MARATHON OIL CORP
Form 10-Q
August 08, 2011

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, 2011

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 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 √ 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 714,008,956 shares of Marathon Oil Corporation common stock outstanding as of July 31, 2011.

MARATHON OIL CORPORATION

Form 10-Q

Quarter Ended June 30, 2011

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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). Any reference to “Marathon” indicates Marathon Oil Corporation as it existed prior to the June 30, 2011 spin-off of the downstream business.

Part I - Financial Information

Item 1. Financial Statements

MARATHON OIL CORPORATION

Consolidated Satements of Income (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(In millions, except per share data)	2011	2010	2011	2010
Revenues and other income:				
Sales and other operating revenues	$ 3,680	$ 2,793	$ 7,336	$ 5,448
Sales to related parties	14	14	29	26
Income from equity method investments	120	83	237	168
Net gain on disposal of assets	45	10	50	822
Other income	6	3	22	28
Total revenues and other income	3,865	2,903	7,674	6,492
Costs and expenses:				
Cost of revenues (excludes items below)	1,667	1,230	3,071	2,277
Purchases from related parties	71	35	127	75
Depreciation, depletion and amortization	564	416	1,199	846
Impairments	307	5	307	439
Selling, general and administrative expenses	130	118	267	220
Other taxes	53	52	111	101
Exploration expenses	145	125	375	223
Total costs and expenses	2,937	1,981	5,457	4,181
Income from operations	928	922	2,217	2,311
Net interest and other	(13)	(15)	(32)	(37)
Loss on early extinguishment of debt	-	(92)	(279)	(92)
Income from continuing operations before income taxes	915	815	1,906	2,182
Provision for income taxes	617	441	1,153	1,191
Income from continuing operations	298	374	753	991
Discontinued operations	698	335	1,239	175
Net income	$ 996	$ 709	$ 1,992	$ 1,166
Per Share Data				
Basic:				
Income from continuing operations	$ 0.42	$ 0.53	$ 1.06	$ 1.39
Discontinued operations	$ 0.98	$ 0.47	$ 1.74	$ 0.25

Net income per share	$ 1.40	$ 1.00	$ 2.80	$ 1.64
Diluted:				
Income from continuing operations	$ 0.42	$ 0.53	$ 1.05	$ 1.39
Discontinued operations	$ 0.97	$ 0.47	$ 1.73	$ 0.25
Net income per share	$ 1.39	$ 1.00	$ 2.78	$ 1.64
Dividends paid	$ 0.25	$ 0.25	$ 0.50	$ 0.49
Weighted average shares:				
Basic	713	710	712	709
Diluted	717	712	716	711

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

MARATHON OIL CORPORATION

Consolidated Statements of Comprehensive Income (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(In millions)	2011	2010	2011	2010
Net income	$ 996	$ 709	$ 1,992	$ 1,166
Other comprehensive income				
Post-retirement and post-employment plans				
Change in actuarial gain	64	128	97	158
Spin-off downstream business	968	-	968	-
Income tax provision on post-retirement and post-employment plans	(403)	(59)	(415)	(83)
Post-retirement and post-employment plans, net of tax	629	69	650	75
Derivative hedges				
Net unrecognized gain	(6)	1	3	3
Income tax benefit (provision) on derivatives	3	-	(1)	1
Derivative hedges, net of tax	(3)	1	2	4
Foreign currency translation and other				
Unrealized gain (loss)	(1)	-	(1)	-
Income tax provision on foreign currency translation and other	-	-	-	-
Foreign currency translation and other, net of tax	(1)	-	(1)	-
Other comprehensive income	625	70	651	79
Comprehensive income	$ 1,621	$ 779	$ 2,643	$ 1,245

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, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 4,711	$ 3,951
Receivables, less allowance for doubtful accounts of $2 and $7	1,790	5,972
Receivables from related parties	53	58
Inventories	343	3,453
Other current assets	417	395
Total current assets	7,314	13,829
Equity method investments	1,475	1,802
Property, plant and equipment, less accumulated depreciation, depletion and amortization of $16,243 and $19,805	20,140	32,222
Goodwill	537	1,380
Other noncurrent assets	1,024	781
Total assets	$ 30,490	$ 50,014
Liabilities		
Current liabilities:		
Accounts payable	$ 1,631	$ 8,000
Payables to related parties	21	49
Payroll and benefits payable	139	418
Accrued taxes	1,839	1,447
Deferred income taxes	-	324
Other current liabilities	193	580
Long-term debt due within one year	338	295
Total current liabilities	4,161	11,113
Long-term debt	4,684	7,601
Deferred income taxes	2,658	3,569
Defined benefit postretirement plan obligations	673	2,171
Asset retirement obligations	1,336	1,354
Deferred credits and other liabilities	271	435
Total liabilities	13,783	26,243
Commitments and contingencies		
Stockholders' Equity		
Preferred stock – no shares issued and outstanding (no par value, 26 million shares authorized)	-	-
Common stock:		
Issued – 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 – 56 million and 60 million shares		(2,493)		(2,665)
Additional paid-in capital		6,723		6,756
Retained earnings		12,053		19,907
Accumulated other comprehensive loss		(346)		(997)
Total stockholders' equity		16,707		23,771
Total liabilities and stockholders' equity	$	30,490	$	50,014

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)	2011	2010
Increase (decrease) in cash and cash equivalents		
Operating activities:		
Net income	$ 1,992	$ 1,166
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on early extinguishment of debt	279	92
Discontinued operations	(1,239)	(175)
Deferred income taxes	(427)	(279)
Depreciation, depletion and amortization	1,199	846
Impairments	307	439
Pension and other postretirement benefits, net	22	29
Exploratory dry well costs and unproved property impairments	264	111
Net gain on disposal of assets	(50)	(822)
Equity method investments, net	(21)	-
Changes in:		
Current receivables	78	(13)
Inventories	46	(41)
Current accounts payable and accrued liabilities	748	531
All other operating, net	122	71
Net cash provided by continuing operations	3,320	1,955
Net cash provided by discontinued operations	1,090	172
Net cash provided by operating activities	4,410	2,127
Investing activities:		
Additions to property, plant and equipment	(1,702)	(1,860)
Disposal of assets	371	1,354
Investments - repayments of loans and return of capital	-	35
Investing activities of discontinued operations	(493)	(635)
Property deposit	(100)	-
All other investing, net	51	(36)
Net cash used in investing activities	(1,873)	(1,142)
Financing activities:		
Debt repayments	(2,843)	(620)
Dividends paid	(356)	(350)
Financing activities of discontinued operations	2,916	(5)
Distribution in Spin-off	(1,622)	-
All other financing, net	126	5
Net cash used in financing activities	(1,779)	(970)
Effect of exchange rate changes on cash	2	(10)
Net increase in cash and cash equivalents	760	5
Cash and cash equivalents at beginning of period	3,951	2,057
Cash and cash equivalents at end of period	$ 4,711	$ 2,062

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

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MARATHON OIL CORPORATION
Consolidated Statement of Stockholders’ Equity (Unaudited)

(In millions)	Preferred Stock	Common Stock	Securities Exchangeable for Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance as of December 31, 2010	$ -	$ 770	$ -	$ (2,665)	$ 6,756	$ 19,907	$ (997)	$ 23,771
Shares issued - stock based compensation	-	-	-	175	(58)	-	-	117
Shares repurchased	-	-	-	(3)	-	-	-	(3)
Stock-based compensation	-	-	-	-	20	-	-	20
Net income	-	-	-	-	-	1,992	-	1,992
Other comprehensive income	-	-	-	-	-	-	64	64
Dividends paid	-	-	-	-	-	(356)	-	(356)
Spin-off of downstream business	-	-	-	-	5	(9,490)	587	(8,898)
Balance as of June 30, 2011	$ -	$ 770	$ -	$ (2,493)	$ 6,723	$ 12,053	$ (346)	$ 16,707

(Shares in millions)	Preferred Stock	Common Stock	Securities Exchangeable for Common Stock	Treasury Stock
Balance as of December 31, 2010	-	770	-	(60)
Shares issued - stock based compensation	-	-	-	4
Balance as of June 30, 2011	-	770	-	(56)

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 for all periods presented. 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 2010 Annual Report on Form 10-K. The results of operations for the quarter and six months ended June 30, 2011 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 (Refining, Marketing and Transportation) business was completed, creating two independent energy companies: Marathon Oil Corporation (“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.

In order to affect the spin-off and govern our relationship with MPC after the spin-off, we entered into a Separation and Distribution Agreement, a Tax Sharing Agreement, an Employee Matters Agreement and a Transition Services Agreement. The Separation and Distribution Agreement governed the separation of the downstream business, the distribution of MPC’s shares of common stock to our stockholders, transfer of assets and intellectual property, and other matters related to our relationship with MPC. The Separation and Distribution Agreement provides for cross-indemnities between Marathon Oil and MPC. In general, we have agreed to indemnify MPC for any liabilities relating to our historical oil and gas exploration and production operations, oil sands mining operations and integrated gas operations, and MPC has agreed to indemnify us for any liabilities relating to the historical downstream operations.

The Tax Sharing Agreement governs the respective rights, responsibilities and obligations of Marathon Oil and MPC with respect to taxes and tax benefits, the filing of tax returns, the control of audits and other tax matters. In addition, the Tax Sharing Agreement reflects each company’s rights and obligations related to taxes that are attributable to periods prior to and including the Separation date and taxes resulting from transactions effected in connection with the Separation. In general, under the Tax Sharing Agreement, Marathon Oil is responsible for all U.S. federal, state, local and foreign income taxes attributable to Marathon Oil or any of its subsidiaries for any tax period that begins after the date of the spin-off, and MPC is responsible for all taxes attributable to it or its subsidiaries, whether accruing before, on or after the spin-off. The Tax Sharing Agreement contains covenants intended to protect the tax-free status of the

spin-off. These covenants may restrict the ability of Marathon Oil and MPC to pursue strategic or other transactions that otherwise could maximize the values of their respective businesses and may discourage or delay a change of control of either company.

The Employee Matters Agreement contains provisions concerning benefit protection for employees who become MPC employees prior to December 31, 2011, treatment of holders of Marathon stock options, stock appreciation rights, restricted stock and restricted stock units, and cooperation between Marathon Oil and MPC in the sharing of employee information and maintenance of confidentiality. Unvested equity-based compensation awards were converted to awards of the entity where the employee holding them is working post-separation. For vested equity-based compensation awards, employees received both Marathon Oil and MPC awards.

Under the Transition Services Agreement, Marathon Oil and MPC are providing and/or making available various administrative services and assets to each other, for the up to a one-year period beginning on the distribution date of the spin-off. The services include: administrative services; accounting services; audit services; health, environmental and safety services; human resource services; information technology services; legal services; natural gas administration services; tax services; and treasury services. In consideration for such services, the companies are paying fees to the other for the services provided, and these fees are generally in amounts intended to allow the party providing services to recover all of its direct and indirect costs incurred in providing these services.

MARATHON OIL CORPORATION

Notes to Consolidated Financial Statements (Unaudited)

The following table presents the carrying value of assets and liabilities of MPC, immediately preceding the spin-off, which is excluded from the Marathon Oil consolidated balance sheet as a result of the spin-off on June 30, 2011.

(In millions)	
Current assets:	
Cash and cash equivalents	$1,622
Receivables	5,041
Inventories	3,679
Other current assets	170
Total current assets of discontinued operations	10,512
Equity method investments	323
Property, plant and equipment	11,935
Goodwill	847
Other noncurrent assets	351
Total assets of discontinued operations	$23,968
Current liabilities:	
Accounts payable	$7,329
Payroll and benefits payable	222
Accrued and deferred taxes	443
Other current liabilities	461
Long-term debt due within one year	12
Total current liabilities of discontinued operations	8,467
Long-term debt	3,262
Deferred income taxes	1,576
Defined benefit postretirement plan obligations	1,489
Deferred credits and other liabilities	276
Total liabilities of discontinued operations	$15,070

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.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In millions)	2011	2010	2011	2010
Revenues applicable to discontinued operations	$20,760	$15,795	$38,602	$29,157
Pretax income from discontinued operations	1,244	646	2,012	248

3. Accounting Standards

Not Yet Adopted

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 U.S. generally accepted accounting principles (“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 and will be effective for our interim and annual periods beginning with the first quarter of 2012. Early application is not permitted. We do not expect adoption of these amendments to have a significant impact on our consolidated results of operations, financial position or cash flows.

The Financial Accounting Standards Board ("FASB") amended the reporting standards for comprehensive income in June 2011 to eliminate the option to present the components of other comprehensive income 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 other comprehensive income, and the total of comprehensive income. The amendments did not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. We are still evaluating this reporting standard, but we do not expect adoption of this amendment to have an impact on our consolidated results of operations, financial position or cash flows.

MARATHON OIL CORPORATION

Notes to Consolidated Financial Statements (Unaudited)

4. Variable Interest Entities

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, 2011. 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 $765 million as of June 30, 2011. 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,			
	2011		2010	
(In millions, except per share data)	Basic	Diluted	Basic	Diluted
Income from continuing operations	$298	$298	$374	$374
Discontinued operations	698	698	335	335
Net income	$996	$996	$709	$709
Weighted average common shares outstanding	713	713	710	710
Effect of dilutive securities	-	4	-	2
Weighted average common shares, including dilutive effect	713	717	710	712
Per share:				
Income from continuing operations	$0.42	$0.42	$0.53	$0.53
Discontinued operations	$0.98	$0.97	$0.47	$0.47
Net income	$1.40	$1.39	$1.00	$1.00

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MARATHON OIL CORPORATION

Notes to Consolidated Financial Statements (Unaudited)

	Six Months Ended June 30,			
	2011		2010	
(In millions, except per share data)	Basic	Diluted	Basic	Diluted
Income from continuing operations	$ 753	$ 753	$ 991	$ 991
Discontinued operations	1,239	1,239	175	175
Net income	$ 1,992	$ 1,992	$ 1,166	$ 1,166
Weighted average common shares outstanding	712	712	709	709
Effect of dilutive securities	-	4	-	2
Weighted average common shares, including dilutive effect	712	716	709	711
Per share:				
Income from continuing operations	$ 1.06	$ 1.05	$ 1.39	$ 1.39
Discontinued operations	$ 1.74	$ 1.73	$ 0.25	$ 0.25
Net income	$ 2.80	$ 2.78	$ 1.64	$ 1.64

The per share calculations above exclude 5 million and 6 million stock options and stock appreciation rights for the second quarter and the first six months of 2011, as they were antidilutive. Excluded in the second quarter and the first six months of 2010 were 12 million stock options and stock appreciation rights.

6. Dispositions

In April 2011, we assigned a 30 percent undivided working interest in our Exploration and Production ("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 2010.

During the first quarter 2010, we closed the sale of a 20 percent outside-operated interest in our E&P segment's Production Sharing Contract and Joint Operating Agreement in Block 32 offshore Angola. We received net proceeds of $1.3 billion and recorded a pretax gain on the sale in the amount of $811 million. We retained a 10 percent outside-operated interest in Block 32.

7. 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.

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 vacuum gas oil; and

3) Integrated Gas ("IG") – markets and transports products manufactured from natural gas, such as liquefied natural gas ("LNG") and methanol, on a worldwide basis.

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 remeasurement and transaction gains or losses are not allocated to operating segments.

Differences between segment totals for income taxes and depreciation, depletion and amortization and our consolidated totals 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. Capital expenditures include accruals.

MARATHON OIL CORPORATION

Notes to Consolidated Financial Statements (Unaudited)

As discussed in Notes 1 and 2, our downstream business was spun-off on June 30, 2011 and has been reported as discontinued operations in all periods presented. Crude oil sales to MPC previously reported as Intersegment revenues are now reported as Customer revenues because such sales are expected to continue subsequent to the spin-off. Such sales were $787 million and $349 million in the second quarter of 2011 and 2010 and $1,395 million and $647 million in the first six months of 2011 and 2010.

	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

	Three Months Ended June 30, 2010			
(In millions)	E&P	OSM	IG	Total
Revenues:				
Customer	$2,570	$190	$33	$2,793
Intersegment	16	-	-	16
Related parties	14	-	-	14
Segment revenues	2,600	190	33	2,823
Elimination of intersegment revenues	(16)	-	-	(16)
Total revenues	$2,584	$190	$33	$2,807
Segment income (loss)	$432	$(60)	$24	$396
Income from equity method investments	40	-	43	83
Depreciation, depletion and amortization	391	16	1	408
Income tax provision (benefit)	625	(10)	12	627
Capital expenditures	585	243	-	828

	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	

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	Six Months Ended June 30, 2010			
(In millions)	E&P	OSM	IG	Total
Revenues:				
Customer	$ 5,018	$ 370	$ 60	$ 5,448
Intersegment	29	-	-	29
Related parties	26	-	-	26
Segment revenues	5,073	370	60	5,503
Elimination of intersegment revenues	(29)	-	-	(29)
Total revenues	$ 5,044	$ 370	$ 60	$ 5,474
Segment income (loss)	$ 934	$ (77)	$ 68	$ 925
Income from equity method investments	77	-	91	168
Depreciation, depletion and amortization	788	39	2	829
Income tax provision (benefit)	1,162	(17)	35	1,180
Capital expenditures	1,188	508	1	1,697

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)	2011	2010	2011	2010
Segment income	$ 713	$ 396	$ 1,473	$ 925
Items not allocated to segments, net of income taxes:				
Corporate and other unallocated items	(21)	7	(136)	(80)
Foreign currency remeasurement of income taxes	(3)	37	(17)	70
Impairments(a)	(195)	(9)	(195)	(271)
Loss on early extinguishment of debt(b)	-	(57)	(176)	(57)
Tax effect of subsidiary restructuring(c)	(122)	-	(122)	-
Deferred income tax items(c)	(50)	-	(50)	(45)
Water abatement - Oil Sands(d)	(48)	-	(48)	-
Gain on dispositions (e)	24	-	24	449
Income from continuing operations	298	374	753	991
Discontinued operations	698	335	1,239	175
Net income	$ 996	$ 709	$ 1,992	$ 1,166

(a) Impairments are discussed in Note 12.
(b) Additional information on debt retired early can be found in Note 14.
(c) Changes in deferred taxes and the non cash tax restructuring are discussed in Note 9.
(d) Oil sands water abatement costs are discussed in Note 17.
(e) Additional information on these gains can be found in Note 6.

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)	2011	2010	2011	2010
Total revenues	$ 3,694	$ 2,807	$ 7,365	$ 5,474
Less: Sales to related parties	14	14	29	26
Sales and other operating revenues	$ 3,680	$ 2,793	$ 7,336	$ 5,448

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8. Defined Benefit Postretirement Plans

The following summarizes the components of net periodic benefit cost related to continuing operations:

	Three Months Ended June 30,			
	Pension Benefits		Other Benefits	
(In millions)	2011	2010	2011	2010
Service cost	$ 10	$ 11	$ 1	$ 1
Interest cost	16	18	4	4
Expected return on plan assets	(16)	(16)	-	-
Amortization:				
– prior service cost (credit)	2	1	(1)	(1)
– actuarial loss	12	14	-	-
Net periodic benefit cost	$ 24	$ 28	$ 4	$ 4

	Six Months Ended June 30,			
	Pension Benefits		Other Benefits	
(In millions)	2011	2010	2011	2010
Service cost	$ 23	$ 23	$ 2	$ 2
Interest cost	33	35	8	8
Expected return on plan assets	(33)	(32)	-	-
Amortization:				
– prior service cost (credit)	3	3	(3)	(3)
– actuarial loss	25	25	-	-
Net periodic benefit cost	$ 51	$ 54	$ 7	$ 7

During the first six months of 2011, we made contributions related to continuing operations of $26 million to our funded pension plans. We expect to make additional contributions up to an estimated $28 million to our funded pension plans over the remainder of 2011. Current benefit payments related to unfunded pension and other postretirement benefit plans of our continuing operations were $2 million and $10 million during the first six months of 2011.

9. Income Taxes

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

	Six Months Ended June 30,	
	2011	2010
Statutory U.S. income tax rate	35 %	35 %
Effects of foreign operations, including foreign tax credits	11	17
Change in permanent reinvestment assertion	12	-
Adjustments to valuation allowances	-	1
Tax law change	2	2
Effective income tax rate for continuing operations	60 %	55 %

The effective income tax rate is influenced by a variety of factors including the geographic and functional sources of income, the relative magnitude of these sources of income, and foreign currency remeasurement effects. 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" shown in Note 7.

The effects of foreign operations on our effective tax rate decreased in the first six months of 2011 as compared to the first six months of 2010, primarily due to the suspension of all production operations in Libya in the first quarter of 2011, where the statutory tax rate is in excess of 90 percent. This decrease was partially offset by a deferred tax charge of $122 million related to an internal restructuring of our international subsidiaries in the second quarter of 2011

In the second quarter of 2011, we recorded $716 million of deferred U.S. tax on undistributed earnings of $2,046 million that we previously intended to permanently reinvest in foreign operations. Offsetting this tax expense were associated foreign tax credits of $488 million.

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We reduced our valuation allowance related to foreign tax credits of $228 million due to recognizing deferred U.S. tax on previously undistributed earnings. In addition, we recorded a valuation allowance of $18 million on our deferred tax assets related to state operating loss carryforwards. Due to the spin-off (see Note 2), we have determined it is more likely than not that we will be unable to realize all recorded deferred tax assets.

On May 25, 2011, Michigan enacted legislation that replaced the Michigan Business Tax ("MBT") with a corporate income tax ("CIT"), effective January 1, 2012. The new CIT legislation eliminates the "book-tax difference deduction" that was provided under the MBT to mitigate the net increase in a taxpayer's deferred tax liability resulting when Michigan moved from the Single Business Tax, a non-income tax, to the MBT, an income tax, on July 12, 2007. Such a change in the tax law must be recognized in earnings in the period enacted regardless of the effective date. The total effect of tax law changes on deferred tax balances is recorded as income tax expense related to continuing operations in the period the law is enacted, even if a portion of the deferred tax balances relate to discontinued operations. As a result of the new CIT legislation, we recorded an expense of $32 million in the second quarter of 2011.

The Patient Protection and Affordable Care Act ("PPACA") and the Health Care and Education Reconciliation Act of 2010 ("HCERA"), (together, the "Acts") were signed in to law in March 2010. The Acts effectively change the tax treatment of federal subsidies paid to sponsors of retiree health benefit plans that provide prescription drug benefits that are at least actuarially equivalent to the corresponding benefits provided under Medicare Part D. The federal subsidy paid to employers was introduced as part of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the "MPDIMA"). Under the MPDIMA, the federal subsidy does not reduce our income tax deduction for the costs of providing such prescription drug plans nor is it subject to income tax individually. Beginning in 2013, under the Acts, our income tax deduction for the costs of providing Medicare Part D-equivalent prescription drug benefits to retirees will be reduced by the amount of the federal subsidy. Such a change in the tax law must be recognized in earnings in the period enacted regardless of the effective date. The total effect of tax law changes on deferred tax balances is recorded as income tax expense related to continuing operations in the period the law is enacted, even if a portion of the deferred tax balances relate to discontinued operations. As a result, we have recorded a charge of $45 million in the first quarter of 2010 for the write-off of deferred tax assets to reflect the change in the tax treatment of the federal subsidy.

The following table summarizes the activity in unrecognized tax benefits:

	Six Months Ended June 30,	
(In millions)	2011	2010
Beginning balance	$ 103	$ 75
Additions based on tax positions related to the current year	2	4
Reductions based on tax positions related to the current year	(2)	(4)
Additions for tax positions of prior years	53	15
Reductions for tax positions of prior years	(8)	(20)
Settlements	(9)	(1)
Ending balance	$ 139	$ 69

If the unrecognized tax benefits as of June 30, 2011 were recognized, $132 million would affect our effective income tax rate. There were $13 million of uncertain tax positions as of June 30, 2011 for which it is reasonably possible that the amount of unrecognized tax benefits would decrease during the next twelve months.

10. 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. A significant portion of our inventories were related to our downstream business (see Note 2) at December 31, 2010.

(In millions)	June 30, 2011	December 31, 2010
Liquid hydrocarbons, natural gas and bitumen	$ 124	$ 1,275
Refined products and merchandise	-	1,774
Supplies and sundry items	219	404
Total inventories, at cost	$ 343	$ 3,453

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11. Property, Plant and Equipment

(In millions)	June 30, 2011	December 31, 2010
E&P		
United States	$ 14,078	$ 13,532
International	12,105	11,736
Total E&P	26,183	25,268
OSM	9,831	9,631
IG	48	47
RM&T(a)	-	16,624
Corporate	321	457
Total property, plant and equipment	36,383	52,027
Less accumulated depreciation, depletion and amortization	(16,243)	(19,805)
Net property, plant and equipment	$ 20,140	$ 32,222

(a) See Note 2 for a discussion of the spin-off of our downstream (RM&T) business.

In the first quarter 2011, production operations in Libya were suspended and we are not currently making deliveries of hydrocarbons from our interest in the Waha concession in eastern Libya. As of June 30, 2011, our net property, plant and equipment investment in Libya is approximately $762 million and our net proved reserves in Libya were 242 million barrels of oil equivalent (“mmboe”) at December 31, 2010. The impact of continued unrest upon our investment and future operations in Libya is unknown at this time. In addition, payments due to the Libyan government or entities affiliated with the Libyan government have been blocked by the U.S. government under a February 25, 2011 executive order. Such amounts, as of June 30, 2011, primarily related to taxes and royalties due on our January and February 2011 sales totaled approximately $200 million.

Exploratory well costs capitalized greater than one year after completion of drilling were $386 million as of June 30, 2011, an increase of $63 million from December 31, 2010. The resumption of our offshore Norway exploration project in 2011 reduced the total suspended exploratory costs by $26 million in the first quarter of 2011. Drilling on the Innsbruck prospect, located on Mississippi Canyon Block 993 in the Gulf of Mexico was suspended in the second quarter of 2010 due to the U.S. Department of Interior’s drilling moratorium. Costs of $88 million related to that project have now been capitalized for greater than one year. We have submitted plans for continuing drilling at Innsbruck and are awaiting regulatory approval.

12. Fair Value Measurements

Fair Values - Recurring

As of June 30, 2011, balances related to interest rate swaps accounted for at fair value on a recurring basis were assets of $5 million and liabilities of $3 million. The interest rate swaps are in Level 2 of the fair value hierarchy and at June 30, 2011, are measured at fair value with a market approach using market price quotes or a price obtained from third-party services such as Bloomberg LP which have been corroborated with data from active markets for similar

assets and liabilities. The majority of our 2010 derivatives related to our downstream business. The following table presents assets and liabilities accounted for at fair value on a recurring basis as of December 31, 2010 by fair value hierarchy level.

	December 31, 2010				
(In millions)	Level 1	Level 2	Level 3	Collateral	Total
Derivative instruments, assets					
Commodity	$ 58	$ -	$ 1	$ 81	$ 140
Interest rate	-	32	-	-	32
Derivative instruments, assets	58	32	1	81	172
Derivative instruments, liabilities					
Commodity	(102)	-	(3)	-	(105)
Derivative instruments, liabilities	$ (102)	$ -	$ (3)	$ -	$ (105)

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Notes to Consolidated Financial Statements (Unaudited)

At December 31, 2010, commodity derivatives in Level 1 are exchange-traded contracts for crude oil, natural gas and refined products measured at fair value with a market approach using the close-of-day settlement price for the market. Commodity derivatives, interest rate derivatives and foreign currency forwards in Level 2 are measured at fair value with a market approach using broker price quotes or prices obtained from third-party services such as Bloomberg L.P. or Platt's, a Division of McGraw-Hill Corporation ("Platt's"), which have been corroborated with data from active markets for similar assets and liabilities. Collateral deposits related to both Level 1 and Level 2 commodity derivatives are in broker accounts covered by master netting agreements. Commodity derivatives in Level 3 are measured at fair value with a market approach using prices obtained from third-party services such as Platt's and price assessments from other independent brokers.

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.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In millions)	2011	2010	2011	2010
Beginning balance	$ (1)	$ 8	$ (2)	$ 9
Included in net income	1	20	-	19
Included in other comprehensive income	-	2	-	4
Transfers to Level 2	-	(30)	-	(30)
Purchases	-	-	-	2
Settlements	(2)	(3)	-	(7)
Spin-off downstream business	2	-	2	-
Ending balance	$ -	$ (3)	$ -	$ (3)

No instruments measured at fair value using Level 3 inputs were held on June 30, 2011. Net income for second quarter and first six months of 2010 included unrealized losses of $2 million and $4 million related to instruments held on June 30, 2010. See Note 13 for the income statement impacts of our derivative instruments.

Fair Values - Nonrecurring

The following tables show the values of assets, by major class, measured at fair value on a nonrecurring basis in periods subsequent to their initial recognition.

	Three Months Ended June 30,			
	2011		2010	
(In millions)	Fair Value	Impairment	Fair Value	Impairment
Long-lived assets held for use	$ 226	$ 282	$ 2	$ 33
Intangible assets	$ -	$ 25	$ -	$ -

	Six Months Ended June 30,			
	2011		2010	
(In millions)	Fair Value	Impairment	Fair Value	Impairment

Long-lived assets held for use	$	226	$	282	$	146	$	439
Intangible assets	$	-	$	25	$	-	$	-

In May 2011, significant water production and reservoir pressure declines occurred at the Droshky development. Plans for a waterflood have been cancelled and the field will be produced to abandonment pressures, expected in the first half of 2012. Consequently, 3.4 mmboe of proved reserves were written off and a $273 million impairment of this long-lived asset to fair value was recorded in the second quarter of 2011. The $226 million fair value of the Droshky development was determined using an income approach based upon internal estimates of future production levels, prices and discount rate, all Level 3 inputs.

Our outlook for U.S. natural gas prices makes it unlikely that sufficient U.S. demand for LNG will materialize by 2021, which is when the rights lapse under arrangements at the Elba Island, Georgia regasification facility. Using an income approach based upon internal estimates of gas prices and future deliveries, which are Level 3 inputs, we determined that the contract had no remaining fair value and recorded a full impairment of this intangible asset held in our Integrated Gas segment.

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In March 2010, we completed a reservoir study which resulted in a portion of our Powder River Basin field being removed from plans for future development in our E&P segment. The field's fair value was measured at $144 million, an income approach based upon internal estimates of future production levels, prices and discount rate which are Level 3 inputs. This resulted in an impairment of $423 million.

Impairments of several other long-lived assets held for use in our E&P segment, that were evaluated in the six months ended June 30, 2011 and 2010 were a result of reduced drilling expectations, reduction of estimated reserves or declining natural gas prices, are also reported above. The fair values of those assets were measured using an income approach based upon internal estimated of future production levels, prices and discount rate, which are Level 3 inputs.

Fair Values – Reported

The following table summarizes financial instruments, excluding the derivative financial instruments, and their reported fair value by individual balance sheet line item at June 30, 2011 and December 31, 2010:

	June 30, 2011		December 31, 2010	
(In millions)	Fair Value	Carrying Amount	Fair Value	Carrying Amount
Financial assets				
Other current assets	$ 225	$ 220	$ 226	$ 220
Other noncurrent assets	243	239	396	231
Total financial assets	468	459	622	451
Financial liabilities				
Long-term debt, including current portion(a)	5,504	4,984	8,364	7,527
Deferred credits and other liabilities	46	47	66	67
Total financial liabilities	$ 5,550	$ 5,031	$ 8,430	$ 7,594

(a) Excludes capital leases.

Our current assets and liabilities include financial instruments, the most significant of which are trade accounts receivables and payables. We believe the carrying values of our current assets and liabilities approximate fair value. Our fair value assessment incorporates a variety of considerations, including (1) the short-term duration of the instruments, (2) our investment-grade credit rating, and (3) our historical incurrence of and expected future insignificance of bad debt expense, which includes an evaluation of counterparty credit risk. Exceptions to this assessment are:

- receivables from United States Steel Corporation ("United States Steel"), which are reported in other current assets above and discussed below; and
- the current portion of our long-term debt, which is reported with long-term debt above and discussed below.

The current portion of receivables from United States Steel is reported in other current assets, and the long-term portion is included in other noncurrent assets. The fair value of the receivables from United States Steel is measured using an income approach that discounts the future expected payments over the remaining term of the obligations. Because this receivable is not publicly-traded and not easily transferable, a hypothetical market based upon United States Steel's borrowing rate curve is assumed and the majority of inputs to the calculation are Level 3. The industrial revenue bonds are to be redeemed on or before December 31, 2011, the tenth anniversary of the USX Separation.

Fair values of our remaining financial assets included in other noncurrent assets and of our financial liabilities included in deferred credits and other liabilities are measured using an income approach and most inputs are internally generated, which results in a Level 3 classification. Estimated future cash flows are discounted using a rate deemed appropriate to obtain the fair value.

Over 90 percent of our long-term debt instruments are publicly-traded. A market approach based upon quotes from major financial institutions is used to measure the fair value of such debt. Because these quotes cannot be independently verified to an active market they are considered Level 3 inputs. The fair value of our debt that is not publicly-traded is measured using an income approach. The future debt service payments are discounted using the rate at which we currently expect to borrow. All inputs to this calculation are Level 3.

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13. Derivatives

For information regarding the fair value measurement of derivative instruments, see Note 12.

As of June 30, 2011, the gross fair values of interest rate swaps that are fair value hedges were assets of $5 million and liabilities of $3 million. The assets and liabilities are located on the consolidated balance sheet in Other noncurrent assets and Deferred credits and other liabilities.

The majority of our 2010 derivatives related to our downstream business. The following table presents the gross fair values of derivative instruments, excluding cash collateral, and where they appear on the consolidated balance sheets as of December 31, 2010.

	December 31, 2010			
(In millions)	Asset	Liability	Net Asset	Balance Sheet Location
Fair Value Hedges				
Interest rate	$ 32	$ -	$ 32	Other noncurrent assets
Total Designated Hedges	32	-	32	
Not Designated as Hedges				
Commodity	58	102	(44)	Other current assets
Total Not Designated as Hedges	58	102	(44)	
Total	$ 90	$ 102	$ (12)	

	December 31, 2010			
(In millions)	Asset	Liability	Net Liability	Balance Sheet Location
Not Designated as Hedges				
Commodity	$ 1	$ 3	$ 2	Other current liabilities
Total Not Designated as Hedges	1	3	2	
Total	$ 1	$ 3	$ 2	

Derivatives Designated as Cash Flow Hedges

As of June 30, 2011, no derivatives were designated as cash flow hedges.

Gains of $10 million related to cash flow hedges were reclassified from accumulated other comprehensive income into net income during the first quarter of 2011. This amortization was accelerated because the related debt was retired.

Derivatives Designated as Fair Value Hedges

In connection with the debt retired in February and March 2011 discussed in Note 14, we settled interest rate swaps with a notional amount of $1,450 million. We recorded a $29 million gain, which reduced the loss on extinguishment of debt.

As of June 30, 2011, we had multiple interest rate swap agreements with a total notional amount of $500 million at a weighted average, LIBOR-based, floating rate of 3.65 percent.

The following table summarizes the pretax effect of derivative instruments designated as hedges of fair value in our consolidated statements of income:

		Gain (Loss)	
		Three Months Ended	Six Months Ended
		June 30,	June 30,
(In millions)	Income Statement Location		