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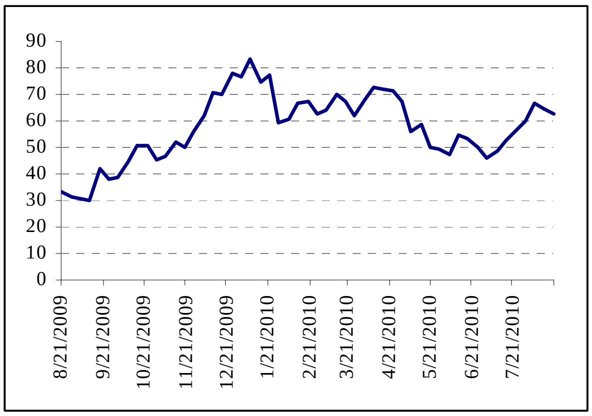
INTEROIL (IOC – BUY)

2Q 2010 REVIEW AND UPDATE

InterOil (IOC)

Price	$62.84
Shares Outstanding (MM)	43.7
Float (MM)	33.44
Short Interest (% of Float)	13.5
Market Cap. (MM)	$2,692
Avg Volume (000, last 3 mos)	808
Cash (MM)	$41.23
Debt (MM)	$77.81
Dividend Yield	NA
Fiscal Year Ending	Dec 31

One-Year Price Chart



Company Description

InterOil Corporation, together with its subsidiaries, primarily engages in the exploration and production of oil and gas properties in Papua New Guinea. The company holds interests in four petroleum prospecting licenses covering approximately 4.7 million gross acres in Papua New Guinea. It also involves in the refining and liquefaction of jet fuel, diesel, and gasoline, as well as naphtha and low sulfur waxy residue. In addition, the company involves in the wholesale distribution of diesel, jet fuel, gasoline, kerosene, and fuel oil, as well as Shell branded commercial and industrial lubricants, such as engine and hydraulic oils. As of December 31, 2009, it provided petroleum products to 56 retail service stations with 43 operating under the InterOil brand name, as well as operated 12 aviation refueling facilities in Papua New Guinea. InterOil Corporation was founded in 1990 and is based in Cairns, Australia.

Summary and Highlights

- InterOil reported diluted earnings of $0.17 per share for the second quarter and cash flow of $0.41 per share.
- In a conference call, management conveyed a very optimistic tone with respect to the proposed Condensate Stripping Plant to be financed by Mitsui and the additional quantities of condensate encountered in the first horizontal leg drilled from the Antelope 2 vertical well.
- Some results from the second horizontal leg to the Antelope 2 well and sooner or later an updated reserve report to replace the last outdated study which was based on the data available on December 31,2009.
- We are anticipating a number of important possibilities that we think are likely to occur over the next few months, such as - further progress in the developing strategic partnership between Mitsui and InterOil, a possible breakthrough in the advanced negotiations with a strategic partner in the proposed LNG export facility and the start of drilling with the second rig which is now on the island.
- Given some or all of the above possibilities, we think the upside potential in the IOC common shares could easily approach 50% from current price levels. Furthermore, we would not underestimate the longer term potential that could be developing here which could be even more attractive to long term investors.

2Q Earnings Review

InterOil reported diluted earnings of $0.17 per share for the second quarter and we calculate cash flow at $0.41 per share, one of the better quarterly financial results reported in recent years. All of the reported earnings reflect downstream operations which were quite strong with indications of even better returns in the future. Refinery throughput was up 7% (63% of capacity) and product sales were higher. Local product demand is being impacted by preliminary work on the Exxon LNG facility, some new mining work, and hopefully in the near future an IOC condensate stripping plant, along with the continuing prospect for an LNG export facility.

In a conference call, management conveyed a very optimistic tone with respect to the proposed Condensate Stripping Plant to be financed by Mitsui and the additional quantities of condensate encountered in the first horizontal leg drilled from the Antelope 2 vertical well. A second horizontal leg was recently started following government approval to probe the lower sections of the Antelope formation. This second horizontal may require one or two months for completion and obviously has the potential to further enhance the proven reserves of gas and condensate.

Management made only modest reference to the on-going negotiations with potential partners in the proposed LNG export facility. A similar bland reference was made with respect to a floating LNG export facility that is under review as an attractive means to accelerate exports of LNG. Prudent investors who are willing to look beyond the near term should be anticipating a number of important possibilities that we think are likely to occur over the next few months, some of which we note below:

- Further progress in the developing strategic partnership between Mitsui and InterOil. This will culminate with the signing of a long term contract or Final Investment Decision, expected in early 2011 but possibly sooner. In the interim, there may be some money transfers to reimburse InterOil for considerable expenses already incurred.

- A possible breakthrough in the advanced negotiations with a strategic partner in the proposed LNG export facility. The new idea of a floating LNG facility may complicate current negotiations but also represents the possibility of a more rapid monetization.

- The start of drilling with the second rig which is now on the island. Apparently, the new rig will drill the Antelope 3 and afterward do some exploratory drilling, perhaps on the Bwata structure that has been identified by seismic.

- Some results from the second horizontal leg to the Antelope 2 well and sooner or later an updated reserve report to replace the last outdated study which was based on the data available on December 31,2009.

Given some or all of the above possibilities, we think the upside potential in the IOC common shares could easily approach 50% from current price levels. Furthermore, we would not underestimate the longer term potential that could be developing here which could be even more attractive to long term investors. As the company transitions from an exploratory to an industrial enterprise with related exploration, the outstanding equity would gain more credibility and provide a number of alternative means of financing. In addition to the obvious exploration prospects there should be numerous long term internal growth possibilities.

The currently proposed Condensate Stripping Plant is planned to have initial capacity of 9,000 b/d, but management has often noted a future production goal of 60,000 b/d. In the current market, we believe this operation could readily generate a pretax profit of $60-$70 per barrel. A similar growth potential could well develop in the LNG export market. The proposed facility is budgeted at $5-$7 billion, but this is only for the first train. We suspect that if and when construction starts, the early foundations will be built to accommodate at least two trains. At this stage, no one knows if there will be more, but management has publicly stated presently proven reserves should be sufficient for at least 15 years of currently forecasted needs and there are numerous prospects for additional reserves.

Will there be additional discoveries on the 35-40 geological structures already identified by seismic studies? To date, IOC has drilled only five wells using modern seismic and a high tech rig, with four considered commercially viable. Logic says that the next wildcat wells will command unusual attention from the world's largest oil companies most of whom are long on cash and short of good oil exploration prospects. We believe lots of excitement is developing in Papua New Guinea and astute investors should be accumulating a piece of the action. As of June 30, InterOil had 43.8 million common shares outstanding (45.8 million diluted) and working capital of $80 million. Long term debt was a modest $49 million.

The writer of this report holds an investment position in InterOil.

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Disclosures

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The views expressed in this research report reflect the personal views of the writer(s) about the subject securities/issues. The writer(s) herby certify that no part of compensation was, is or will be directly or indirectly related to the specific recommendation(s) in this research report.

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Sell: the security is expected to underperform the market during the next 6-12 months.

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