InterOil Corp.

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(IOC:NYSE)

Company Brief

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Exploration and Production

Thoughts on Floating LNG Project After Minister`s Skeptical Comments

- The National, a newspaper in PNG, published an article last night that quoted the country's new energy minister making some skeptical comments about InterOil's proposed floating LNG project. The article quotes Francis Potape as saying that he does not want PNG being used as a "guinea pig" for new technology. He added "we will not allow technology that has not been accepted and that has not been internationally practiced and approved."
- Here are the observations we would make following this article. First, the headline risk resulting from the minister's comments is obviously unhelpful, hence today's weakness in IOC shares. Anything that increases uncertainty, even superficially, is inherently negative from the market's perspective.
- Second, the substance of this is not something about which we would be overly worried. The minister is brand new in his position, and we would not be surprised if he is trying to create some waves to get his views in the spotlight. It is also important to note that the PNG government as a whole has historically been supportive of floating LNG; in fact, the national oil company, Petromin, is planning its own floating project. In addition, it is objectively misleading to call floating LNG a "guinea pig" technology. While it has not been historically commercialized, companies as large as Shell are pursuing such projects in multiple jurisdictions, including nearby Australia. Floating LNG is not in any sense a "science experiment." For all these reasons, we do not believe it is likely that the PNG government will force InterOil to cancel its floating LNG project.
- Third, even assuming the worst-case scenario – the remote possibility of InterOil having to cancel its floating LNG project – the underlying natural gas would simply be reallocated to the onshore LNG component of the overall natural gas development. The two million ton per year floater could easily be replaced by an additional onshore modular plant of equal size. Ultimately, gas is gas – the resource is fungible.
- Finally, notwithstanding these comments, the PNG government remains broadly supportive of InterOil's resource development. If anything, the government is encouraging the fastest possible timeline for development, with an eye to next year's elections. In fact, in a July 1 article published in The Post Courier, another PNG newspaper, Francis Potape discussed a "fast track" regulatory process to support InterOil's resource development.

Rating

Outperform 2

Current Price

Current Price (7/26/2011 10:35 a.m.)	$58.61
52-Week Range	$81.98 - $47.29
Suitability	High Risk

Market Data

Shares Out. (mil.)	49.9
Market Cap. (mil.)	$2,925
Avg. Daily Vol. (10 day)	328,340
Dividend/Yield	$0.00/0.0%
Book Value (03/11)	$14.27
LT Debt (mil.)/% Cap.	$106/13%
NAV/Share	$109.51

Earnings & Valuation Metrics

	2010A	2011E	2012E
Non-GAAP EPS	$(0.11)	$(0.08)	$(0.14)
P/E Ratios (Non-GAAP)	NM	NM	NM
GAAP EPS	$(1.03)	$(0.08)	$(0.14)
Revenues (mil.)	$807	$1,186	$1,392
EBITDA (mil.)	$60	$71	$69
Cash Flow/Share	$0.96	$1.00	$0.66

Company Description

InterOil Corp., based in Australia, is an oil and gas company with operations in Papua New Guinea (PNG). InterOil is building a fully integrated energy business with four distinct components: upstream, refining, liquefied natural gas (LNG), and downstream. The company operates PNG's only refinery and owns a network of retail and wholesale distribution outlets, while also pursuing an exploration program.

Footnotes: Non-GAAP EPS excludes unrealized hedging losses, property impairments, and other extraordinary items.

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Market Perform (MP3) Expected to perform in line with the underlying country index.
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Sell (4) Expected absolute drop in the share price of more than 10% in next 12 months.

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	Coverage Universe Rating Distribution		Investment Banking Distribution	
	RJA	**RJL**	**RJA**	**RJL**
Strong Buy and Outperform (Buy)	55%	76%	16%	61%
Market Perform (Hold)	39%	22%	5%	40%
Underperform (Sell)	5%	2%	0%	0%

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Aggressive Growth (AG) Medium or higher risk equities of companies in fast growing and competitive industries, with less predictable earnings and acceptable, but possibly more leveraged balance sheets.

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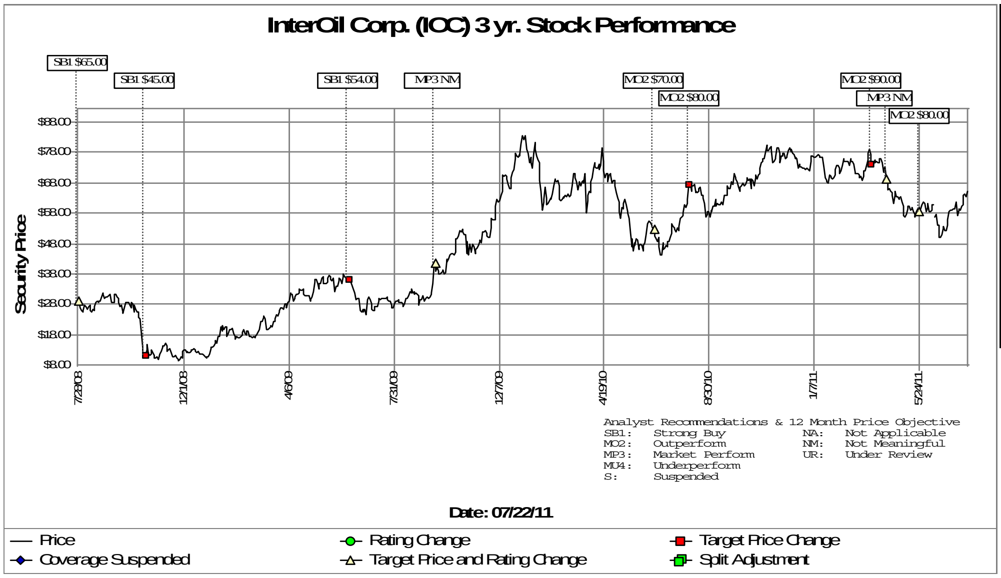
Target Prices: The information below indicates our target price and rating changes for IOC stock over the past three years.



Update Date	Closing Price	Target Price	Rating
5/24/11	58.65	80.00	2
4/12/11	69.21	NM	3
3/23/11	74.37	90.00	2
8/4/10	67.60	80.00	2
6/22/10	52.57	70.00	2
9/21/09	41.69	NM	3
6/12/09	36.35	54.00	1
10/13/08	11.05	45.00	1
7/28/08	28.83	65.00	1

Valuation Methodology: Our valuation methodology for InterOil is centered on our estimate of the company's net asset value (NAV) per share.

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Specific Investment Risks Related to the Industry or Issuer

Oil and Gas Price Volatility
Profitability of companies producing crude oil and natural gas is directly affected by changes in oil and gas prices. These prices are influenced by a multitude of regional, national and global factors, many of which are outside the control of companies in the industry. Supply-related factors include industrywide levels of capital spending and production decisions by OPEC. Demand-related factors include macroeconomic conditions.

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Company-Specific Risks for InterOil Corp.

Project Execution Risk
InterOil does not currently have any proved oil and gas reserves. For the company to begin to book its estimated contingent resources as proved reserves, there must be one or more formal plans of development. The timeline for developing the proposed condensate stripping plant and both of the proposed LNG plants extends to 2014. Historically, large-scale energy infrastructure projects such as these have tended to come in above budget and take longer than expected to complete.

Refining Margin Risk
A refiner's profitability is largely determined by the margin between refined product prices and crude oil feedstock prices. Both of these sets of prices are influenced by numerous factors that affect supply and demand, many of them outside a refiner's control. These include macroeconomic activity, the level of domestic and international refining capacity, and geopolitical conditions. Refining margins have historically been, and are likely to continue to be, highly volatile.

International Risk
All of InterOil's operations are located in Papua New Guinea, which exposes the company to risks associated with doing business in a foreign market. This includes the potential for unfavorable changes in taxes, regulations, exchange rates, and macroeconomic fundamentals.

Clarion Finanz Risk
InterOil's proposed LNG development is a joint venture with Clarion Finanz, a financial institution based in Switzerland. Clarion is a privately held firm, without a website, so there is minimal visibility into its operations, corporate governance, funding, and financial condition.

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