

Morgan Stanley & Co. LLC

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August 12, 2011

Stock Rating
Overweight

Industry View
Attractive

InterOil Corporation

Nearing a Major Inflection: Reiterate Overweight

Highly confident IOC earnings call. IOC is a development stage company with 9.4Tcfe of resource, an LNG project and significant untapped exploration potential in PNG. In our view, the stock value and our \$135 target price will be reached as the project and company de-risks, as additional sophisticated partners join the project and those involved (Samsung, Noble Group and Mitsui) reach FID when all preliminary agreements become final and binding. Today's conference call exuded confidence as all project elements appear to be coming together. IOC's LNG project and the long and controversial journey of this stock appear to be reaching the final destination of a re-rating. CEO, Phil Mulecek, stated a clear expectation to sign "2-3 more off-takes" that are "forthcoming," with over 20Tcfe of interest in the remaining 3.5Tcfe of project gas (over 6x coverage), and a potential resource monetization at \$5-7per mcf price before Triceratops-2 (or T-2 an ironic name) spuds. A sale or forward monetization of gas at \$5-7 is over 12-17x the implied resource value of resource in the stock and a discount to spot pricing at \$16 per mcf.

Exploration represents additional value. Recent seismic, discussed on the call, revealed more reefal development than currently mapped and that the two Bwata and Triceratops structures have merged into a single field. In our view, this new data provides clear upside to the P-50 pre-drill estimate of 4.6Tcfe of the T-2 well that will likely TD before year-end. No value for T-2 is in our target price. Weather conditions have slowed the site development and we expect T-2 results in December or January, if there are any delays. IOC also discussed new seismic lines in block PL236 indicating new anomalies in 3 targets. An underlying tone of the call was acceleration of activity and we believe the newly introduced potential monetization (i.e., proceeds), higher interest in off-take and better seismic results are all related to significantly higher confidence in the resource outside the 9.4tcf of resource discovered.

Key Ratios and Statistics

Reuters: IOC.N Bloomberg: IOC US

Integrated Oil / United States of America

Price target	\$135.00
Shr price, close (Aug 11, 2011)	\$53.97
Mkt cap, curr (mm)	\$2,580
52-Week Range	\$81.98-47.29

Fiscal Year ending	12/10	12/11e	12/12e	12/13e
ModelWare EPS (\$)	(1.03)	0.71	0.28	(0.40)
Prior ModelWare EPS (\$)	-	0.36	-	-
P/E	NM	76.5	190.2	NM
Consensus EPS (\$)	(1.03)	0.44	0.56	0.87
Div yld (%)	0.0	0.0	0.0	0.0

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

§ = Consensus data is provided by FactSet Estimates.

e = Morgan Stanley Research estimates

Quarterly ModelWare EPS

Quarter	2010	2011e		2012e	
		Prior	Current	Prior	Current
Q1	(0.07)	-	0.18a	-	0.13
Q2	0.17	-	0.48a	-	0.14
Q3	(0.34)	-	0.05a	-	0.03
Q4	(0.75)	-	(0.01)	-	(0.02)

e = Morgan Stanley Research estimates, a = Actual company reported data

Recent Reports

Title	Date
InterOil Corporation: A Key Milestone Reached: First Gas Off-take Signed Evan Calio / Todd Firestone / Ben Hur / Marko Lazarevic	Aug 2, 2011
InterOil Corporation: PNG Political Risks Create a New Near-team Uncertainty Evan Calio / Todd Firestone / Ben Hur / Marko Lazarevic	Jul 26, 2011

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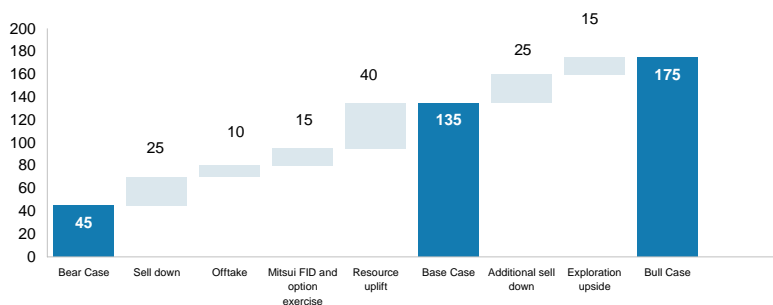
InterOil Corp. (IOC, \$54, Overweight, Price Target \$135)

Risk-Reward View: Positive Risk/Reward Skew



Price Target \$135	Derived from our base case.
Bull Case \$175	Exploration Upside; new prospect - Triceratops Full field development by 2017, +15Tcfe of resource at 2011YE; second phase of LNG and CSP trains announced; \$6 per share for exploration, Assumes a 5% sell-down at \$2 per mcf. And, 35% discount to NAV.
Assumes \$85 oil price (perpetuity)	
Base Case \$135	Joint Venture Partnerships are Signed Assumes a 5% sell-down at \$2 per mcf, Mitsui, Flex and EWC reach FID, Mitsui exercises 2x2.5% options, mid-point of GLJ resource range. And 45% discount to full field NAV (8mmtpa LNG, 1.7mtpa FLNG, CSPs).
Assumes \$85 oil price (perpetuity)	
Bear Case \$45	Delay in FID, Resource Estimate Lower Assumes no FID in 2011, no sell-down, a \$75 oil price and low end of GLJ resource estimate, IOC exploration resource and stranded gas is valued at \$40/sh and refinery \$5/sh.
Assumes \$75 oil price	

Bear to Bull



Source: Morgan Stanley Research
The probability we assign to a successful LNG project in our base case is only illustrative. It does not forecast a precise series of events and does not account for all possible outcomes but instead illustrates our sense of the relative plausibility of the outcome, based on current industry dynamics.

Why Overweight?

- Trading at over a 70% discount to our NAV (NAV omits any value for exploration acreage) one of the widest discounts in energy. Project execution should close the discount to NAV with FID in 2H11 the next major milestone.
- Potential EBITDA generation of \$1.2Bn in 2015 with plateau EBITDA (15+ year plateau) of ~+\$2.5Bn per annum 2017+ on flat \$85 oil price.
- One of the largest exploration land positions in PNG, one of the fastest emerging LNG hubs with attractive royalty regime. IOC has +40 indentified prospects, several with reefal indication, on its 3.9MM acres with over a decade of exploration experience in PNG.

Potential Catalysts/Key Value Drivers


- Signing HOAs for natural gas off-take(s) for gas production with oil-linkage. 2H11.
- FID of condensate facility with partner, Mitsui. 2H11. Expansion of Mitsui relationship and potential upstream options in connection with larger CSP (900mmcf/d vs. 400mmcf/d).
- FID of 3mmtpa land based LNG facility with partner, EWC. 2H11.
- FID of 2mmtpa FLNG with partner, FlexLNG and Samsung. 2H11.
- Spud the first exploration well since company-maker Antelope in 2H11 with results by YE. The well, Triceratops-2 has preliminary pre-drill resource estimate of filed of 4.6Tcfe "most likely."

- Potential upstream sell-downs, (likely post-FID in 2012).

Where We Could Be Wrong

- **Continued delays in achieving LNG Project start-up.** IOC has limited cash flow. A failure to execute agreements on the various elements, condensate stripping, FLNG, and land based modular LNG is a risk.
- **Exploration failure.** IOC is proving its resource base and any exploration failure is a risk.
- **PNG risks.** 100% of IOC's operating assets are located in PNG, an unexpected change in the political climate could have adverse effects for IOC.

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	<p>Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations. For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.</p>
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(as of July 31, 2011)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	% of Total IBC	% of Rating Category
Overweight/Buy	1107	40%	451	48%	41%
Equal-weight/Hold	1136	41%	372	40%	33%
Not-Rated/Hold	114	4%	20	2%	18%
Underweight/Sell	384	14%	97	10%	25%
Total	2,741		940		

Data include common stock and ADRs currently assigned ratings. An investor's decision to buy or sell a stock should depend on individual circumstances (such as the investor's existing holdings) and other considerations. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

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Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

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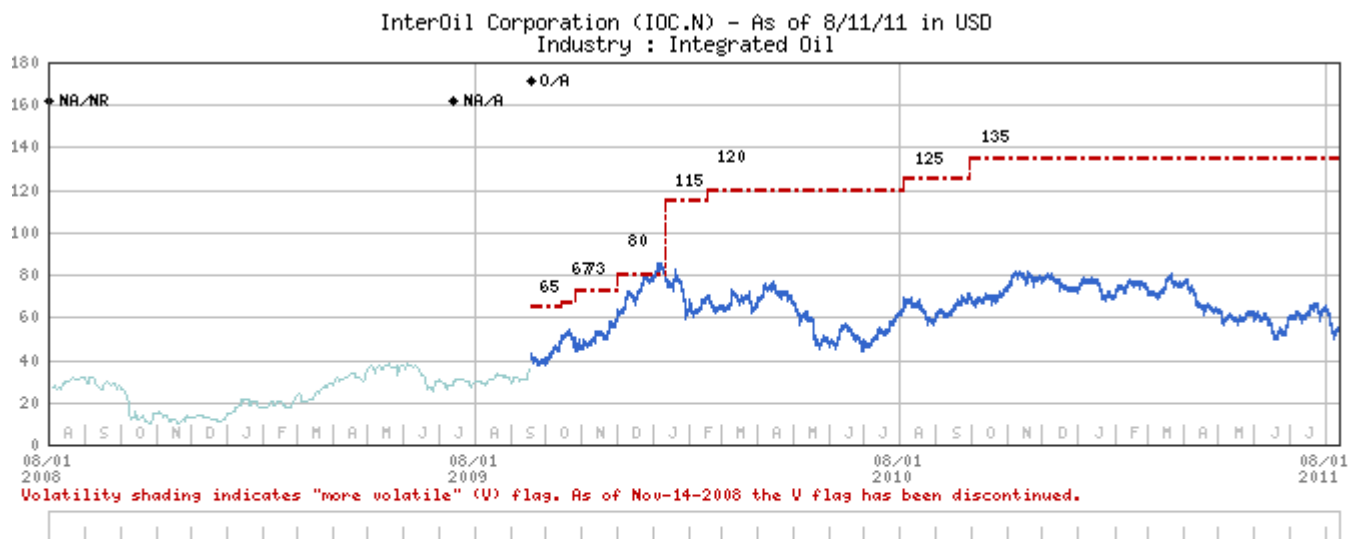
Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

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Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index.

Stock Price, Price Target and Rating History (See Rating Definitions)



Stock Rating History: 8/1/08 : NA/NR; 7/14/09 : NA/A; 9/18/09 : O/A

Price Target History: 9/18/09 : 65; 10/14/09 : 67; 10/26/09 : 73; 12/1/09 : 80; 1/11/10 : 115; 2/16/10 : 120; 8/4/10 : 125; 9/30/10 : 135

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) ■
 Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (U) No Rating Available (NA)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage: Integrated Oil

Company (Ticker)	Rating (as of)	Price* (08/11/2011)
Evan Calio		
Chevron Corporation (CVX.N)	O (07/14/2009)	\$94.07
Cobalt International Energy Inc (CIE.N)	O (12/02/2010)	\$9.91
ConocoPhillips (COP.N)	U (10/01/2010)	\$65.52
Exxon Mobil Corporation (XOM.N)	E (07/14/2009)	\$71.58
Hess Corporation (HES.N)	O (05/06/2011)	\$56.72
InterOil Corporation (IOC.N)	O (09/18/2009)	\$53.97
Marathon Oil Corporation (MRO.N)	E (07/08/2011)	\$26.43
Murphy Oil Corporation (MUR.N)	O (07/23/2010)	\$51.27
Occidental Petroleum (OXY.N)	E (01/25/2011)	\$84.8

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* Historical prices are not split adjusted.