a market or income approach. Generally at least one input is unobservable, such as the use of an internally generated model or an external data source. Commodity derivatives in Level 3 include a $526 million liability related to two U.K. natural gas sales contracts that are accounted for as derivative instruments and a $432 million liability for crude oil options related to sales of Canadian synthetic crude oil. The fair value of the U.K. natural gas contracts is measured with an income approach based upon cash flows from expected sales volumes and the U.K. forward natural gas strip price. The crude oil options are measured at fair value using a Black-Scholes option pricing model, an income approach that utilizes market prices and market volatility obtained from a third-party service.

Notes to Consolidated Financial Statements (Unaudited)

The following is a reconciliation of the net beginning and ending balances recorded for derivative instruments classified as Level 3 in the fair value hierarchy for the three and six months ended June 30, 2008.

(In millions)		Three Months Ended June 30, 2008
Beginning balance	$	(485)
Total realized and unrealized losses:		
Included in net income		(542)
Purchases, sales, issuances and settlements, net		39
Ending Balance	$	(988)

(In millions)		Six Months Ended June 30, 2008
Beginning balance	$	(359)
Total realized and unrealized losses:		
Included in net income		(679)
Included in other comprehensive income		(1)
Purchases, sales, issuances and settlements, net		51
Ending Balance	$	(988)

The change in unrealized losses included in net income related to instruments held at June 30, 2008 was $557 million and $707 million for the second quarter and first six months of 2008. Amounts reported in net income are classified as sales and other operating revenues or cost of revenues for commodity derivative instruments, as net interest and other financing income for interest rate derivative instruments and as cost of revenues for foreign currency derivatives.

12. Debt

At June 30, 2008, Marathon had $981 million of commercial paper outstanding under its U.S. commercial paper program that is supported by its $3.0 billion revolving credit facility.

On March 12, 2008, Marathon issued $1 billion aggregate principal amount of senior notes bearing interest at 5.900 percent with a maturity date of March 15, 2018. Interest on the senior notes is payable semi-annually beginning September 15, 2008.

In February 2008, the 805 million Canadian dollar revolving term credit facility of Marathon Oil Canada Corporation was repaid and the facility was terminated.

13. Stock-Based Compensation Plans

The following table presents a summary of stock option award and restricted stock award activity for the second quarter 2008:

	Number of Shares Under Option (a)	Weighted Average Exercise Price	Restricted Stock Awards	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2007	12,214,853	$ 34.58	1,527,831	$ 39.87
Granted (b)	2,463,528	52.01	369,741	49.71
Exercised	(282,194)	24.79	(535,356)	27.04
Canceled	(185,050)	49.66	(68,313)	39.29
Outstanding at June 30, 2008	14,211,137	$ 37.60	1,293,903	$ 48.03

(a) Of the stock option awards outstanding as of June 30, 2008, 5,537,357, 8,171,670 and 502,110 were outstanding under the 2007 Incentive Compensation Plan, the 2003 Incentive Compensation Plan and the 1990 Stock Plan, including 749,282 stock options with tandem stock appreciation rights.

(b) The weighted average grant date fair value of stock option awards granted was $13.09 per share.

Notes to Consolidated Financial Statements (Unaudited)

14. Stockholders’ Equity

Share repurchase – As of June 30, 2008, Marathon had acquired 64 million common shares at a cost of $2,815 million under its $5 billion authorized share repurchase program, including 6 million common shares acquired during the first six months of 2008 at a cost of $295 million.

Stock split – On April 25, 2007, Marathon’s Board of Directors declared a two-for-one split of the Company’s common stock which was affected in the form of a stock dividend distributed on June 18, 2007, to stockholders of record at the close of business on May 23, 2007.

15. 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. 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. Certain of the Company’s commitments are discussed below.

Marathon is a defendant, along with many other companies with refinery operations, in 58 cases in 12 states alleging methyl tertiary butyl ether (“MTBE”) contamination in groundwater. These cases, after their removal from state to federal court, have been consolidated in a multi-district litigation (“MDL”) in the Southern District of New York for pre-trial proceedings. On July 22, 2008, the judge issued an opinion holding that the MTBE settlement agreement represented a "good faith" settlement. The settling defendants, which included Marathon, were required to obtain a good faith determination for the California and Illinois cases in order to insure protection from contribution actions. The federal judge in the MDL concluded that both the approximate percentage of estimated liability being paid and the dollar amounts being allocated were reasonable. Similar approvals must also be obtained from state court judges in Illinois and California. The timing of payment under the settlement agreement could be impacted by an appeal of the judges' rulings on fairness. Such settlement is not expected to significantly impact Marathon’s consolidated results of operations, financial position or cash flows.

Contractual commitments – At June 30, 2008 and December 31, 2007, Marathon’s contract commitments to acquire property, plant and equipment totalled $4,130 million and $3,893 million. During the first six months of 2008, the majority of additional contract commitments were related to Gulf of Mexico projects.

16. Supplemental Cash Flow Information

	Six Months Ended June 30,	
(In millions)	2008	2007
Net cash provided from operating activities included:		
Interest paid (net of amounts capitalized)	$ 54	$ 20
Income taxes paid to taxing authorities	1,498	1,630

Commercial paper and revolving credit arrangements, net:				
Commercial paper - issuances	$	28,992	$	-
- repayments		(28,013)		-
Credit agreements - borrowings	$	249	$	-
- repayments		(844)		-
Noncash investing and financing activities:				
Bond obligation assumed for trusteed funds	$	-	$	1,000
Noncash effect of deconsolidation of EGHoldings:				
Decrease in non-cash assets	$	-	$	1,759
Record equity method investment		-		942
Decrease in liabilities		-		310
Elimination of minority interest		-		544

Notes to Consolidated Financial Statements (Unaudited)

17. Subsequent Events

On July 31, 2008, Marathon announced that the board of directors is evaluating the separation of Marathon into two independent, publicly-traded companies. One entity would consist of the Exploration and Production, Integrated Gas and Oil Sands Mining businesses; and the other entity would consist of the Refining, Marketing and Transportation business.

On July 9, 2008, Marathon entered into an agreement to sell its outside-operated and undeveloped offshore acreage in Norway, including $41 million in associated deferred income tax assets. The proceeds before closing adjustments are $416 million. The transaction is expected to close by the end of 2008. Beginning the third quarter of 2008, the operating assets, the net carrying value of which is not significant, will be classified as held for sale until the transaction closes.

18. Accounting Standards Not Yet Adopted

In June 2008, the FASB issued FASB Staff Position on EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" ("FSP EITF 03-6-1") which provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and, therefore, need to be included in the earnings allocation in computing earnings per share ("EPS") under the two-class method. For Marathon, FSP EITF 03-6-1 is effective January 1, 2009 and all prior-period EPS data (including any amounts related to interim periods, summaries of earnings and selected financial data) will be adjusted retrospectively to conform to its provisions. Early application of FSP EITF 03-6-1 is not permitted. Although restricted stock awards meet this definition of participating securities, Marathon does not expect application of FSP EITF 03-6-1 to have a significant impact on its reported EPS.

On April 25, 2008, the FASB issued FASB Staff Position on FAS 142-3 (FSP 142-3) which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, Goodwill and Other Intangible Assets. The intent of this FSP is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset. For Marathon, FSP 142-3 will be effective on January 1, 2009, early adoption is prohibited. The provisions of FSP 142-3 is to be applied prospectively to intangible assets acquired after the effective date, except for the disclosure requirements which must be applied prospectively to all intangible assets recognized as of, and subsequent to, the effective date. Marathon is currently evaluating the provisions of this statement.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133." This statement expands the disclosure requirements for derivative instruments to provide information regarding (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under SFAS No. 133 and its related interpretations and (iii) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. To meet these objectives, the statement requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts and gains and losses on derivative instruments and disclosures about credit-risk-related contingent features in derivative agreements. For Marathon, SFAS No. 161 is effective January 1, 2009. The statement encourages but does not require disclosures for

earlier periods presented for comparative purposes at initial adoption. Marathon is currently evaluating the provisions of this statement.

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" ("SFAS No. 141 (R)"). This statement significantly changes the accounting for business combinations. Under SFAS No.141(R), an acquiring entity will be required to recognize all the assets acquired, liabilities assumed and any non-controlling interest in the acquiree at their acquisition-date fair value with limited exceptions. The statement expands the definition of a business and is expected to be applicable to more transactions than the previous business combinations standard. The statement also changes the accounting treatment for changes in control, step acquisitions, transaction costs, acquired contingent liabilities, in-process research and development, restructuring costs, changes in deferred tax asset valuation allowances as a result of a business combination and changes in income tax uncertainties after the acquisition date. Accounting for changes in valuation allowances for acquired deferred tax assets and the resolution of uncertain tax positions for prior business combinations will impact tax expense instead of impacting goodwill. Additional disclosures are also required. For Marathon, SFAS No. 141(R) will be applied prospectively effective January 1, 2009.

Notes to Consolidated Financial Statements (Unaudited)

Also in December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51." This statement establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement clarifies that a noncontrolling interest in a subsidiary (sometimes called a minority interest) is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements, but separate from the parent's equity. It requires that the amount of consolidated net income attributable to the noncontrolling interest be clearly identified and presented on the face of the consolidated income statement. SFAS No. 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated, based on the fair value of the noncontrolling equity investment on the deconsolidation date. Additional disclosures are required that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. For Marathon, SFAS No. 160 will be effective January 1, 2009 and early adoption is prohibited. The statement must be applied prospectively, except for the presentation and disclosure requirements which must be applied retrospectively for all periods presented in consolidated financial statements. Marathon is currently evaluating the provisions of this statement.

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

Marathon Oil Corporation is engaged in worldwide exploration, production and marketing of liquid hydrocarbons and natural gas; mining, extraction and transportation of bitumen from oil sands deposits in Alberta, Canada, and upgrading of the bitumen for the production and marketing of synthetic crude oil and by-products; domestic refining, marketing and transportation of crude oil and petroleum products, primarily in the Midwest, upper Great Plains, Gulf Coast and southeastern regions of the 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 2007 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," "may," "shou 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 2007 Annual Report on Form 10-K.

We hold a 60 percent interest in Equatorial Guinea LNG Holdings Limited ("EGHoldings"). Effective May 1, 2007, we no longer consolidate EGHoldings. Our investment is accounted for prospectively using the equity method of accounting. Unless specifically noted, amounts presented for the Integrated Gas segment for periods prior to May 1, 2007, include amounts related to the minority interests.

Overview and Outlook

Exploration and Production ("E&P")

Net liquid hydrocarbon and natural gas sales during the second quarter and first six months of 2008 averaged 350 and 364 thousand barrels of oil equivalent per day ("mboepd"), an increase of 4 percent and 7 percent over the same periods of 2007, primarily due to increased sales of natural gas from the Alba field offshore Equatorial Guinea.

The Alvheim development offshore Norway commenced production on June 8, 2008. Currently there are five wells producing from the Alvheim portion of the development. The Vilje field, which is tied back to the Alvheim floating production, storage and offloading vessel, began producing July 31, 2008. Based on results thus far, Alvheim/Vilje is expected to reach a combined production rate of 75 mboepd net to Marathon (120 mboepd gross) before the end of 2008. We have a 65 percent operated interest in the Alvheim fields and a 47 percent outside-operated interest in the Vilje field.

The Neptune development in the Gulf of Mexico commenced production of oil and natural gas in early July 2008 and reached full oil capacity after 15 days of operations. The field is currently producing from five wells and the sixth well is expected on line in August. Marathon has a 30 percent outside-operated interest in the Neptune development. The facility's design capacity is 50,000 barrels per day ("bpd") of oil and 50 million cubic feet per day ("mmcfd") of natural gas.

We continue to increase production from the Williston Basin (the Bakken shale formation) in North Dakota. We currently have seven rigs drilling. We expect to drill approximately 65 company-operated wells in 2008 and will have over 100 wells in the play by the end of 2008. Our net production from the Bakken shale increased 130 percent from the fourth quarter 2007 rate of 2,170 barrels of oil equivalent per day (“boepd") to the second quarter 2008 rate of 5,070 boepd, and is currently in excess of 6,000 boepd.

During the second quarter of 2008 we were awarded the 15 blocks bid in the Central Gulf of Mexico Lease Sale No. 206 conducted by the Minerals Management Service in the first quarter of 2008. Two blocks are 100 percent Marathon, and the remaining blocks were bid with partners, at a total cost of $121 million. Initial drilling on these leases, and those acquired at Lease Sale No. 205 in October 2007, is planned for 2009. We are also currently participating in two deepwater exploration wells in the Gulf of Mexico with a third well planned later this year.

During the first six months of 2008, in the Gulf of Mexico, we drilled a successful appraisal well on the Droshky discovery and participated in the successful Stones appraisal well. Future drilling activity is being planned which will determine the potential commerciality of this discovery. We hold a 25 percent outside-operated interest in Stones.

Offshore Angola, we have received approval to proceed with the first deepwater oil development project in Block 31. The development is comprised of the Plutao, Saturno, Venus and Marte ("PSVM") fields. Key contracts are ready to be awarded and construction work is expected to begin later this year. A total of 48 production and injection wells are planned for the PSVM development.

During the first six months of 2008, we participated in the Portia discovery on Block 31 offshore Angola which was our 27th discovery on Blocks 31 and 32. We also participated in three wells in our Angola exploration and appraisal program that have reached total depth, the results of which will be announced upon receipt of government and partner approval. At June 30, 2008 we were participating in one appraisal well in Block 32. On Block 31 we are currently drilling an exploratory well and plan to drill two additional exploratory wells in 2008. We hold a 10 percent outside-operated interest in Block 31 and a 30 percent outside-operated interest in Block 32.

In Indonesia, we are the operator of a drilling rig consortium which has secured a two-year contract for a deepwater exploration drilling rig. The rig will be used for deepwater exploration activities by us and four other companies in Indonesia. Initial drilling is expected to commence in the second half of 2009. The participants have the right to extend this rig commitment.

We decided to cease efforts to pursue exploration opportunities in Ukraine and will close our office in Kiev. We anticipate completing this withdrawal during the third quarter of 2008.

During the first quarter of 2008, we transferred our interest in an exploration and production license in Sudan to the operator, and as a result, we no longer have any interests in Sudan.

On July 9, 2008, we entered into an agreement to sell our outside-operated interests (24 percent of Heimdal field, 47 percent of Vale field and 20 percent of Skirne field) and associated undeveloped acreage offshore Norway, including $41 million in associated deferred income tax assets. Total proceeds before closing adjustments are expected to be $416 million. The transaction is expected to close during the late third quarter or early fourth quarter of 2008.

The above discussion includes forward-looking statements with respect to the Gulf of Mexico lease sale, the timing and levels of future production from the Alvheim/Vilje project, Blocks 31 and 32 offshore Angola, the anticipated disposition of interests in the Heimdal area and related assets, and anticipated future exploratory drilling activity. Some factors that could potentially affect these forward-looking statements include pricing, supply and demand for petroleum products, the amount of capital available for exploration and development, regulatory constraints, timing of commencing production from new wells, drilling rig availability, 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. Except for the Alvheim/Vilje developments and Block 31, the foregoing forward-looking statements may be further affected by the inability to obtain or delay in obtaining necessary government and third-party approvals and permits. The disposition of interests in the Heimdal area could also be adversely affected by customary closing conditions. The foregoing factors (among others) could cause actual results to differ materially from those set forth in the forward-looking statements.

Oil Sands Mining ("OSM")

Our bitumen production, before royalties, was 24 thousand barrels per day ("mbpd") in the second quarter and in the first six months of 2008. Second quarter production was lower than expected due to a revised plan to manage the disposal of tailings that resulted in mining a lower grade ore, as well as planned and unplanned maintenance at the mine. Tailings consist primarily of water and sediment that remains after the bitumen is extracted from the ore. In addition, although operations reliability improved over the fourth quarter of 2007, cold weather caused downtime in

the first quarter of 2008.

The Athabasca Oil Sands Project ("AOSP") Phase 1 expansion, which includes construction of mining and extraction facilities at the Jackpine mine, expansion of treatment facilities at the existing Muskeg River mine, expansion of the Scotford upgrader and development of related infrastructure, is anticipated to begin operations in late 2010. This is a forward-looking statement which could be affected by transportation logistics, availability of materials and labor, unforeseen hazards such as weather conditions, delays in obtaining or conditions imposed by necessary government and third-party approvals and other risks customarily associated with construction projects.

During the first quarter of 2008, the royalty calculation methodology for the AOSP was revised to allow for additional eligible costs to the project. As a result, the project reverted to the one percent gross royalty (in lieu of the 25 percent post-recovery rate) as of July 1, 2007. Due to the continued strong commodity price environment, it is anticipated that the third quarter of 2008, the AOSP will revert to the 25 percent net royalty regime for the existing operations.

Refining, Marketing and Transportation ("RM&T")

In the second quarter and first six months of 2008, our total refinery throughputs were 6 percent and 8 percent lower than in the second quarter and first six months of 2007. Crude oil refined likewise decreased 5 percent and 9 percent in the same periods.

Our ethanol blending program increased to 55 mbpd in the second quarter of 2008 from 40 mbpd in the second quarter of 2007. For the first six months of 2008 ethanol we blended 28 percent more ethanol than in the same period of 2007. The future expansion or contraction of our ethanol blending program will be driven by the economics of ethanol supply and government regulations.

Second quarter of 2008 Speedway SuperAmerica LLC same store gasoline sales volume declined five percent when compared to the second quarter of 2007 while same store merchandise sales increased by one percent for the same period.

Construction continues to progress as planned on the Garyville refinery expansion project. In the second quarter of 2008, permits were received and construction was begun on our heavy oil upgrading and expansion project at the Detroit refinery. The Detroit project increases the refinery’s ability to process heavy crude oil by 80 mbpd.

We are no longer pursuing the October 2007 agreement to purchase of four light product terminals in Ohio and an ownership interest in a refined product pipeline.

The above discussion includes forward-looking statements with respect to the Garyville and Detroit refinery expansion projects. Factors that could affect those projects include transportation logistics, availability of materials and labor, unforeseen hazards such as weather conditions, delays in obtaining or conditions imposed by necessary government and third-party approvals, and other risks customarily associated with construction projects. These factors (among others) could cause actual results to differ materially from those set forth in the forward-looking statements.

Integrated Gas (“IG”)

We own 45 percent of Atlantic Methanol Production Company LLC (“AMPCO”) and 60 percent of Equatorial Guinea LNG Holdings Limited (“EGHoldings”), both of which are accounted for under the equity method of accounting. AMPCO operates a methanol plant and EGHoldings operates an LNG production facility, both located on Bioko Island, Equatorial Guinea. Alba field dry natural gas, which remains after the condensate and LPG are removed, is supplied to both of these facilities under long-term contracts at fixed prices. We consider the prices under these contracts to be comparable to the price that could be realized from transactions with unrelated parties in this market under the same or similar circumstances, because of the location of and limited local demand for natural gas in Equatorial Guinea.

The EGHoldings LNG production facility delivered 14 cargoes during the second quarter of 2008 compared to 3 cargoes in the second quarter of 2007, which was its first quarter of production. As a result, our share of LNG sales worldwide totaled 6,402 metric tonnes per day (“mtpd”) for the second quarter of 2008 compared to 1,997 mtpd in the second quarter of 2007 and 6,657 mtpd in the first six months of 2008 compared to 1,582 mtpd in the first six months of 2007. These LNG sales volumes include both consolidated sales volumes and our share of the sales volumes of equity method investees. LNG sales from Alaska are conducted through a consolidated subsidiary. LNG and methanol sales from Equatorial Guinea are conducted through equity method investees.

A planned turnaround at the LNG production facility started in mid-July and the facility was back to full capacity by early August. The methanol plant experienced a shutdown at the beginning of the third quarter of 2008 due to a process issue. As of the date of this filing, the facility has been returned to full production.

Evaluation of Separation of Business

On July 31, 2008, Marathon announced that the board of directors is evaluating the separation of Marathon into two independent, publicly-traded companies, each focused on its own set of business opportunities. One entity would consist of the Exploration and Production, Integrated Gas and Oil Sands Mining businesses; and the other entity would consist of the Refining, Marketing and Transportation business. Results of this evaluation and a decision by the board of directors are anticipated during the fourth quarter of 2008. Should the decision be made to separate, the separation would likely occur during the first quarter of 2009.

The above discussion includes forward-looking statements with respect to the evaluation of separating Marathon into two distinct businesses. Some factors that could potentially affect these forward-looking statements include board approval, future financial condition and operating results, and economic, business, competitive and/or regulatory factors affecting our business. The foregoing factors (among others) could cause actual results to differ materially from those set forth in the forward-looking statements.

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 changes to our critical accounting estimates subsequent to December 31, 2007, except those related to fair value estimates resulting from the adoption of SFAS No. 157 as discussed below.

Fair Value Estimates

On January 1, 2008, we adopted SFAS No. 157 for those financial assets and liabilities recognized or disclosed at fair value in the consolidated financial statements on a recurring basis. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. It does not require us to make any new fair value measurements, but rather establishes a fair value hierarchy that prioritizes the inputs to the valuation techniques used to measure fair value. Level 1 inputs are given the highest priority in the fair value hierarchy, as they represent observable inputs that reflect unadjusted quoted prices for identical assets or liabilities in active markets as of the reporting date, while Level 3 inputs are given the lowest priority, as they represent unobservable inputs that are not corroborated by market data. Valuation techniques that maximize the use of observable inputs are favored.

FSP FAS 157-2, “Effective Date of FASB Statement No. 157,” deferred the effective date of SFAS No. 157 for one year for certain nonfinancial assets and nonfinancial liabilities, which for us includes impairments of goodwill, intangible assets and other long-lived assets, and initial measurement of asset retirement obligations, asset exchanges, business combinations and partial sales of proved properties.

For Marathon, the primary impact from the adoption of SFAS No. 157 at January 1, 2008, related to the fair value measurement of derivative instruments. Derivatives in Level 1 are exchange-traded contracts for crude oil, natural gas, refined products and ethanol measured at fair value with a market approach using the close-of-day settlement prices for the market. Derivatives in Level 2 are measured at fair value with a market approach using broker quotes or third-party pricing services, which have been corroborated with market data. Level 3 derivatives are measured at fair value using either a market or income approach. Generally at least one input is unobservable, such as the use of an internally generated model or an external data source. Commodity derivatives in Level 3 include a $526 million liability related to two U.K. natural gas sales contracts that are accounted for as derivative instruments and a $432 million liability for crude oil options related to sales of Canadian synthetic crude oil. The fair value of the U.K. natural gas contracts is measured with an income approach based upon cash flows from expected sales volumes and the U.K. forward natural gas strip price. The crude oil options are measured at fair value using a Black-Scholes option pricing model, an income approach that utilizes market prices and market volatility obtained from a third-party service. Additional information about derivatives may be found in Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Management's Discussion and Analysis of Results of Operations

Consolidated Results of Operations

Revenues are summarized by segment in the following table:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In millions)	2008	2007	2008	2007
E&P	$ 3,424	$ 2,141	$ 6,416	$ 3,990
OSM	16	-	215	-
RM&T	18,975	14,735		