MARATHON OIL CORP
Form 10-Q
August 03, 2012

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, 2012

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 Street, 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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of

Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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

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

There were 705,432,356 shares of Marathon Oil Corporation common stock outstanding as of June 29, 2012.

MARATHON OIL CORPORATION

Form 10-Q

Quarter Ended June 30, 2012

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Unless the context otherwise indicates, references in this Form 10-Q to “Marathon Oil,” “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 Oil 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)

	Three Months Ended June 30,		Six Months Ended June 30,	
(In millions, except per share data)	2012	2011	2012	2011
Revenues and other income:				
Sales and other operating revenues	$3,718	$3,680	$7,495	$7,336
Sales to related parties	13	14	27	29
Income from equity method investments	60	120	138	237
Net gain (loss) on disposal of assets	(28)	45	138	50
Other income	21	6	26	22
Total revenues and other income	3,784	3,865	7,824	7,674
Costs and expenses:				
Cost of revenues (excludes items below)	1,302	1,667	2,709	3,071
Purchases from related parties	56	71	119	127
Depreciation, depletion and amortization	580	564	1,154	1,199
Impairments	1	307	263	307
General and administrative expenses	130	130	250	267
Other taxes	67	53	145	111
Exploration expenses	173	145	315	375
Total costs and expenses	2,309	2,937	4,955	5,457
Income from operations	1,475	928	2,869	2,217
Net interest and other	(57)	(13)	(107)	(32)
Loss on early extinguishment of debt	-	-	-	(279)
Income from continuing operations before income taxes	1,418	915	2,762	1,906
Provision for income taxes	1,025	617	1,952	1,153
Income from continuing operations	393	298	810	753
Discontinued operations	-	698	-	1,239
Net income	$393	$996	$810	$1,992
Per Share Data				
Basic:				
Income from continuing operations	$0.56	$0.42	$1.15	$1.06
Discontinued operations	$-	$0.98	$-	$1.74
Net income	$0.56	$1.40	$1.15	$2.80
Diluted:				
Income from continuing operations	$0.56	$0.42	$1.14	$1.05
Discontinued operations	$-	$0.97	$-	$1.73
Net income	$0.56	$1.39	$1.14	$2.78
Dividends paid	$0.17	$0.25	$0.34	$0.50
Weighted average shares:				
Basic	706	713	705	712
Diluted	709	717	709	716

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

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MARATHON OIL CORPORATION

Consolidated Statements of Comprehensive Income (Unaudited)

(In millions)	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
Net income	$393	$996	$810	$1,992
Other comprehensive income				
Postretirement and postemployment plans				
Change in actuarial loss	(3)	64	10	97
Spin-off downstream business	-	968	-	968
Income tax benefit (provision) on postretirement and postemployment plans	1	(403)	(4)	(415)
Postretirement and postemployment plans, net of tax	(2)	629	6	650
Derivative hedges				
Net unrecognized gain	-	1	-	10
Spin-off downstream business	-	(7)	-	(7)
Income tax benefit (provision) on derivatives	-	3	-	(1)
Derivative hedges, net of tax	-	(3)	-	2
Foreign currency translation and other				
Unrealized loss	(1)	(1)	-	(1)
Income tax provision on foreign currency translation and other	-	-	-	-
Foreign currency translation and other, net of tax	(1)	(1)	-	(1)
Other comprehensive income (loss)	(3)	625	6	651
Comprehensive income	$390	$1,621	$816	$2,643

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

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MARATHON OIL CORPORATION
Consolidated Balance Sheets (Unaudited)

(In millions, except per share data)	June 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$452	$493
Receivables	2,047	1,917
Receivables from related parties	17	35
Inventories	335	361
Prepayments	101	96
Deferred tax assets	87	99
Other current assets	215	223
Total current assets	3,254	3,224
Equity method investments	1,319	1,383
Property, plant and equipment, less accumulated depreciation, depletion and amortization of $17,777 and $17,248	26,001	25,324
Goodwill	525	536
Other noncurrent assets	1,151	904
Total assets	$32,250	$31,371
Liabilities		
Current liabilities:		
Commercial paper	$550	$-
Accounts payable	2,158	1,864
Payables to related parties	25	18
Payroll and benefits payable	120	193
Accrued taxes	1,440	2,015
Other current liabilities	211	163
Long-term debt due within one year	187	141
Total current liabilities	4,691	4,394
Long-term debt	4,513	4,674
Deferred income taxes	2,534	2,544
Defined benefit postretirement plan obligations	761	789
Asset retirement obligations	1,489	1,510
Deferred credits and other liabilities	477	301
Total liabilities	14,465	14,212
Commitments and contingencies		
Stockholders' Equity		
Preferred stock – no shares issued and outstanding (no par value, 26 million shares authorized)	-	-
Common stock:		
Issued – 770 million and 770 million shares (par value $1 per share, 1.1 billion shares authorized)	770	770
Securities exchangeable into common stock – no shares issued and outstanding (no par value, 29 million shares authorized)	-	-

Held in treasury, at cost – 65 million and 66 million shares	(2,646)	(2,716)
Additional paid-in capital	6,667	6,680
Retained earnings	13,358	12,788
Accumulated other comprehensive loss	(364)	(370)
Total equity of Marathon Oil's stockholders	17,785	17,152
Noncontrolling interest	-	7
Total equity	17,785	17,159
Total liabilities and stockholders' equity	$32,250	$31,371

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)

	Six Months Ended June 30,	
(In millions)	2012	2011
Increase (decrease) in cash and cash equivalents		
Operating activities:		
Net income	$810	$1,992
Adjustments to reconcile net income to net cash provided by operating activities:		
Discontinued operations	-	(1,239)
Loss on early extinguishment of debt	-	279
Deferred income taxes	75	(51)
Depreciation, depletion and amortization	1,154	1,199
Impairments	263	307
Pension and other postretirement benefits, net	(22)	22
Exploratory dry well costs and unproved property impairments	174	264
Net gain on disposal of assets	(138)	(50)
Equity method investments, net	7	(21)
Changes in:		
Current receivables	(107)	78
Inventories	(18)	46
Current accounts payable and accrued liabilities	(450)	372
All other operating, net	(6)	122
Net cash provided by continuing operations	1,742	3,320
Net cash provided by discontinued operations	-	1,090
Net cash provided by operating activities	1,742	4,410
Investing activities:		
Additions to property, plant and equipment	(2,181)	(1,702)
Disposal of assets	218	371
Investments - return of capital	21	36
Investing activities of discontinued operations	-	(493)
Property deposit	-	(100)
All other investing, net	(59)	15
Net cash used in investing activities	(2,001)	(1,873)
Financing activities:		
Commercial paper, net	550	-
Debt issuance costs	(9)	-
Debt repayments	(111)	(2,843)
Dividends paid	(240)	(356)
Financing activities of discontinued operations	-	2,916
Distribution in spin-off	-	(1,622)
All other financing, net	20	126
Net cash provided by (used in) financing activities	210	(1,779)
Effect of exchange rate changes on cash	8	2
Net increase (decrease) in cash and cash equivalents	(41)	760
Cash and cash equivalents at beginning of period	493	3,951
Cash and cash equivalents at end of period	$452	$4,711

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; however, in the opinion of management, these statements 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.

As a result of the spin-off (see Note 2), the results of operations for our downstream (Refining, Marketing and Transportation) business have been classified as discontinued operations in 2011. The disclosures in this report are presented on the basis of continuing operations, unless otherwise stated. Any reference to “Marathon” indicates Marathon Oil Corporation as it existed prior to the June 30, 2011 spin-off.

These interim financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Marathon Oil Corporation (“Marathon Oil”) 2011 Annual Report on Form 10-K. The results of operations for the second quarter and first six months of 2012 are not necessarily indicative of the results to be expected for the full year.

2. Spin-off Downstream Business

On June 30, 2011, the spin-off of the downstream business was completed, creating two independent energy companies: Marathon Oil and Marathon Petroleum Corporation (“MPC”). On June 30, 2011, stockholders of record as of 5:00 p.m. Eastern Daylight Savings time on June 27, 2011 (the “Record Date”) received one common share of MPC stock for every two common shares of Marathon stock held as of the Record Date.

The following table presents selected financial information regarding the results of operations of our downstream business which are reported as discontinued operations. Transaction costs incurred to affect the spin-off of $57 million and $74 million for the second quarter and first six months of 2011 are included in discontinued operations.

(In millions)	Three Months Ended, June 30, 2011	Six Months Ended June 30, 2011
Revenues applicable to discontinued operations	$20,760	$38,602
Pretax income from discontinued operations	1,244	2,012

3. Accounting Standards

Recently Adopted

In September 2011, the Financial Accounting Standards Board ("FASB") amended accounting standards to simplify how entities test goodwill for impairment. The amendment reduces complexity by allowing an entity the option to make a qualitative evaluation of whether it is necessary to perform the two-step goodwill impairment test. The amendment is effective for our interim and annual periods beginning with the first quarter of 2012. Adoption of this amendment did not have a significant impact on our consolidated results of operations, financial position or cash flows.

The FASB amended the reporting standards for comprehensive income in June 2011 to eliminate the option to present the components of Other Comprehensive Income ("OCI") as part of the statement of changes in stockholders' equity. All non-owner changes in stockholders' equity are required to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two statement approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of OCI, and total comprehensive income. The presentation of items that are reclassified from OCI to net income on the income statement is also required. The amendments did not change the items that must be reported in OCI or when an item of OCI must be reclassified to net income. The amendments are effective for us beginning with the first quarter of 2012, except for the presentation of reclassifications, which has been deferred. Adoption of these amendments did not have a significant impact on our consolidated results of operations, financial position or cash flows.

MARATHON OIL CORPORATION
Notes to Consolidated Financial Statements (Unaudited)

In May 2011, the FASB issued an update amending the accounting standards for fair value measurement and disclosure, resulting in common principles and requirements under accounting principles generally accepted in the U.S. ("U.S. GAAP") and International Financial Reporting Standards ("IFRS"). The amendments change the wording used to describe certain of the U.S. GAAP requirements either to clarify the intent of existing requirements, to change measurement or expand disclosure principles or to conform to the wording used in IFRS. The amendments are to be applied prospectively for our interim and annual periods beginning with the first quarter of 2012. The adoption of the amendments did not have a significant impact on our consolidated results of operations, financial position or cash flows. To the extent they were necessary, we have made the expanded disclosures in Note 13.

4. Variable Interest Entity

The owners of the Athabasca Oil Sands Project ("AOSP"), in which we hold a 20 percent undivided interest, contracted with a wholly-owned subsidiary of a publicly traded Canadian limited partnership ("Corridor Pipeline") to provide materials transportation capabilities among the Muskeg River and Jackpine mines, the Scotford upgrader and markets in Edmonton. The contract, originally signed in 1999 by a company we acquired, allows each holder of an undivided interest in the AOSP to ship materials in accordance with its undivided interest. Costs under this contract are accrued and recorded on a monthly basis, with a $3 million current liability recorded at June 30, 2012. Under this agreement, the AOSP absorbs all of the operating and capital costs of the pipeline. Currently, no third-party shippers use the pipeline. Should shipments be suspended, by choice or due to force majeure, we remain responsible for the portion of the payments related to our undivided interest for all remaining periods. The contract expires in 2029; however, the shippers can extend its term perpetually. This contract qualifies as a variable interest contractual arrangement and the Corridor Pipeline qualifies as a Variable Interest Entity ("VIE"). We hold a variable interest but are not the primary beneficiary because our shipments are only 20 percent of the total; therefore, the Corridor Pipeline is not consolidated by Marathon Oil. Our maximum exposure to loss as a result of our involvement with this VIE is the amount we expect to pay over the contract term, which was $703 million as of June 30, 2012. The liability on our books related to this contract at any given time will reflect amounts due for the immediately previous month's activity, which is substantially less than the maximum exposure over the contract term. We have not provided financial assistance to Corridor Pipeline and we do not have any guarantees of such assistance in the future.

5. Income per Common Share

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

	Three Months Ended June 30,			
	2012		2011	
(In millions, except per share data)	Basic	Diluted	Basic	Diluted
Income from continuing operations	$393	$393	$298	$298
Discontinued operations	-	-	698	698
Net income	$393	$393	$996	$996
Weighted average common shares outstanding	706	706	713	713
Effect of dilutive securities	-	3	-	4

Weighted average common shares, including dilutive effect	706	709	713	717
Per share:				
Income from continuing operations	$0.56	$0.56	$0.42	$0.42
Discontinued operations	$-	$-	$0.98	$0.97
Net income	$0.56	$0.56	$1.40	$1.39

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MARATHON OIL CORPORATION
Notes to Consolidated Financial Statements (Unaudited)

	Six Months Ended June 30,			
	2012		2011	
(In millions, except per share data)	Basic	Diluted	Basic	Diluted
Income from continuing operations	$810	$810	$753	$753
Discontinued operations	-	-	1,239	1,239
Net income	$810	$810	$1,992	$1,992
Weighted average common shares outstanding	705	705	712	712
Effect of dilutive securities	-	4	-	4
Weighted average common shares, including dilutive effect	705	709	712	716
Per share:				
Income from continuing operations	$1.15	$1.14	$1.06	$1.05
Discontinued operations	$-	$-	$1.74	$1.73
Net income	$1.15	$1.14	$2.80	$2.78

The per share calculations above exclude 10 million and 9 million stock options and stock appreciation rights for the second quarter and first six months of 2012, as they were antidilutive. Excluded for the second quarter and first six months of 2011 were 5 million and 6 million stock options and stock appreciation rights.

6. Acquisitions

In April 2012, we entered into agreements to acquire approximately 20,000 net acres in the core of the Eagle Ford shale. The smaller transactions closed during the second quarter of 2012. The largest transaction, with a value of $750 million before closing adjustments, closed on August 1, 2012.

7. Dispositions

2012

In May 2012, we reached an agreement to relinquish our Exploration and Production ("E&P") segment's operatorship of and interests in the Bone Bay and Kumawa exploration licenses in Indonesia. A $36 million payment will be made upon government ratification of the agreement, to settle all of our obligations related to these licenses, including well commitments. This amount was accrued and reported as a loss on disposal of assets in the second quarter of 2012.

In April 2012, we entered into agreements to sell all of our E&P segment's assets in Alaska. One transaction closed in the second quarter of 2012 with proceeds and a net gain of $7 million. The remaining transaction, with a value of $375 million before closing adjustments, is expected to close in the second half of 2012, pending regulatory approval and closing conditions. Assets held for sale are included in the June 30, 2012 balance sheet as follows:

(In millions)	
Other current assets	$60
Other noncurrent assets	187
Total assets	247

Deferred credits and other liabilities	87
Total liabilities	$87

In January 2012, we closed on the sale of our E&P segment's interests in several Gulf of Mexico crude oil pipeline systems for proceeds of $206 million. This includes our equity method interests in Poseidon Oil Pipeline Company, L.L.C. and Odyssey Pipeline L.L.C., as well as certain other oil pipeline interests, including the Eugene Island pipeline system. A pretax gain of $166 million was recorded in the first quarter of 2012.

MARATHON OIL CORPORATION
Notes to Consolidated Financial Statements (Unaudited)

2011

In April 2011, we assigned a 30 percent undivided working interest in our E&P segment's approximately 180,000 acres in the Niobrara shale play located within the DJ Basin of southeast Wyoming and northern Colorado for total consideration of $270 million, recording a pretax gain of $39 million. We remain operator of this jointly owned leasehold.

In March 2011, we closed the sale of our E&P segment's outside-operated interests in the Gudrun field development and the Brynhild and Eirin exploration areas offshore Norway for net proceeds of $85 million, excluding working capital adjustments. A $64 million pretax loss on this disposition was recorded in the fourth quarter of 2010.

8. Segment Information

We have three reportable operating segments. Each of these segments is organized and managed based upon the nature of the products and services they offer.

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

  - 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 vacuum gas oil; and

- Integrated Gas ("IG") – produces and markets products manufactured from natural gas, such as liquefied natural gas ("LNG") and methanol, in Equatorial Guinea.

Information regarding assets by segment is not presented because it is not reviewed by the chief operating decision maker ("CODM"). Segment income represents income from continuing operations, net of income taxes, attributable to the operating segments. Our corporate general and administrative costs are not allocated to the operating segments. These costs primarily consist of employment costs (including pension effects), professional services, facilities and other costs associated with corporate activities, net of associated income tax effects. Foreign currency transaction gains or losses are not allocated to operating segments. Impairments, gains or losses on disposal of assets or other items that affect comparability (as determined by the CODM) also are not allocated to operating segments.

Differences between segment totals and our consolidated totals for income taxes and depreciation, depletion and amortization represent amounts related to corporate administrative activities and other unallocated items which are included in "Items not allocated to segments, net of income taxes" in the reconciliation below. Total capital expenditures include accruals but not corporate activities.

As discussed in Note 2, our downstream business was spun-off on June 30, 2011 and has been reported as discontinued operations in 2011.

	Three Months Ended June 30, 2012			
(In millions)	E&P	OSM	IG	Total
Revenues:				
Customer	$3,383	$335	$-	$3,718
Related parties	13	-	-	13
Total revenues	$3,396	$335	$-	$3,731
Segment income	$417	$51	$13	$481
Income from equity method investments	38	-	22	60
Depreciation, depletion and amortization	521	50	-	571
Income tax provision	1,110	17	5	1,132
Capital expenditures	1,184	43	1	1,228

MARATHON OIL CORPORATION
Notes to Consolidated Financial Statements (Unaudited)

	Three Months Ended June 30, 2011			
(In millions)	E&P	OSM	IG	Total
Revenues:				
Customer	$3,220	$447	$13	$3,680
Intersegment	15	-	-	15
Related parties	14	-	-	14
Segment revenues	3,249	447	13	3,709
Elimination of intersegment revenues	(15)	-	-	(15)
Total revenues	$3,234	$447	$13	$3,694
Segment income	$601	$69	$43	$713
Income from equity method investments	66	-	54	120
Depreciation, depletion and amortization	501	49	1	551
Income tax provision	598	23	17	638
Capital expenditures	749	80	-	829

	Six Months Ended June 30, 2012			
(In millions)	E&P	OSM	IG	Total
Revenues:				
Customer	$6,781	$714	$-	$7,495
Related parties	27	-	-	27
Total revenues	$6,808	$714	$-	$7,522
Segment income	$894	$92	$17	$1,003
Income from equity method investments	102	-	36	138
Depreciation, depletion and amortization	1,037	99	-	1,136
Income tax provision	2,146	31	6	2,183
Capital expenditures	2,185	95	1	2,281

	Six Months Ended June 30, 2011			
(In millions)	E&P	OSM	IG	Total
Revenues:				
Customer	$6,506	$753	$77	$7,336
Intersegment	41	-	-	41
Related parties	29	-	-	29
Segment revenues	6,576	753	77	7,406
Elimination of intersegment revenues	(41)	-	-	(41)
Total revenues	$6,535	$753	$77	$7,365
Segment income	$1,269	$101	$103	$1,473
Income from equity method investments	124	-	113	237
Depreciation, depletion and amortization	1,087	86	3	1,176
Income tax provision	1,211	33	43	1,287
Capital expenditures	1,417	200	1	1,618

MARATHON OIL CORPORATION
Notes to Consolidated Financial Statements (Unaudited)

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)	2012	2011	2012	2011
Segment income	$481	$713	$1,003	$1,473
Items not allocated to segments, net of income taxes:				
Corporate and other unallocated items	(65)	(24)	(109)	(153)
Gain (loss) on dispositions (a)	(23)	24	83	24
Impairments(b)	-	(195)	(167)	(195)
Tax effect of subsidiary restructuring	-	(122)	-	(122)
Loss on early extinguishment of debt(c)	-	-	-	(176)
Deferred income tax items	-	(50)	-	(50)
Water abatement - Oil Sands	-	(48)	-	(48)
Income from continuing operations	393	298	810	753
Discontinued operations	-	698	-	1,239
Net income	$393	$996	$810	$1,992

(a) Additional information on these gains and losses can be found in Note 7.
(b) Impairments are discussed in Note 13.
(c) Additional information on debt retired early can be found in Note 15.

The following reconciles total revenues to sales and other operating revenues as reported in the consolidated statements of income:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In millions)	2012	2011	2012	2011
Total revenues	$3,731	$3,694	$7,522	$7,365
Less: Sales to related parties	13	14	27	29
Sales and other operating revenues	$3,718	$3,680	$7,495	$7,336

9. 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)	2012	2011	2012	2011
Service cost	$13	$10	$1	$1
Interest cost	16	16	3	4
Expected return on plan assets	(16)	(16)	-	-
Amortization:				

– prior service cost (credit)	2	2	(1)	(1)
– actuarial loss	13	12	-	-
Net periodic benefit cost	$28	$24	$3	$4

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MARATHON OIL CORPORATION
Notes to Consolidated Financial Statements (Unaudited)

	Six Months Ended June 30,			
	Pension Benefits		Other Benefits	
(In millions)	2012	2011	2012	2011
Service cost	$25	$23	$2	$2
Interest cost	32	33	7	8
Expected return on plan assets	(32)	(33)	-	-
Amortization:				
– prior service cost (credit)	4	3	(3)	(3)
– actuarial loss	25	25	-	-
Net periodic benefit cost	$54	$51	$6	$7

During the first six months of 2012, we made contributions of $68 million to our funded pension plans. We expect to make additional contributions up to an estimated $50 million over the remainder of 2012. Current benefit payments related to unfunded pension and other postretirement benefit plans were $6 million and $8 million during the first six months of 2012.

10. Income Taxes

The effective income tax rate is influenced by a variety of factors including the geographic and functional sources of income and the relative magnitude of these sources of income. The provision for income taxes is allocated on a discrete, stand-alone basis to pretax segment income and to individual items not allocated to segments. The difference between the total provision and the sum of the amounts allocated to segments and to individual items not allocated to segments is reported in “Corporate and other unallocated items” in Note 8.

Our effective tax rate in the first six months of 2012 was 71 percent. This rate is higher than the U.S. statutory rate of 35 percent primarily due to earnings from foreign jurisdictions, primarily Norway and Libya, where the tax rates are in excess of the U.S. statutory rate. An increase in earnings and associated taxes from foreign jurisdictions, primarily Norway, as compared to prior periods caused an increase in our valuation allowance on current year foreign tax credits. In Libya, where the statutory tax rate is in excess of 90 percent, limited production resumed in the fourth quarter of 2011 and liquid hydrocarbon sales resumed in the first quarter of 2012. A reliable estimate of 2012 annual ordinary income from our Libyan operations cannot be made and the range of possible scenarios when including ordinary income from our Libyan operations in the worldwide annual effective tax rate calculation demonstrates significant variability. As such, for the first six months of 2012, an estimated annual effective tax rate was calculated excluding Libya and applied to consolidated ordinary income excluding Libya and the tax provision applicable to Libyan ordinary income was recorded as a discrete item in the period. Excluding Libya, the effective tax rate would be 64 percent for the first six months of 2012.

Our effective tax rate in the first six months of 2011 was 60 percent which is higher than the U.S. statutory tax rate of 35 percent primarily due to earnings from foreign jurisdictions where the tax rates are in excess of the U.S. statutory rate and the valuation allowance recorded against 2011 foreign tax credits. In addition, in the second quarter of 2011 we recorded a deferred tax charge related to an internal restructuring of our international subsidiaries.

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MARATHON OIL CORPORATION
Notes to Consolidated Financial Statements (Unaudited)

The following table summarizes the activity in unrecognized tax benefits:

	Six Months Ended June 30,	
(In millions)	2012	2011
Beginning balance	$157	$103
Additions based on tax positions related to the current year	2	2
Reductions based on tax positions related to the current year	-	(2)
Additions for tax positions of prior years	69	53
Reductions for tax positions of prior years	(55)	(8)
Settlements	(7)	