InterOil Corp.
(IOC:AMEX)

Strong Buy 1

EQUITY RESEARCH

Wayne Andrews
(713) 789-3551
Wayne.Andrews@RaymondJames.com

Jeffrey L. Mobley, CFA
(713) 278-5261
Jeff.Mobley@RaymondJames.com

Pavel Molchanov
Research Associate

September 30, 2004

Exploration and Production
Initiation of Coverage

RAYMOND JAMES

Niche Refining Foundation, Extraordinary Exploration Upside

The Raymond James Financial Center, 880 Carillon Parkway, St. Petersburg, FL 33716
Institutional clients may call for additional information:
Research 800-237-5643 • Trading 800-237-8426

RAYMOND JAMES
& ASSOCIATES, INC.
Member New York Stock Exchange/SIPC

Table of Contents

Appendices

Please read disclosure/risk information on page 31 and Analyst Certification page 32.

InterOil Corp.

(IOC:AMEX)

Strong Buy 1

September 30, 2004

Exploration and Production
Initiation of Coverage

Wayne Andrews
(713) 789-3551
Wayne.Andrews@RaymondJames.com

Jeffrey L. Mobley, CFA
(713) 278-5261
Jeff.Mobley@RaymondJames.com

Pavel Molchanov
Research Associate
.

InterOil Corp. (http://www.interoil.com) is a Canadian-based oil and gas company with operations in Papua New Guinea. InterOil is building a fully integrated energy business, with three distinct components: upstream, midstream, and downstream. The company operates PNG`s only commercial refinery and owns a network of retail and wholesale distribution outlets, while pursuing an exploration program on an area of 8.8 million acres.

IOC: Initiating Coverage with a Strong Buy Rating

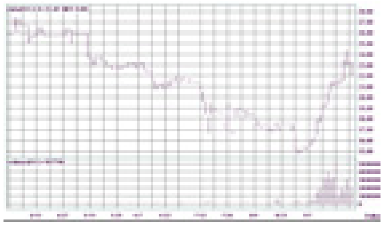
- By pursuing a fully integrated approach, InterOil has emerged as the **dominant energy player** in its niche market of Papua New Guinea (PNG). The company has a solid base of midstream and downstream assets, providing a stream of operating cash flow, which is helping fund an active exploration program on a large acreage position.
- Before InterOil's 36,500 barrel per day refinery came on-line in the summer of 2004, PNG had no domestic refining capacity. The new facility will enable InterOil and local consumers to capture most of the transport costs and refining margins that had previously been paid to shipping and oil companies in the region. For InterOil, this means robust, **above-average refining margins**, secured by the 30-year Import Parity Pricing (IPP) agreement with the national government.
- InterOil owns the largest and most **wide-ranging downstream asset base** in PNG. It is in the process of completing its acquisition of Royal Dutch/Shell's entire domestic network of retail and distribution properties. These assets will be leased back to Shell, giving InterOil a stable revenue stream. Earlier in 2004, InterOil further strengthened its downstream base by buying BP plc's local retail and distribution network, which will be InterOil-operated.
- We believe that InterOil's emerging E&P business has huge upside potential – virtually none of which is incorporated in the share price. The company is the largest holder of exploration licenses in PNG, with a land portfolio of 8.8 million acres. The company estimates that the long-term, undiscovered **resource potential** on only 10 of its 30 identified drilling prospects could be **as high as 4.5 billion barrels**.
- IOC shares are trading at a 23% **discount** to our calculated net asset value (NAV) of $29.15 per share. This compares with a 17.6x 2005E price/earnings, vs. a 10.5x average for a peer group of pure-play U.S. refiners. Our $35.00 target price is based on our NAV estimate, plus a conservative premium for the company's extensive reserve potential.

EPS FY=Dec	Q1 Mar	Q2 Jun	Q3 Sep	Q4 Dec	Full Year
2003A	$0.01	$(0.03)	$(0.06)	$(0.06)	$(0.14)
2004E	(0.06)A	(0.10)A	(0.03)	0.40	0.22
2005E	0.32	0.32	0.32	0.32	1.28

Cash Flow/Share FY=Dec	Q1 Mar	Q2 Jun	Q3 Sep	Q4 Dec	Full Year
2003A	$0.01	$(0.03)	$(0.06)	$(0.06)	$(0.14)
2004E	(0.06)A	(0.02)A	0.03	0.46	0.43
2005E	0.39	0.39	0.39	0.39	1.56

Rows may not add due to rounding.

Current Price	
(9/29/04)	$22.49
Projected 12-Month Target Price:	$35.00
52-Week Range	$29.50-$14.79
Dividend/Yield	$0.00/0.0%
Book Value (06/04)	$5.71
Suitability	Cyclical
Shares Out. (mil.)	24.9
Market Cap. (mil.)	$560.0
Avg. Daily Vol. (10 day)	265,010
Proj. 3-Yr EPS Growth Rate	12%
ROE (2005E)	18.6%
NAV	$29.15
Long-Term Debt/Cap	$133.6/47%
P/E Ratios	
2004E	NM
2005E	17.6x
P/CF Ratios	
2004E	52.3x
2005E	14.4x
Revenues (mil.)	
2003A	$0.3
2004E	$258.8
2005E	$644.6
EBITDA (mil.)	
2003A	$(1.2)
2004E	$15.3
2005E	$58.8



Insider Trading BOT/SL last 6 months 0/0

Float (mil.) 16.9

Common Equity (mil.)/% of Cap......... $150.1/53%

InterOil Corporation

InterOil Corp. is a Canadian-based oil and gas company with operations in Papua New Guinea. InterOil is building a fully integrated energy business, with three distinct components: upstream, midstream, and downstream. The company operates PNG's only commercial refinery and owns a network of retail and wholesale distribution outlets, while pursuing an exploration program on an area of 8.8 million acres.

Investment Considerations

Vertically Integrated Approach

InterOil has a unique core competency of operating exclusively in the South Pacific island nation of Papua New Guinea. The company is developing a fully integrated niche oil and gas company in three business segments. InterOil has positioned itself to own assets through the entire value chain and has become PNG's dominant energy company.

The midstream segment, which is currently the **core** of InterOil's operations, has as its principal asset a commercial oil refinery with a capacity of 36,500 barrels per day. This segment is underpinned by a 30-year agreement with the government of PNG that enables the company to market its domestic refined products at an Import Parity Price, thus capturing transportation and associated costs as part of its profit margin. The refinery became operational in the summer of 2004. The first domestic refined product sales occurred on August 10, and the first export sales on September 4.

The downstream segment consists of the largest and most comprehensive network of retail and distribution assets in PNG – both strategically and geographically. In April 2004, InterOil acquired the domestic subsidiary of BP plc (BP/$57.36), which includes all of its petroleum distribution assets and operations in the country. The asset portfolio comprises three terminals, seven depots, and over 40 retail sites. InterOil has also agreed to purchase the entire domestic distribution asset base of Royal Dutch/Shell (RD/$51.26). This **blue-chip portfolio** comprises a network of 70 core distribution outlets that accounts for ~50% of PNG's fuel requirements. The Shell portfolio includes terminals, depots, retail service stations, and commercial refueling facilities. Shell will continue to operate the assets on a leaseback basis from InterOil.

The upstream segment is an emerging growth area for InterOil. The company holds exploration acreage in PNG with an extensive asset portfolio of 8.8 million acres, including 8.0 million onshore acres. This acreage has the advantage of moderate terrain, barge access to infrastructure, and proximity to the refinery, allowing for a relatively lower cost of development, earlier production, and quicker access to market. InterOil is in the process of carrying out a drilling program in the Eastern Papuan Basin. Two exploration wells and an appraisal well have been drilled to-date and have encountered multiple oil shows, confirming the existence of **hydrocarbons** in the area. Exploration programs continue, with seismic being shot over several prospective structures. Each of these independent structures offers a high-impact resource potential. Over 30 prospects have been identified so far.

PNG: An Attractive Place to Do Business

For a multitude of reasons, PNG represents a highly appealing operating location for a growth company, especially in the petroleum sector. In particular, the country offers the following **key advantages**:

- A stable, Western-oriented sociopolitical environment;
- A democratic political system with a strong common law tradition and high regard for property rights;
- Pro-growth fiscal and monetary policies;
- **Concessionary** tax terms for oil and gas exploration;
- Vast and largely **untapped** natural resources; and
- A solid growth outlook for refined product demand given the country's continuing industrialization and urbanization.

Excellent Relations with the PNG Government

In a developing economy such as PNG, success for a foreign investor depends in large part on the company's relationship with the government. InterOil enjoys excellent ties with PNG authorities and has negotiated many favorable, **long-term agreements** with them. In particular, we highlight the following three agreements:

- A 30-year agreement enables InterOil's refinery to capture most of the **freight costs** and **refinery margins**, which are currently paid to international shipping and oil companies. The state ensures that domestic distributors purchase all of their petroleum products from the refinery at the Import Parity Price.
- InterOil has been guaranteed a PNG income tax exemption for its midstream segment. This five-year "**tax holiday**" will last from 2005 through year-end 2009.
- InterOil has signed a 99-year lease with the government for the land on which the refinery is located. The site near the PNG capital of Port Moresby is the only sheltered, deep-water harbor in the region, which provides the advantage of **reduced shipping costs** for the company.

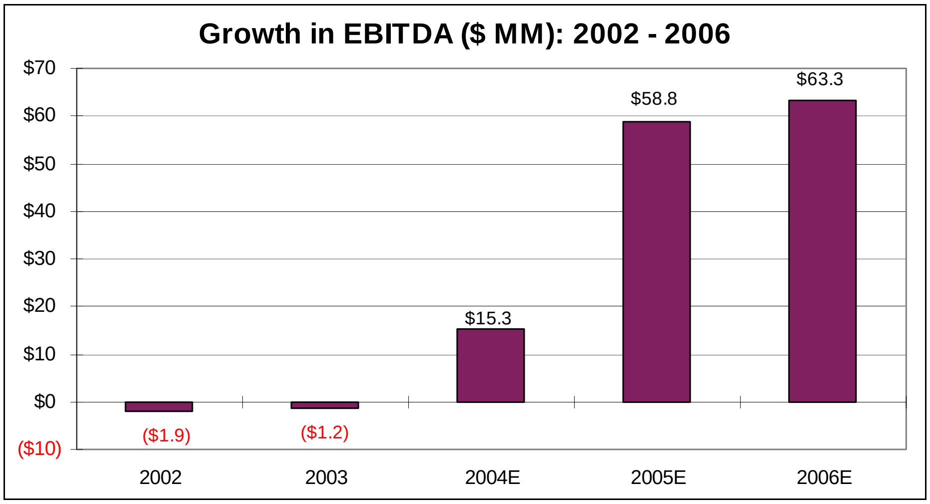
Strategic Agreements with Integrated Majors

In addition to its agreements with the PNG government, InterOil has secured long-term strategic contracts with two major integrated oil companies for marketing its exports and delivering crude oil to the refinery.

- The ~50% of refinery volumes that are available for export will be sold to Shell, for export to the nearby Pacific islands and northern Australia. InterOil will share benefits with Shell on the sale of such refined products. Any **incremental profit contributions**, which could be significant under this marketing arrangement, have not been included in our financial forecast for InterOil.
- BP will be the exclusive agent for all crude supply to the refinery for an initial period of five years. The agreement with BP not only guarantees crude supply, but also details an arrangement whereby InterOil and BP will share profits on any comparable quality cargoes delivered at a price below the PNG crude benchmark. The supply contract has the potential to add **significant operating profit** above the margins we have forecast for InterOil.

Refinery Starts Cash Flow Stream

Refinery commissioning and initial start-up procedures are currently under-way, initiating first sales revenue, cash flow, and EBITDA. Cash flow should be sufficient to fund an extensive upstream exploration program. We project $58.8 million of EBITDA in 2005, which compares to $15.3 million in the start-up year, 2004.



Source: InterOil Corp., RJ est.

Experienced Management Team

InterOil has a talented and seasoned management team, led by Chairman and CEO Phil Mulacek. On top of their extensive operational and financial experience in the oil and gas industry, the senior executives have a solid track record of working in Papua New Guinea and the surrounding Asian markets. They have established a positive reputation for InterOil in the domestic market and have built a close working relationship with suppliers, consumers, and the PNG government.

Attractive Valuation

We have calculated a net asset value (NAV) of $29.15 per share, which takes into account a discounted cash flow (DCF) analysis of InterOil's midstream and downstream assets, undeveloped acreage, and other assets and liabilities. The company does not currently have any proved oil and gas reserves, and we have conservatively not incorporated any forward-looking reserve assumptions in our NAV model. Instead, we value the company's undeveloped acreage at a modest $25 per acre.

InterOil Corp. Net Asset Value - as of 6/30/04 ($ millions)	
Midstream DCF	522.8
Downstream DCF	142.1
Undeveloped Acreage	220.0
Working Capital	36.8
Net Worth of Assets	921.7
Less: Long-Term Liabilities	(144.9)
Less: Minority Interest	(6.5)
NAV Of Common, $MM	**$770.3**
NAV/Share	**$29.15**
Fully Dil. Shares Outstanding, MM	26.4

Assumptions: After 2005, WTI crude oil is $35.00/Bbl; Kutubu spread vs. WTI is ($0.14)/Bbl; undev. acreage valued at $25/acre; cash flow discounted at 10%; domestic midstream demand grows at 3%/year; domestic downstream demand grows at 2%/year

InterOil shares are currently trading at 17.6x 2005E price/earnings, vs. a 10.5x average for a peer group of pure-play U.S. refiners. We believe that InterOil should trade at a **substantial premium** to its peers due to: (1) the guaranteed IPP agreement, which locks in a minimum refinery margin well above its U.S. peers; (2) potential incremental operating profits derived through supply and distribution partnerships with major oil companies; and (3) the superior growth outlook for the PNG refined product market as compared to the vastly more mature U.S. market.

Comparable Companies - U.S. Refiners

Company (Ticker)	Stock Price	Market Cap. ($ MM)	Forward P/E	L-T EPS Growth (%)	PEG Ratio
Frontier Oil (FTO)	$23.34	$628	11.0	3.5%	3.1
Giant Industries (GI)	$23.92	$291	8.4	20.2%	0.4
Premcor (PCO)	$37.86	$3,380	10.3	2.0%	5.2
Sunoco (SUN)	$72.58	$5,470	12.5	7.0%	1.8
Tesoro Petroleum (TSO)	$28.43	$1,880	10.6	6.0%	1.8
Valero Energy (VLO)	$78.55	$10,040	10.2	7.0%	1.5
Peer Mean			**10.5**	**7.6%**	**1.4**
InterOil (IOC)	**$22.49**	**$560**	**17.6**	**12.0%**	**1.5**

Note: For the comparable companies, P/E and growth are consensus estimates.

Source: Yahoo! Finance, RJ est.

Our target price of $35.00 is based on our NAV estimate, plus a conservative premium for the company's extensive reserve potential. This is equivalent to a multiple of 27.3x our 2005 EPS estimate and 17.9x our 2005 EBITDA estimate. We believe there is likely to be **considerable upside** beyond this target price as InterOil's drilling program generates definitive results and U.S. investors become more comfortable with the company's business model.

Risk

InterOil is subject to many of the same risks as a typical U.S. oil and gas company. Those risks include:

- Commodity price fluctuations
- Operating risks
- Political and regulatory risk
- Financial risk

In addition, because of the unique nature of the company's business model, we would highlight the following risk factors.

- 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 country, especially a developing one. This includes the potential for unfavorable changes in taxes, regulations, exchange rates, and macroeconomic fundamentals.

- Refining margin risk: Given that InterOil's midstream business segment currently represents the vast majority of the company's revenues, adverse fluctuations in refining margins in the South Pacific region could negatively affect the company's profitability.

- Exploration risk: InterOil does not currently have any proved oil and gas reserves. The success of its upstream exploration program in Papua New Guinea is dependent on finding commercial quantities of oil and gas on its exploration acreage and on having sufficient funds, whether from internal cash flow or external sources, to fund the drilling program.

- Share liquidity risk: With InterOil's small market capitalization and somewhat limited trading volume, its stock can be illiquid. As a result, for some investors, it may be difficult to buy or sell the company's shares without meaningfully moving its stock price.

Operations

Introduction to Papua New Guinea

Papua New Guinea is an island state between the Coral Sea and the South Pacific Ocean. PNG is to the north of Australia and to the east of Indonesia, as shown on the maps on the following page. The country has a population of 5.4 million. The official language is English. The capital city and main financial center, Port Moresby, is located on the southeastern coast of the country's largest landmass, the island of New Guinea.

Source: U.S. State Department.

Source: CIA World Factbook 2004.

PNG has had a democratic and generally **stable political system** since its independence from Australia in 1975. Aside from a secessionist revolt on the island of Bougainville – which ended in 1997 – political violence has been almost nonexistent. Free speech, free press, voting rights, and property rights are constitutionally guaranteed.

The titular head of state is Queen Elizabeth II, who is represented by a governor-general. Actual executive power, however, is exercised by the prime minister and the cabinet. Under the Westminster system, the prime minister is the leader of the majority party (or coalition) in the 109-member National Parliament. General elections are held at least every five years. The next elections will be held no later than June 2007, with the exact date at the prime minister's discretion. PNG has an independent judicial branch, headed by the Supreme Court, and an **independent central bank**, the Bank of Papua New Guinea.

There are 19 provinces in the country, plus the National Capital District. The provincial governments have a similar constitutional arrangement to the national government and have concurrent power in areas such as agriculture, business development, town planning, forestry, and natural resources. National laws take precedence over provincial laws if the two conflict.

In the international arena, PNG is a member of the United Nations, the Commonwealth, the Pacific Islands Forum, and many other multilateral organizations. The country has close ties with its neighbors (Indonesia and Australia) and **positive relations with the United States**. In particular, the U.S. has provided significant development aid to PNG over the past five years and has also held joint operations with the PNG military.

PNG is a lower income country with a developing yet fully **market-based economy**. In 2003, gross domestic product (GDP) was approximately $11.4 billion, or $2,200 per capita. Key industries include copra crushing; palm oil processing; plywood and wood chip production; mining of gold, silver, and copper; crude oil production; construction; and tourism.

PNG's main imports (generally manufactured goods) are sourced from Australia, Japan, the United States, Singapore, New Zealand, Britain, mainland China, and Hong Kong. The main destinations of PNG's exports (such as minerals and wood products) are Australia, Japan, South Korea, China, Germany, the United States, Britain, and Singapore. PNG currently enjoys a surplus in its balance of trade.

PNG is richly endowed with **natural resources**, though development has been hampered by rugged terrain and the high cost of infrastructure. Agriculture provides a subsistence livelihood for ~85% of the population. Mineral deposits, including oil, gold, and copper, account for ~25% of GDP and ~72% of export earnings. Economic growth has been somewhat weak over the past four years. In 2003, for instance, real GDP growth was ~0.7%. However, the government has had considerable success in attracting international support, specifically gaining the backing of the International Monetary Fund and the World Bank for development assistance loans.

Challenges facing the current administration include curbing inflation, improving investor confidence, and continuing privatization. Accordingly, in an effort to boost growth, the administration is pursuing a series of liberalizing economic policies. Among the highlights are the following:

- A fiscal policy designed to broaden the tax base with spending directed to strengthening physical infrastructure;
- An **attractive taxation regime** and low or zero tariffs on many business inputs, including some of the lowest rates of corporate tax in the Asia-Pacific region;
- Reform of import controls, with the replacement of quantitative restrictions (i.e., quotas) by tariffs;
- A progressive removal of price controls on domestically traded goods;
- A market-oriented approach to monetary policy with a non- intervention stance, which allows appropriate private sector credit growth and pursues internationally **competitive interest rates**;
- Continued liberalization of exchange control regulations to facilitate capital flows and a less regulated investment regime; and

- A labor policy allowing for continued deregulation of the labor market and flexibility in the wage-setting process.

PNG receives international aid from many sources. Australia, the only donor which gives direct budget support, is the biggest contributor to the development assistance program, providing about $350 million per year. Other major sources of assistance are Japan, the United States, the European Union, the Asian Development Bank, the World Bank, and the Commonwealth Fund for Technical Co-operation. These countries and agencies, as well as others, provide both technical and financial assistance.

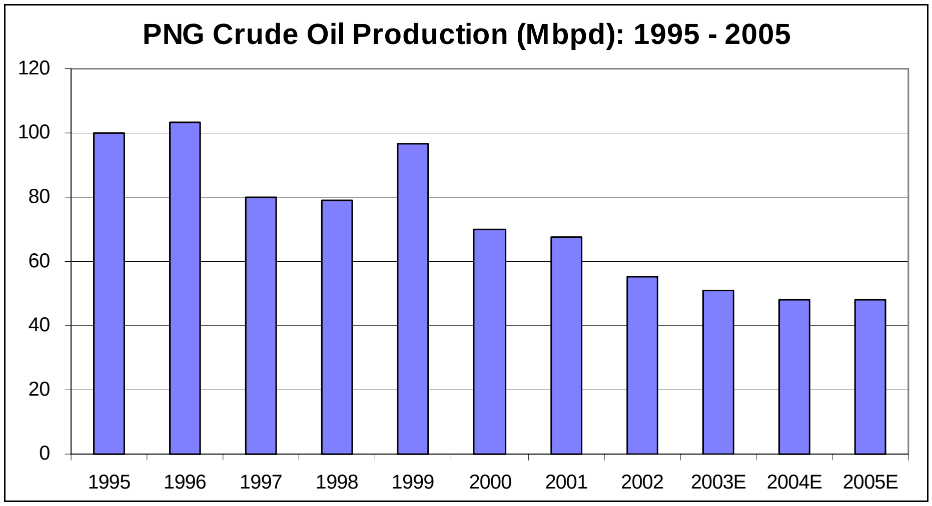
The country's currency, the Kina, has been free-floating since 1994. The Kina's exchange rate vs. the U.S. dollar, Australian dollar, and other major currencies is quite stable; the current value is ~3.2 PGK per 1.0 USD. The Bank of Papua New Guinea works to maintain **monetary stability**.

PNG's Petroleum Sector

As was previously mentioned, InterOil's refinery is the first and only one in PNG. It is, therefore, a major milestone in the country's ongoing process of industrialization and overall economic development. However, long before the refinery had been even conceived, PNG was a crude oil producer. While the country is a small player in the global oil market, the petroleum sector accounts for ~15% of GDP and ~30% of exports.

Geologically, PNG lies on the northern margin of the Australian continental plate. The country has five sedimentary basins with a total of area of over 200,000 square miles. In total, they contain comparable reserve potential and play systems to Indonesia's Papua Province and the Timor Sea area. According to the PNG Investment Promotion Authority, P2 (proved and probable) reserves are estimated at **500 million barrels of oil** and **15 trillion cubic feet of gas**. Of the five petroleum basins, the Papuan Basin is by far the most explored and developed. It is also the most prolific and is host to all the major domestic discoveries made to-date. However, even this basin has had just over 100 exploration wells since drilling began in 1913. This gives an indication of the area's untapped **resource potential**.

PNG has favorable project economics in terms of finding and development (F&D) costs. The Investment Promotion Authority estimates that average costs are as low as **$3.60 per barrel**, far below the world average of ~$10/Bbl. Nevertheless, exploration activity has been anemic in the past five years. This may be because PNG's oil potential is little-known outside the country, which naturally reduces the interest level among large industry players. No major new oil discoveries have been made since 1996. As shown in the following chart, oil production is currently at ~50 Mbpd, down by more than half from levels exceeding 100 Mbpd in the mid-1990s. The production drop is largely a result of organic declines from existing fields, along with a lack of new drilling.



Source: EIA, RJ est.

To increase investment, PNG's fiscal terms for the upstream have become much more competitive in recent years. In 2003, the government introduced special concessionary terms. These terms, the most important of which is a reduction in the sector-specific corporate tax rate from 45% to 30%, are intended to provide significant incentives for exploration. The new 30% rate will be available for petroleum operations pursuant to exploration licenses granted before year-end 2017. While part of the reason for this tax reform was a broad-based desire to boost foreign investment, InterOil – as one of the largest foreign investors in PNG – played a major role in encouraging this decision.

Midstream Operations: An Overview

InterOil's midstream business is the heart of the company's operations. The company recognized years ago that there is a clear and compelling need for a domestic oil refinery in PNG. Until 2004, PNG had been one of the few oil-producing countries without a single refinery of its own. All domestic crude oil had been exported, and all of the refined fuel requirements had been imported from Singapore and Australia at distances ranging from 1,400 to 4,400 miles. As the map below suggests, this had been an expensive and inherently inefficient supply chain.

Source: InterOil Corp.

The InterOil refinery will predominantly use domestic crude oil (the Kutubu grade) to produce a wide range of petroleum products which will supply the entire PNG market, leaving a balance of product that will be exported. Construction of the refinery was completed in the summer of 2004, and the facility is in the process of being commissioned.

The company's 30-year agreement with the PNG government – the Project Agreement and Extension Deed – will enable the refinery to capture most of the freight costs and refinery margins, which are currently paid to shipping and integrated oil companies. In addition, the five-year tax holiday guarantees that InterOil will be exempt from PNG corporate income tax on its midstream earnings from 2005 through year-end 2009. The government has agreed to these attractive terms because the refinery will be highly beneficial to PNG's economy and its citizens. First, valuable foreign exchange reserves previously used for the importation of refined products will be conserved. Second, the refinery project represents the single largest investment project currently underway in the country, with a total capital cost of some $214 million.

Pursuant to the project agreement, the government has undertaken to ensure (if necessary, through legislation) that the domestic distributors purchase all of their petroleum products from the refinery (subject to availability), at the **Import Parity Price**. No "dumping" of cheaper products will be permitted. The IPP is set by the government on a monthly basis. The IPP structure is a very important concept, as it provides the key margin that is expected to drive the midstream segment's **profitability**. The IPP comprises the differential between Singapore Posted Prices and InterOil's feedstock cost *plus* the PNG import freight component.

In addition to its sales-related agreements with the PNG government, InterOil has secured long-term contracts for marketing its exports and delivering crude oil to the refinery. The ~50% of refinery volumes that are available for export will be sold to Shell Overseas Holdings Ltd. Meanwhile, BP Singapore (the trading arm of BP International) will be the exclusive agent for all crude supply for an initial period of five years. We also note that InterOil, under a separate agreement with the government, has the first right to access local crude for 30 years. This right provides a **secure source of crude** for the refinery.

The agreement with BP not only guarantees crude supply, but also details an arrangement whereby InterOil and BP will share profits on any comparable quality cargoes delivered at a price below the PNG crude benchmark (Kutubu). We believe that BP entered into this agreement not for the minuscule supply contract, but for the incremental profits in delivering stranded or "odd-lot" shipments to the refinery. The supply contract has the potential to add **significant operating profit** above the margins we have forecast for InterOil.

InterOil has also developed a second strategic partnership with a major oil company to share in the profits of distributing refined product in excess of local PNG demand. Shell has agreed to market all excess refined product, approximately 50% of refinery output, to the nearby Pacific islands and northern Australia. InterOil will share benefits with Shell on the sale of such refined products. This agreement will allow Shell to more efficiently service small consumers in high-priced markets. Any incremental profit contributions, which could be significant under this marketing arrangement, have not been included in our financial forecast for InterOil.

Midstream Operations: The Refinery

The refinery's nominal capacity is 36,500 barrels per day (bpd), sized to meet the current and long-term predicted demand for the whole of the PNG market. At present, domestic demand is only ~18,500 bpd, leaving ~50% of the refinery's output for exports. Over the coming years, however, **economic and population growth** should continuously boost domestic demand. The company projects that normal operations will be based on 96% capacity utilization, also known as the "run rate." The refinery has a total storage capacity of 1.9 million barrels. This includes crude storage of 750,000 barrels, equivalent to more than 20 days of throughput.

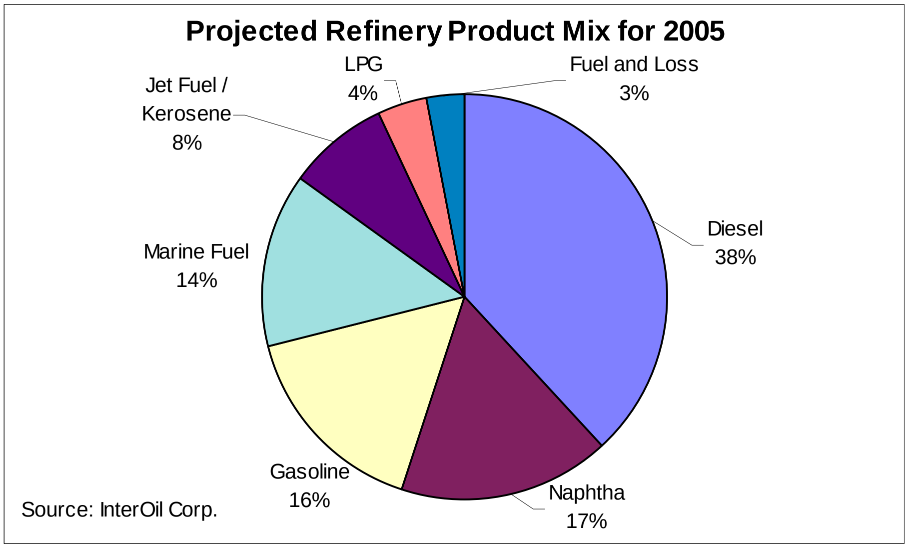
The configuration that has been chosen for the refinery is based on processing only light sweet crude (such as Kutubu), which has a low sulphur content. This avoids the need for hydrotreating or complex and expensive heavy oil processing. The refinery therefore consists of only atmospheric distillation plus a modest catalytic reformer for production of gasoline. All this means that both capital costs and operating costs are comparable on a dollar per barrel basis with the much larger "world scale" refineries of the integrated majors. In particular, environmental costs are expected to be very low. We should also note that the refinery has been built to fully comply with the stringent environmental standards of the World Bank. In the same vein, InterOil has developed a long-term community development assistance program for the three main villages in the refinery's immediate vicinity. We believe that this forward-looking strategy amply demonstrates the company's consistent commitment to sustainable and **socially responsible development**, which is key for maintaining positive relations with PNG's government and local consumers.

The 180-acre refinery site is located in a **strategically and commercially attractive** area (as shown by the map below). Built on a former Australian naval base that is being leased for 99 years from the PNG government, the site is centrally located across the harbor from Port Moresby, PNG's capital city and the only sheltered, deep-water harbor in the region. The distance to Port Moresby, which is also PNG's largest population center (and therefore largest refined product market), is only 15 miles by road and 2.5 miles by water.

Source: InterOil Corp.

Port Moresby's harbor compares quite favorably to such prominent shipping destinations in the region as the Australian cities of Sydney and Brisbane. The key attraction of this for InterOil is materially **reduced shipping costs**. The refinery jetty design has been made flexible to facilitate vessels of up to 110,000 deadweight tons (dwt) in size. Small vessels can load crude from the PNG river systems and unload at the refinery. Larger crude tankers will then be able to load at the sheltered refinery terminal.

The following chart shows the relative percentages of each individual product, representing the refinery's product slate for 2005 and beyond. Diesel is by far the largest category, with 38% of total volume. This is followed by naphtha with 17%, which will be sold to Shell for export in two distinct grades – one for petrochemical feedstock and the other for ethylene production. (The shipping of two grades commands a price premium, as it avoids the more expensive "splitting" process that would otherwise be required.) In addition, the refinery will produce motor gasoline, marine fuel, jet fuel and kerosene, and liquefied petroleum gas (LPG). PNG will be InterOil's principal market for all of these products; any surplus to domestic demand will be marketed by Shell to nearby Pacific Islands and northern Australia. The category marked "fuel and loss" represents the quantity of crude oil used up by the facility's internal operating needs.

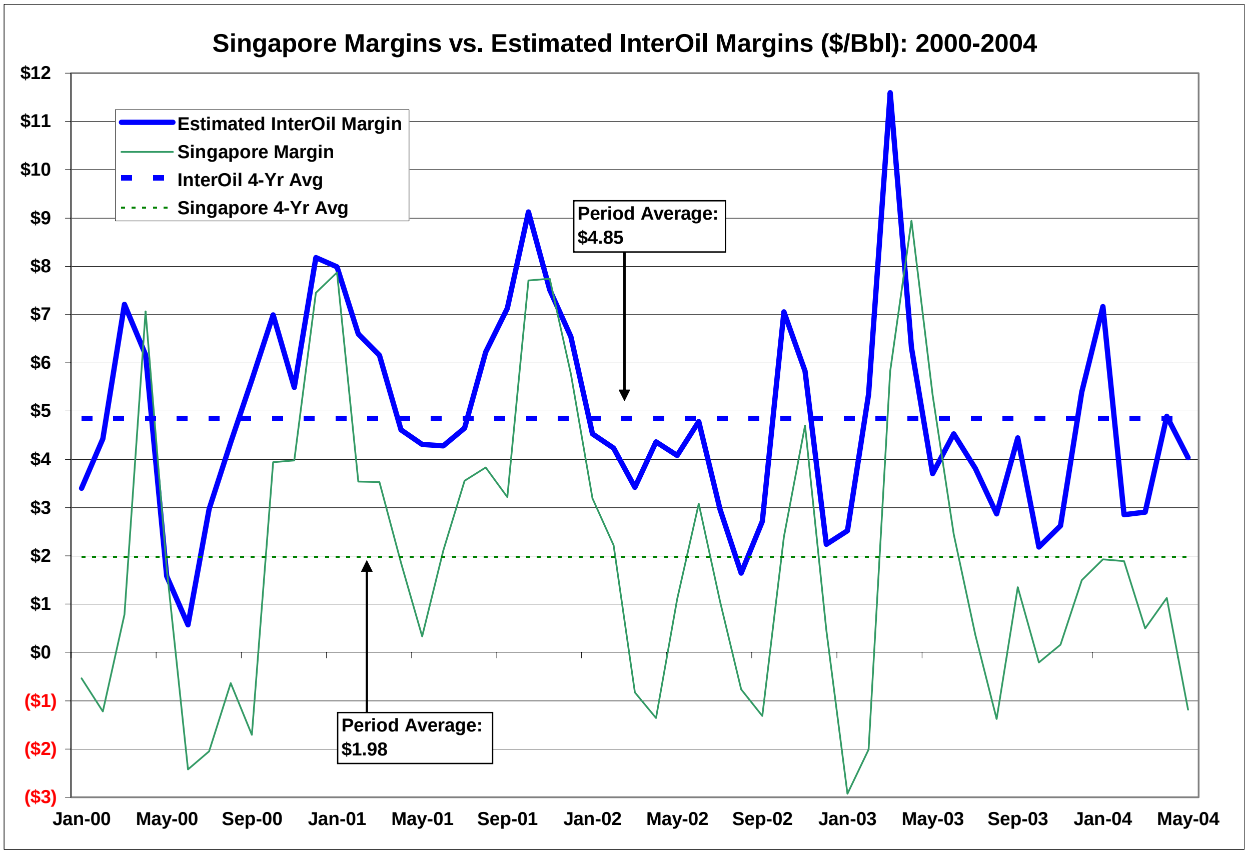


Refinery operations are outsourced to Petrofac, an independent facilities management company that operates worldwide. Under its contract, Petrofac is responsible for day-to-day activities, maintenance, and production. In addition, the refinery site includes a fully equipped laboratory, which is managed by Shell Global Services (SGS), a global leader in verification, testing, and certification for the petroleum industry. SGS is responsible for establishing the required quality assurance programs, providing laboratory personnel and test equipment, and certifying all refined products.

Midstream Operations: Refining Margins

Because of the Import Parity Price policy, secured by InterOil's 30-year project agreement with the PNG government, the company will be able to get highly attractive refining margins for its midstream business. Domestic distributors will be required to purchase all of their petroleum products from the refinery (subject to availability) at the IPP. In other words, no "dumping" of cheaper products will be permitted.

The key margin that drives the refinery's profitability is the spread between PNG's wholesale price of refined product (the IPP) and the cost of crude oil feedstock. This spread consists of two major components: (1) the differential between the Singapore Posted Product prices and the price of crude; *plus* (2) the Singapore to PNG import freight component. As shown in the following chart, this spread should result in more than a doubling of margins compared to Singapore levels. Specifically, the recent (January 2000 through May 2004) average for Singapore margins (based on InterOil's current product slate) was about $1.98 per barrel. In contrast, InterOil's margins under the IPP structure during the same time period would have been about $4.85 per barrel, or **more than 140% higher**, on a pro forma basis. Of course, there is significant short-term volatility in the day-to-day margins, but it seems abundantly clear that IPP provides a meaningful boost to the long-term average margin level.



Source: InterOil Corp.

We note that the Singapore margin forecasts used in our model are based on a five-year average, which includes a period when these margins were at historically low levels. Today, these margins are at $3 to $4 per barrel.

Downstream Operations

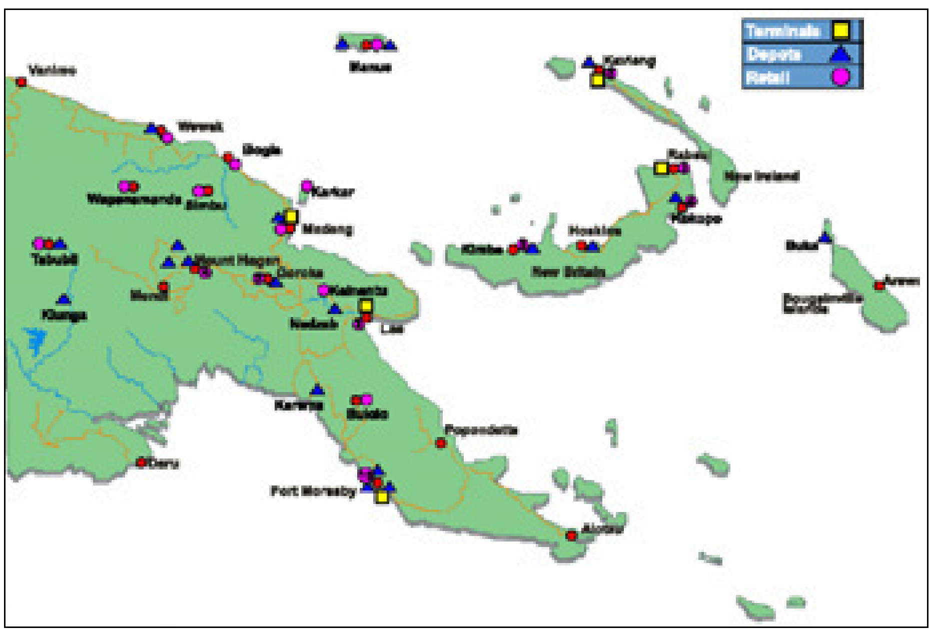
The downstream segment represents the second component of InterOil's vertically integrated business model. This segment consists of two parts: one that is InterOil-owned but leased to Shell, and another that is both owned and operated by InterOil. In the aggregate, InterOil's downstream segment accounts for **~75% of PNG's fuel requirements**.

In 2001, InterOil agreed to purchase all of Shell's retail and distribution assets in PNG for $18 million. The transaction is expected to close in the fourth quarter of 2004, once PNG regulatory review is complete and the InterOil refinery is fully commissioned. The Shell portfolio comprises a **blue-chip distribution network of 70 outlets** that includes terminals, depots, retail service stations, and commercial refueling facilities. It is strategically and geographically the largest and most comprehensive distribution asset base in PNG. The agreement with Shell significantly enhances the commercial value of InterOil's refinery project, as the acquired distribution network accounts for ~50% of the country's total downstream sector. Beginning in the first quarter of 2005, InterOil will lease these assets back to Shell, with Shell maintaining responsibility for daily operations, under its own brand. This alliance combines the strength of InterOil's refinery and upstream projects with Shell's marketing and distribution expertise, thus ensuring a seamless supply of refined products to the domestic market.

On April 28, 2004, InterOil completed the acquisition of BP Papua New Guinea Limited from BP. The $11.3 million transaction included all of BP's distribution assets and commercial and retail operations in the country, along with $7.3 million of inventory. The asset portfolio comprises three terminals, seven depots, and over 40 retail sites. It accounts for ~25% of PNG's total downstream sector. The company has been renamed InterOil Products Limited (IPL), establishing InterOil's own downstream business. In May, IPL began operating as a standalone entity; it will purchase its product requirements from the refinery on the same commercial terms as all other domestic distributors. On September 24, InterOil opened its first re-branded service station in Port Moresby, at a ceremony attended by the PNG Minister of Petroleum and Energy. The rollout of the re-branded stations is continuing in the fourth quarter.

We believe that the acquisition of BP's assets makes clear strategic sense for InterOil. BP had been operating in PNG for over 30 years, giving it a **solid track record** and a **large portfolio** of choice downstream locations. Inter-Oil's assumption of the BP business is being assisted by the secondment of existing BP management under a services agreement with BP Australia, to provide for an efficient transfer over the coming year. In other words, the transition from the BP brand to the InterOil brand should proceed quite smoothly. The majority of IPL's 160 employees are PNG nationals. The main centers of employment are the cities of Port Moresby, Lae, Madang, Rabaul, and Mt. Hagen.

The map below shows the nationwide scope of InterOil's downstream distribution network.



Source: InterOil Corp.

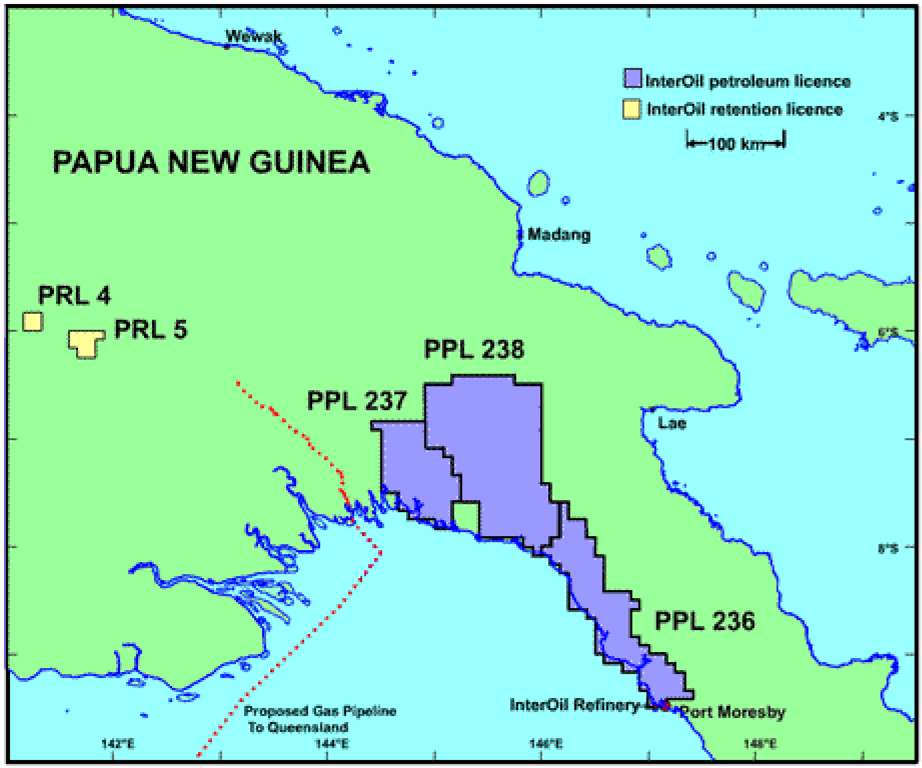
Upstream Operations

InterOil is the **largest holder of oil and gas exploration licenses** in PNG, with an extensive asset portfolio consisting of 8.8 million acres (shown in the map on the following page). InterOil has 100% ownership and is the operator of three Petroleum Prospecting Licenses: PPL 236, PPL 237, and PPL 238. All three were granted in March 2003. These licenses are located onshore in the Eastern Papuan Basin, in close proximity to the company's refinery. The economic field size for an oilfield in the Eastern Papuan Basin is estimated at only 5 million barrels. All prospects identified in the company's multi-well drilling program are located in moderate terrain that would allow for an oil discovery to be barged or trucked to the refinery. Due to these logistical advantages, the period between discovery and production (and hence cash flow) should be materially shortened.

PPL 236 – The license covers an area that includes InterOil's refinery, with good road access to the prospective locations. The proximity to Port Moresby means that even a modest gas discovery may be economic for a pipeline to the capital area, including InterOil's refinery and potential electrical power generation facilities. A small oil discovery this close to the refinery would be economic with **low development, operating, and transport costs**. One large structure, Whale, and two fault and reef structures, Sea Dragon and Marlin, have been identified in this permit.

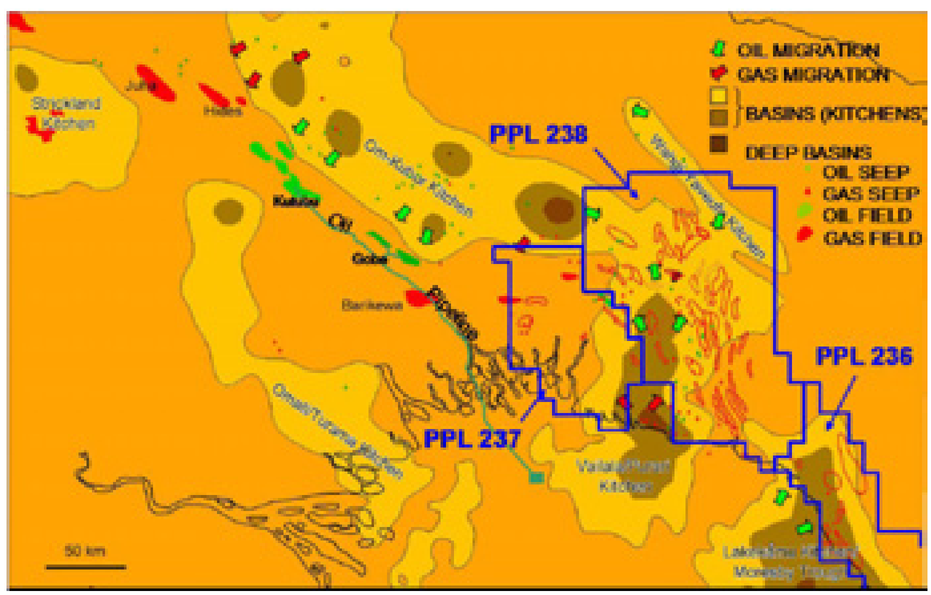
PPL 237 – This license is well-positioned to receive hydrocarbons that have migrated out of the adjacent Omati and Aure Trough areas. The license contains the gas discovery Bwata-1. Little exploration work has been done in this area over the past 20 years, and application of modern technologies should result in a **considerably improved appraisal**. The flat nature of the terrain means that low-altitude airborne geophysical exploration methods (for instance, gravity and magnetics) may be appropriate. Barge transport of oil to InterOil's refinery would be facilitated by the presence of several rivers, which exit to the sea. Prospects for the expanded drilling program include the independent structures T-Rex, Triceratops, Brontosaurus, and Stegosaurus. The Puri-1 oil discovery is also located within this license.

PPL 238 – InterOil identified the potential in this area and was rewarded with encouraging results from the stratigraphic wells and field surveys that indicate a new oil system in the Pale/Subu Sandstones. InterOil's two current exploration wells, Moose-2 and Sterling Mustang-1, are located within this license. There are numerous oil and gas seeps in the area, and large surface structures suggest the **potential for large oilfields**. A number of shallow bore-holes encountered oil and gas shows. The licensed property is partially connected by road to the refinery, and navigable rivers penetrate inland to the prospective areas. InterOil believes that this favorable location will result in lower drilling and development costs compared to existing operations in the highlands.



Source: InterOil Corp.

In addition to its three operated licenses, InterOil holds non-operated working interests (20%) in two Petroleum Retention Licenses: PRL 4 and PRL 5. Both contain potential gas condensate fields with access to the Fly River.



Source: InterOil Corp.

In December 2002, InterOil announced an eight-well drilling program, **largest exploration drilling** program on independent structures in PNG history. This program commenced in March 2003 with the drilling of the Moose #1 prospect, located in PPL 238. Following encouraging initial drilling results, the program has since been doubled in size to 16 wells. There are two drilling operations currently underway: Moose #2 (which spudded in December 2003) and Sterling Mustang #1 (which spudded in January 2004), both of which are also in PPL 238.

InterOil undertook two seismic acquisition programs in late 2003 and early 2004. The seismic surveys began with initiation of the Hadina survey in November 2003 and concluded with the completion of the Orloli program in January 2004. The Hadina survey covered the Rhino, Mammoth, and Mastodon structures in PPL 238. The Orloli survey covered the Stegosaurus structure in PPL 237. Initial data processing was completed in February 2004, showing **high-quality data**. Ground gravity data was acquired along the seismic lines and will be used to complement the seismic interpretation. The gravity results will be examined in conjunction with the seismic data to determine to what extent that method can be used to high-grade prospects for seismic acquisition or drilling, as gravity data can be acquired at a fraction of the cost of seismic data.

Recent data at the Sterling Mustang prospect has shown increasing gas shows. In other words, gas **quality** is richer and heavier, and the **quantity** of gas increases, as the well is drilled deeper. This information encourages the company on the geologic prospects of this structure. The dip meter indicates an anticline. Based on the data it has gathered, the company has decided that a drilling rig with greater depth capacity (over 10,500 feet) is needed to explore this and other identified structures on its extensive land position in the Eastern Papuan Basin. On June 29, 2004, operations with the current drilling rig were therefore suspended at Sterling Mustang. Seismic will be shot across this structure while the company awaits the new rig, to assist in determining the best location to drill. The new rig is expected to arrive in the fourth quarter of 2004.

The Moose structure is a broad structure with 984 feet of limestone section, followed by a shale section. Below this shale is the estimated target zone of the Pale sandstone. The limestone section recovered 14 oil shows, which indicate generation from up to four different oil sources. These results have encouraged the company to continue to explore to a depth below the shale zone, to test for the primary sandstone target. Earlier this year, a spot seismic sample was shot at the Moose #1 site, which indicated that the zone of interest may be located at a depth of 4,700 feet. Based on this information, a full line of seismic is being shot over the combined Moose and Elk structures. As is the case with Sterling Mustang, InterOil has halted drilling operations in order to acquire drilling equipment with greater depth capabilities. Drilling of the Moose #2 was stopped on August 10, 2004, and the new rig is expected to arrive in the fourth quarter.

In total, InterOil has identified 30 potential structures on its three operated licenses. Management believes that the 10 main exploration targets contain P10 undiscovered resource **potential of up to 4.5 billion barrels**. This is detailed in the table on the following page. While we emphasize that none of these resources are classified as proved reserves, and ultimate recovery is likely to differ greatly from this "best-case" scenario, even a modest percentage of 4.5 billion barrels would be an extremely sizable oil discovery. We believe that virtually none of the long-term potential upside is currently being incorporated by the market in InterOil's stock price. As we previously mentioned, we do not include any resource potential in our net asset value calculation outside our conservative acreage valuation.

Undiscovered Resource Estimate (MMBbls)			
Target	**Pale Sandstone**	**Limestone**	**Total**
Bison	157	109	266
Black Bass	NA	27	27
Elk - Fractual	14	120	134
Longhorn	291	41	332
Marlin	NA	126	126
Mastodon	883	792	1,675
Moose	118	48	166
Rhino	366	305	671
Sterling Mustang	76	77	153
Whale	610	431	1,041
Total	**2,515**	**2,076**	**4,591**

Source: InterOil Corp.

Management Profile

On top of their extensive operational and financial experience in the oil and gas industry, InterOil's senior executives have a solid track record of working in Papua New Guinea. They have established a positive reputation for InterOil in the domestic market and have built a close working relationship with suppliers, consumers, and the PNG government.

Phil Mulacek – Chairman, CEO, and President. Mr. Mulacek is the Chairman of the Board of Directors, Chief Executive Officer, and President of InterOil, positions he has held since 1997. He is the founder of Petroleum Independent and Exploration Corporation (P.I.E.), a privately-held Houston-based oil and gas company with operations across the southwestern United States. P.I.E., founded in 1981, led the development of InterOil's refinery and the commercial activities that were necessary to secure the refinery's economic viability. Mr. Mulacek has over 25 years of experience in oil and gas exploration and production and holds a degree in petroleum engineering.

Christian Vinson – COO. Mr. Vinson is a member of the board and has been the Chief Operating Officer since 1995. He joined InterOil from P.I.E. As COO, he has the in-country responsibility for government and community relations and corporate development. He played a key role in the development of the company; in particular, he was responsible for securing the 30-year refinery project agreement with the PNG government. He has developed long-standing relationships with key PNG government and industry leaders over the past 10 years.

Tom Donovan – CFO. Mr. Donovan is the General Manager of Finance/ Accounts and the Chief Financial Officer. Prior to joining InterOil, he was director of corporate accounting for Rapid Design Service, Inc., where he successfully managed the development and implementation of an enterprise-wide integrated accounting system.

Gary Duvall – VP of Corporate Development. Mr. Duvall was previously a director of international business development at The Williams Companies (WMB/$11.96), a large Houston-based natural gas producer. While at Williams, he was responsible for evaluating potential acquisitions and the development of energy infrastructure projects in target countries, focusing on Europe and the Asia-Pacific region. He has worked in various areas of the energy industry for 19 years.

Graeme Alexander – Corporate Counsel and Secretary. Mr. Alexander has extensive legal and geological experience, having worked as a minerals geologist for 10 years before specializing in law. He also has significant PNG in-country experience, developed during his position as principal commercial partner of Gadens Lawyers. Prior to that, he was senior counsel of Mobil Exploration & Production Pty. Ltd. and Ampolex Ltd., during which time he also worked on PNG matters. He has worked in the legal and geological fields in the minerals and petroleum industries for a total of 30 years.

Andy Carroll – General Manager, Exploration and Production. Mr. Carroll has held this position since 1997. He started his career with BP and worked offshore in the North Sea and Ireland and onshore in the United Kingdom. He held various positions with Dome Petroleum, drilling in the Canadian Arctic and deepwater UK. In 1988, he joined Ampolex in Australia as manager of marketing; he was responsible for crude oil sales, gas marketing, and shipping and hedging. In 1994, he became the PNG asset manager and team leader. He has worked in international oil operations for 26 years.

Chris Collins – General Manager, Downstream. Before joining InterOil, Mr. Collins held various executive positions with The Shell Company of Australia. While at Shell, he had responsibilities in downstream oil marketing, which included reseller network development, allied retail business development, franchising, and asset management. He has 15 years of petroleum industry experience.

Angela Hartigan – General Manager, Marketing. Ms. Hartigan started her career in 1979 with ExxonMobil Corp. (XOM/$48.15) and has gained extensive experience in the petroleum marketing, refining and shipping sectors of the Australian and Southeast Asian oil industry. She has had over 11 years experience with Exxon and held various positions, including products trading manager and crude trading manager. In the latter role, she was directly responsible for negotiation of sales contracts for Exxon’s share of crude oil production from the Bass Strait and Timor Sea fields. She is also a former director for Vitol Australia, where she sourced and managed trading and marketing opportunities within Australia for Vitol’s international trading arm. She has worked in the petroleum industry for 24 years.

Alexander Nairn – General Manager, Projects. Before joining InterOil, Mr. Nairn was managing director of Chicago Bridge & Iron Company – South Africa (CBI/$29.75). In this role he was responsible for company activities in Sub-Saharan Africa, Libya, and Tunisia and managed participation in several very large capital projects. The Saldanha Steel Plant project was awarded the Best Projects 1998 award by U.S.-based Engineering News; the Mossgas refinery was the first large-scale gas-to-liquids plant in the world. Earlier in his career, Mr. Nairn was involved in project management of numerous large-scale oil and gas projects in the Middle East and North Sea. He has worked on the installation of large energy infrastructure projects for 25 years.

Recent and Projected Performance

2003 and 2004

Until the second quarter of 2004, InterOil was a development-stage company. The only revenue in 2002, 2003, and 1Q04 was income from investments. Expenses during this time were almost solely general and administrative (G&A) costs, plus exploration costs expensed in the upstream segment. For full-year 2003, the company reported a net loss of $3.6 million, or $(0.14) per diluted share; in 1Q04, the company reported a net loss of $1.5 million, or $(0.06) per diluted share.

In 2Q04, the company had its first-ever operating revenue – $12.6 million, derived from downstream sales in May and June. These sales came from the distribution assets acquired from BP in late April. A significant increase in G&A costs associated with the new assets contributed to a widening of the net loss to $(2.5 million), or $(0.10) per diluted share.

The third quarter was a major transformational point for the company. The most important event was that the refinery commenced operation, having received its first cargo of crude oil in June. Two additional cargoes have subsequently been delivered for a total of ~770,000 barrels of feedstock delivered to date. On August 10, the first refined product was lifted from the refinery for delivery to the local market. On September 7, the first cargoes of export sales were loaded. While commissioning activities will continue into 4Q04, the overall refinery project is now **virtually 100% complete**. During the commissioning period, the refinery has reached throughput levels as high as 32,500 bpd (the name plate capacity). Sustained full production of 36,500 bpd is expected to be reached once commissioning is concluded.

2005 and Beyond

During 2005, InterOil will have its first full year of both midstream and downstream operations. For the midstream segment, we project total revenue of $567.8 million and a gross margin of 10.4%. This is based on refinery sales of 12.4 MMBbls, or 34.0 MBbls/d. For the downstream segment, we project total revenue of $76.7 million and a gross margin of 28.3%. This is based on company-operated downstream sales of 1.2 MMBbls, or 3.2 MBbls/d, along with leasing revenue collected from Shell.

For the company in the aggregate, we project 2005 gross income of $80.7 million; operating income of $51.4 million; and net income of $33.9 million, or $1.28 per share. This would imply nearly a six-fold increase in earnings per share over the $0.22 that we project for full-year 2004. Our 2005 cash flow per share estimate is $1.56, nearly four times higher than the $0.43 that we project for full-year 2004.

Growth in midstream and downstream revenue after 2005 is likely to be driven by three factors: PNG population growth, PNG economic development, and a relative shift from refined product exports to domestic consumption. In particular, because refining margins are significantly higher domestically than in the export market, growing PNG demand would provide a **further boost to InterOil's profitability**. Over the long term, refining margins should remain broadly similar to 2005 levels, but they will continue to fluctuate on a day-to-day basis, in part due to crude oil price variability.

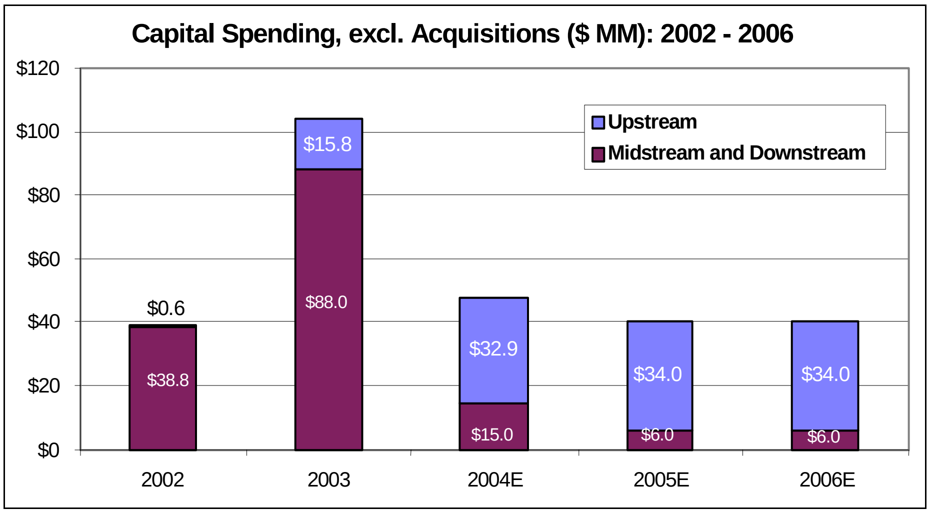
A major unknown factor is when the company will be able to begin upstream production of oil and/or gas. This is impossible to forecast with any degree of precision at this time; accordingly, our earnings estimates and valuation assumptions do not assume any production in the foreseeable future.

Capital Spending and Financing

Capital Expenditures

In 2002 and 2003, the refinery's construction meant that nearly all of InterOil's capital spending was devoted to the project. Capitalized expenditures on upstream operations were only $0.6 million in 2002 (out of a total of $39.4 million) and $15.8 million in 2003 (out of a total of $103.8 million). By the time the refinery's commissioning concludes in the fourth quarter of 2004, InterOil's investment in the project will have exceeded $210 million.

Now that the refinery is almost complete, InterOil is significantly **ramping up its drilling** program. In the first half of 2004, upstream spending was $16.9 million; we project that a similar amount, $16.0 million, will be spent in the second half. For 2005, our upstream spending forecast is $34.0 million, as shown in the chart below. This estimate could turn out to be conservative.



Source InterOil Corp., RJ est.

InterOil follows the successful efforts method of accounting for oil and gas exploration and development activities. This means that direct acquisition costs of development properties, along with geological and geophysical costs, are capitalized. The cost of drilling wells that result in additions to proved reserves are also capitalized. On the other hand, unsuccessful wells ("dry holes") are expensed. Capitalized costs for producing wells will be subject to depletion according to the units-of-production method.

Financial Flexibility

InterOil has a moderate debt profile, especially considering that it had no operating revenue until the second quarter of 2004. As of June 30, 2004, it had $88.6 million in long-term debt (including the current portion), giving it a debt-to-total capitalization ratio of 37.0%. During the third quarter, the company increased its debt by $45.0 million, raising the pro forma debt-to-cap ratio to 47.1%. The company's debt consists of two main components: an $85.0 million financing facility from the Overseas Private Investment Corporation (OPIC) and a $45.0 million convertible note.

The loan from OPIC, a development agency of the U.S. federal government, was agreed upon in 2001. The last installment was drawn in the summer of 2004. The loan's sole purpose was to facilitate the refinery's construction. The fact that this is OPIC's largest-ever direct debt facility demonstrates, we believe, the agency's **high level of confidence** in the refinery project. It also suggests that Washington is committed to seeing this project succeed, largely due to its geopolitical interests in the region around PNG.

The loan expires on June 30, 2013, with half-yearly repayments of $4.5 million having commenced on June 30, 2004. The agreement contains customary financial covenants, including the maintenance of minimum levels of tangible net worth and limits on additional debt. The interest rate is equal to the treasury cost applicable to each promissory note outstanding plus the OPIC spread (currently 3.5%). The average interest rate in 2003 was 6.7%.

In August 2004, InterOil announced and closed a private placement of senior convertible debentures to several institutional investors. Because of higher-than-expected demand, the placement's size was increased to $45 million from an initial range of $30 million to $40 million. **Raymond James & Associates participated in the placement**. The company used the net proceeds for working capital, particularly the purchase of inventory for the refinery.

The following are key features of the convertible notes:

- The notes have a final maturity date of five years from issuance and bear interest at a rate of 8.875%, payable quarterly.
- Holders may convert the notes at any time into common shares at a fixed conversion price of $20.16 per share.
- Starting 21 months from closing, holders will have the option to request redemption of portions of the principal in equal amounts at stated dates until the maturity date.
- After the one-year anniversary of closing, if the common stock's price exceeds $28.23 per share, InterOil may (under certain circumstances) require holders to convert the notes into common shares at the fixed conversion price.

Recent Transactions

In April 2004, InterOil closed the acquisition of BP plc's PNG subsidiary, BP Papua New Guinea Limited. After receiving all necessary PNG government approvals and completing all other closing conditions, the transaction was completed on April 28. The subsidiary has since been renamed InterOil Products Limited. This transaction, valued at $11.3 million, included all of BP's distribution assets and operations in PNG, along with $7.3 million in inventory. The asset portfolio comprises three terminals, seven depots, and over 40 retail sites; it accounts for ~25% of PNG's fuel requirements. InterOil has retained key BP Australia personnel for a period of up to 12 months to assist with the transition.

In 2001, InterOil agreed to purchase Shell's entire distribution asset base in PNG. The transaction is expected to close in the fourth quarter of 2004, once PNG regulatory review is complete and the InterOil refinery is fully commissioned. This blue-chip Shell portfolio comprises a network of 70 core distribution outlets that accounts for ~50% of PNG's fuel requirements. The portfolio includes terminals, depots, retail service stations, and commercial refueling facilities. Shell will continue to operate the assets under its own brand on a leaseback basis from InterOil.

On September 8, 2004, InterOil's shares began trading on the American Stock Exchange (AMEX). Following this listing, the stock continues to trade on the Toronto Stock Exchange (TSX), the Australian Stock Exchange (ASX) in Sydney, and PNG's Port Moresby Stock Exchange (POMSoX).

Investment Conclusion

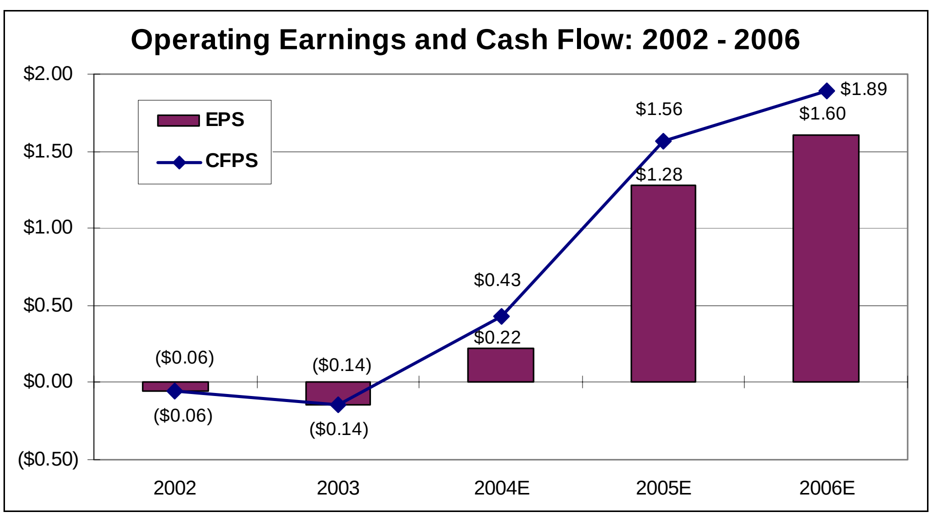
Growth

By pursuing a fully integrated approach, InterOil has emerged as the **dominant energy** player in its niche market of Papua New Guinea. The company has a solid base of midstream and downstream assets, providing a stream of operating cash flow, which is helping fund an active exploration program on a large acreage position.

Before InterOil's 36,500 barrel per day refinery came on-line in the summer of 2004, PNG had no domestic refining capacity. The new facility will enable InterOil and local consumers to capture most of the transport costs and refining margins that had previously been paid to shipping and oil companies in the region. For InterOil, this means robust, **above-average refining margins**, secured by the 30-year Import Parity Pricing agreement with the national government.

InterOil owns the largest and most **wide-ranging downstream asset base** in PNG. It is in the process of completing its acquisition of Royal Dutch/Shell's entire domestic network of retail and distribution properties. These assets will be leased back to Shell, giving InterOil a stable revenue stream. Earlier in 2004, InterOil further strengthened its downstream base by buying BP plc's local retail and distribution network, which will be InterOil-operated.

We believe that InterOil's emerging E&P business has huge upside potential – virtually none of which is incorporated in the share price. The company is the largest holder of exploration licenses in PNG, with a land portfolio of 8.8 million acres. The company estimates that the long-term, undiscovered **resource potential** on only 10 of its 30 identified drilling prospects could be **as high as 4.5 billion barrels**.



Source: InterOil Corp., RJ est.

Risk

InterOil is subject to many of the same risks as a typical U.S. oil and gas company. Those risks include:

- Commodity price fluctuations
- Operating risks
- Political and regulatory risk
- Financial risk

In addition, because of the unique nature of the company's business model, we would highlight the following risk factors.

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 country, especially a developing one. This includes the potential for unfavorable changes in taxes, regulations, exchange rates, and macroeconomic fundamentals.

Refining margin risk: Given that InterOil's midstream business segment currently represents the vast majority of the company's revenues, adverse fluctuations in refining margins in the South Pacific region could negatively affect the company's profitability.

Exploration risk: InterOil does not currently have any proved oil and gas reserves. The success of its upstream exploration program in Papua New Guinea is dependent on finding commercial quantities of oil and gas on its exploration acreage and on having sufficient funds, whether from internal cash flow or external sources, to fund the drilling program.

Share liquidity risk: With InterOil's small market capitalization and somewhat limited trading volume, its stock can be illiquid. As a result, for some investors, it may be difficult to buy or sell the company's shares without meaningfully moving its stock price.

Return

We have calculated a net asset value of $29.15 per share, which takes into account a discounted cash flow analysis of InterOil's midstream and downstream assets, undeveloped acreage, and other assets and liabilities. The company does not currently have any proved oil and gas reserves, and we have not incorporated any forward-looking reserve assumptions in our NAV model. Instead, we value the company's undeveloped acreage at a modest $25 per acre.

InterOil shares are currently trading at 17.6x 2005E price/earnings, vs. a 10.5x average for a peer group of pure-play U.S. refiners. We believe that InterOil should trade at a **substantial premium** to its peers due to: (1) the guaranteed IPP agreement, which locks in a minimum refinery margin well above its U.S. peers; (2) potential incremental operating profits derived through supply and distribution partnerships with major oil companies; and (3) the superior growth outlook for the PNG refined product market as compared to the vastly more mature U.S. market.

Our target price of $35.00 is based on our NAV estimate, plus a modest premium for the company's extensive reserve potential. This is equivalent to a multiple of 27.3x our 2005 EPS estimate and 17.9x our 2005 EBITDA estimate. We believe there is likely to be **considerable upside** beyond this target price as InterOil's drilling program generates definitive results and U.S. investors become more comfortable with the company's business model.

InterOil Corp.

QUARTERLY INCOME AND CASH FLOW (MILLIONS)

Earnings & Cash Flow	**2002 A**	**2003 A**	**Q1 A**	**Q2 A**	**Q3 E**	**Q4 E**	**2004 E**	**Q1 E**	**Q2 E**	**Q3 E**	**Q4 E**	**2005 E**
Midstream Revenue	$0.0	$0.0	$0.0	$0.0	$66.2	$142.8	$209.0	$142.0	$142.0	$142.0	$142.0	$567.8
Average Sales Price, $/Bbl					$45.39	$45.67	$45.59	$45.73	$45.73	$45.73	$45.73	$45.73
Downstream Revenue	0.0	0.0	0.0	12.6	18.2	18.8	49.5	19.2	19.2	19.2	19.2	76.7
Average Sales Price, $/Bbl					$61.54	$63.57	$62.56	$64.93	$64.93	$64.93	$64.93	$64.93
Investment Income and Other	0.4	0.3	0.2	0.1	0.0	0.0	0.3	0.0	0.0	0.0	0.0	0.0
Total Operating Revenues	$0.4	$0.3	$0.2	$12.7	$84.4	$161.5	$258.8	$161.1	$161.1	$161.1	$161.1	$644.6
Midstream Cost of Goods Sold	$0.0	$0.0	$0.0	$0.0	$63.2	$128.1	$191.3	$127.2	$127.2	$127.2	$127.2	$508.8
Midstream COGS, $/Bbl					$43.33	$40.99	$42.16	$40.98	$40.98	$40.98	$40.98	$40.98
Gross Margin, %					4.6%	10.3%	7.5%	10.4%	10.4%	10.4%	10.4%	10.4%
Downstream Cost of Goods Sold	$0.0	$0.0	$0.0	$10.5	$13.8	$13.8	$38.0	$13.8	$13.8	$13.8	$13.8	$55.0
Downstream COGS, $/Bbl					$46.57	$46.57	$46.57	$46.57	$46.57	$46.57	$46.57	$46.57
Gross Margin, %				16.8%	24.3%	26.7%	25.6%	28.3%	28.3%	28.3%	28.3%	28.3%
Gross Income	0.4	0.3	0.2	2.2	7.4	19.7	29.5	20.2	20.2	20.2	20.2	80.7
Combined Operating Costs	$0.0	$0.0	$0.0	$0.0	$3.5	$3.5	$6.9	$3.5	$3.5	$3.5	$3.5	$13.9
Depr., Depl., & Amortization	0.0	0.0	0.0	0.0	1.7	1.7	3.4	1.9	1.9	1.9	1.9	7.4
Selling, G & A Expenses	2.2	1.5	0.9	2.4	2.0	2.0	7.3	2.0	2.0	2.0	2.0	8.0
Exploration	0.1	0.2	0.0	1.5	0.0	0.0	1.5	0.0	0.0	0.0	0.0	0.0
Operating Income	(2.0)	(1.4)	(0.8)	(1.7)	0.3	12.5	10.4	12.8	12.8	12.8	12.8	51.4
Total Interest Expense	0.0	0.0	0.0	0.0	0.3	1.1	1.4	3.5	3.5	3.5	3.5	13.8
Foreign Exchange Adjustment and Other	0.6	(2.1)	(0.7)	(0.4)	0.0	0.0	(1.1)	0.0	0.0	0.0	0.0	0.0
Income Tax Expense	0.0	0.0	0.0	0.5	0.8	0.9	2.2	0.9	0.9	0.9	0.9	3.7
Non-Controlling Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Inc Before EI & MI	(1.3)	(3.6)	(1.5)	(2.5)	(0.8)	10.6	5.7	8.5	8.5	8.5	8.5	33.9
Reported Net Income	(1.3)	(3.6)	(1.5)	(2.5)	(0.8)	10.6	5.7	8.5	8.5	8.5	8.5	33.9
Adjustments for Nonrecurring Items	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Inc from Cont Operations	($1.3)	($3.6)	($1.5)	($2.5)	($0.8)	$10.6	$5.7	$8.5	$8.5	$8.5	$8.5	$33.9
Reported Net Inc/Share	($0.06)	($0.15)	($0.06)	($0.10)	($0.03)	$0.42	$0.23	$0.34	$0.34	$0.34	$0.34	$1.36
FD Adjusted Net Income/Share	($0.06)	($0.14)	($0.06)	($0.10)	($0.03)	$0.40	$0.22	$0.32	$0.32	$0.32	$0.32	$1.28
Primary Shares Outstanding, Mil.	20.6	23.5	24.8	24.9	24.9	24.9	24.9	24.9	24.9	24.9	24.9	24.9
Fully Diluted Shares Outstanding, Mil.	22.1	24.8	26.2	26.4	26.4	26.4	26.4	26.4	26.4	26.4	26.4	26.4
Cash Flow	**2002 A**	**2003 A**	**Q1 A**	**Q2 A**	**Q3 E**	**Q4 E**	**2004 E**	**Q1 E**	**Q2 E**	**Q3 E**	**Q4 E**	**2005 E**
Net Income	($1.3)	($3.5)	($1.5)	($2.5)	($0.8)	$10.6	$5.7	$8.5	$8.5	$8.5	$8.5	$33.9
Depl., Depr. & Amort.	0.0	0.0	0.0	0.0	1.7	1.7	3.4	1.9	1.9	1.9	1.9	7.4
Deferred Income Tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other Non-Cash & Adjustments	0.0	0.0	0.0	2.1	0.0	0.0	2.1	0.0	0.0	0.0	0.0	0.0
Cash Flow	($1.3)	($3.5)	($1.5)	($0.4)	$0.9	$12.3	$11.2	$10.3	$10.3	$10.3	$10.3	$41.3
Primary Cash Flow/Share	($0.06)	($0.15)	($0.06)	($0.02)	$0.04	$0.49	$0.45	$0.41	$0.41	$0.41	$0.41	$1.66
Fully Diluted Cash Flow/Share	($0.06)	($0.14)	($0.06)	($0.02)	$0.03	$0.46	$0.43	$0.39	$0.39	$0.39	$0.39	$1.56

InterOil Corp.

Quarterly Midstream and Downstream Volumes

	2002 A	**2003 A**	**Q1 A**	**Q2 A**	**Q3 E**	**Q4 E**	**2004 E**	**Q1 E**	**Q2 E**	**Q3 E**	**Q4 E**	**2005 E**
Midstream Sales (MBbls)												
Diesel - Domestic					443.5	943.7	1,387.3	943.7	943.7	943.7	943.7	3,774.8
Diesel - Export					126.5	271.8	398.2	269.0	269.0	269.0	269.0	1,076.2
Motor Gasoline - Domestic					0.0	173.1	173.1	171.4	171.4	171.4	171.4	685.5
Motor Gasoline - Export					0.0	345.6	345.6	342.1	342.1	342.1	342.1	1,368.5
Naphtha - Export					498.8	553.2	1,051.9	547.7	547.7	547.7	547.7	2,190.6
All Other					390.2	838.5	1,228.6	830.1	830.1	830.1	830.1	3,320.4
Total Midstream					1,458.9	3,125.8	4,584.7	3,104.0	3,104.0	3,104.0	3,104.0	12,416.0
Downstream Sales (MBbls)												
IPP Product												
Motor Gasoline					28.9	28.9	57.7	28.9	28.9	28.9	28.9	115.4
Diesel					190.6	190.6	381.1	190.6	190.6	190.6	190.6	762.2
Kerosene					16.7	16.7	33.4	16.7	16.7	16.7	16.7	66.8
Total IPP					236.1	236.1	472.2	236.1	236.1	236.1	236.1	944.4
Import Product												
Lubes					2.6	2.6	5.3	2.6	2.6	2.6	2.6	10.6
Fuel Oil					56.6	56.6	113.2	56.6	56.6	56.6	56.6	226.5
Total Import					59.3	59.3	118.5	59.3	59.3	59.3	59.3	237.0
Total Downstream					295.4	295.4	590.7	295.4	295.4	295.4	295.4	1,181.5

INCOME STATEMENT (MILLIONS)					
InterOil Corp.	**2002 A**	**2003 A**	**2004 E**	**2005 E**	**2006 E**
Midstream Revenue	$0.0	$0.0	$209.0	$567.8	$508.4
Average Sales Price, $/Bbl			$45.59	$45.73	$40.94
Downstream Revenue	$0.0	$0.0	$49.5	$76.7	$78.2
Average Sales Price, $/Bbl			$62.56	$64.93	$64.86
Investment Income and Other	$0.4	$0.3	$0.3	$0.0	$0.0
Total Operating Revenues	$0.4	$0.3	$258.8	$644.6	$586.6
Midstream Cost of Goods Sold	$0.0	$0.0	$191.3	$508.8	$445.1
Midstream COGS, $/Bbl			$42.16	$40.98	$35.84
Gross Margin, %			7.5%	10.4%	12.5%
Downstream Cost of Goods Sold	$0.0	$0.0	$38.0	$55.0	$56.1
Downstream COGS, $/Bbl			$46.57	$46.57	$46.57
Gross Margin, %			25.6%	28.3%	28.2%
Gross Income	$0.4	$0.3	$29.5	$80.7	$85.4
Combined Operating Costs	0.0	0.0	6.9	13.9	13.9
Depr., Depl., & Amortization	0.0	0.0	3.4	7.4	7.5
Selling, G & A Expenses	2.2	1.5	7.3	8.0	8.1
Exploration	0.1	0.2	1.5	0.0	0.0
Operating Income	($2.0)	($1.4)	$10.4	$51.4	$55.8
Total Interest Expense	0.0	0.0	1.4	13.8	9.5
Foreign Exchange Adjustment and Other	0.6	(2.1)	(1.1)	0.0	0.0
Income Tax Expense	0.0	0.0	2.2	3.7	4.0
Non-Controlling Interest	0.0	0.0	0.0	0.0	0.0
Reported Net Income	($1.3)	($3.6)	$5.7	$33.9	$42.4
Adjustments for Nonrecurring Items	0.0	0.0	0.0	0.0	0.0
Net Inc from Cont Operations	($1.3)	($3.6)	$5.7	$33.9	$42.4
Reported EPS	($0.06)	($0.15)	$0.23	$1.36	$1.70
Extraordinary Items Adjustment	$0.00	$0.00	$0.00	$0.00	$0.00
Adjusted EPS	($0.06)	($0.15)	$0.23	$1.36	$1.70
FD Adjusted EPS	($0.06)	($0.14)	$0.22	$1.28	$1.60
Primary Shares Out., MM	20.6	23.5	24.9	24.9	24.9
Fully Diluted Shares Out., MM	22.1	24.8	26.4	26.4	26.4

CASH FLOW STATEMENT (MILLIONS)					
Operating Sources	**2002 A**	**2003 A**	**2004 E**	**2005 E**	**2006 E**
Net Income	($1.3)	($3.6)	$5.7	$33.9	$42.4
Depl., Depr. & Amort.	0.0	0.0	3.4	7.4	7.5
Deferred Income Tax	0.0	0.0	0.0	0.0	0.0
Other Non-Cash & Adjustments	(0.0)	(0.0)	2.1	(0.0)	(0.0)
Total	($1.3)	($3.6)	$11.2	$41.3	$49.9
Adj. Cash Flow/Share	($0.06)	($0.14)	$0.43	$1.56	$1.89
Operating Uses					
Change in Non-cash Working Capital	0.2	0.3	0.9	0.0	0.0
Additions to Oil & Gas Properties	(0.6)	(15.8)	(32.9)	(34.0)	(34.0)
Expenditures on Capital Assets	(38.8)	(88.0)	(15.0)	(6.0)	(6.0)
Other	9.9	(21.4)	29.7	0.0	0.0
Total	($29.3)	($124.9)	($17.3)	($40.0)	($40.0)
Operating Cash Flow	($30.6)	($128.5)	($6.1)	$1.3	$9.9
Non-Operating Sources					
Asset Sales	0.0	0.0	0.0	0.0	0.0
Change in Long-Term Debt	30.2	52.0	47.2	(4.6)	(12.7)
Sale of Common Stock	0.9	63.2	0.2	0.0	0.0
Other	2.1	15.5	3.0	0.0	0.0
Total	$33.2	$130.7	$50.4	($4.6)	($12.7)
Beginning Cash	$0.7	$3.3	$5.6	$52.8	$46.8
Change in Cash	$2.6	$2.3	$43.5	($6.0)	($6.0)
Ending Cash	$3.3	$5.6	$49.0	$46.8	$40.8

BALANCE SHEET (MILLIONS)					
Assets	**2002 A**	**2003 A**	**2004 E**	**2005 E**	**2006 E**
Cash & Marketable Securities	3.3	5.6	49.0	46.8	40.8
Current Assets	7.7	32.7	41.0	37.3	37.3
Net Book Value of Oil & Gas Properties	2.9	23.0	54.7	88.7	122.7
Capital Assets	121.2	202.3	223.3	221.8	220.3
Total Assets	$135.1	$263.6	$368.0	$394.6	$421.1
Liabilities & Shareholders Equity					
Current Liabilities	10.2	16.3	66.7	66.7	66.7
Long-Term Debt	31.0	74.0	121.2	113.9	98.0
Non-Controlling Interest	6.5	6.5	6.5	6.5	6.5
Other Non-Current Liabilities	0.0	19.8	12.9	12.9	12.9
Common Shareholders Equity	87.4	147.0	160.7	194.6	237.0
Total Liab & Shldrs Equity	$135.1	$263.6	$368.0	$394.6	$421.1
Common & Equiv. Shares, MM	22.1	26.2	26.4	26.4	26.4
Debt/Capital Ratio	26%	33%	43%	37%	29%

Important Investor Disclosures

Stock Ratings: The common stock of InterOil Corp. currently has a **Strong Buy** rating. Within our four-tiered rating system, Strong Buy (SB1) means that the stock is expected to appreciate and produce a total return of at least 15% and outperform the S&P 500 over the next six months; *for higher-yielding and more conservative equities, such as REITs and certain MLPs, a total return of at least 15% is expected to be realized over the next 12 months*. Outperform (MO2) means the stock is expected to appreciate and outperform the S&P 500 over the next 12 months; *for higher-yielding and more conservative equities, such as REITs and certain MLPs, an Outperform rating is used for securities where we are comfortable with the relative safety of the dividend and expect a total return modestly exceeding the dividend yield over the next 12 months*. Market Perform (MP3) means the stock is expected to perform generally in line with the S&P 500 over the next 12 months and is potentially a source of funds for more highly rated securities; and Underperform (MU4) means the stock is expected to underperform the S&P 500 or its sector over the next six to 12 months and should be sold.

Out of approximately 569 stocks in the Raymond James coverage universe, 54% have Strong Buy or Outperform ratings (Buy), 37% are rated Market Perform (Hold) and 9% are rated Underperform (Sell). Within those rating categories, 32% of the Strong Buy or Outperform (Buy) rated companies either currently are or have been Raymond James Investment Banking clients within the past three years; 22% of the Market Perform (Hold) rated companies are or have been clients and 20% of the Underperform (Sell) rated companies are or have been clients.

Analyst Holdings and Compensation: Equity analysts and their staffs at Raymond James are compensated based on a salary and bonus system. Several factors enter into the bonus determination including quality and performance of research product, the analyst's success in rating stocks versus an industry index, and support effectiveness to trading and the retail and institutional sales forces. Other factors may include but are not limited to: overall ratings from internal (other than investment banking) or external parties and the general productivity and revenue generated in covered stocks.

Raymond James Relationships: RJA expects to receive or intends to seek compensation for investment banking services from the subject companies in the next three months.

Company Name	Disclosure
InterOil Corp.	**Raymond James & Associates co-managed a private offering of convertible debt for InterOil Corp. in August 2004.**

Valuation Methodology: The Raymond James methodology for assigning ratings and target prices includes a number of qualitative and quantitative factors including an assessment of industry size, structure, business trends and overall attractiveness; management effectiveness; competition; visibility; financial condition, and expected total return, among other factors. These factors are subject to change depending on overall economic conditions or industry- or company-specific occurrences. Our valuation methodology for InterOil is centered on our estimate of the company's Net Asset Value (NAV) and also takes into consideration target multiples of Enterprise Value to projected 2005 EBITDA and price to projected 2005 EPS.

General Risk Factors: Following are some general risk factors that pertain to the projected 12-month target prices included on our research for stocks rated Strong Buy or Outperform: (1) Industry fundamentals with respect to customer demand or product / service pricing could change and adversely impact expected revenues and earnings; (2) Issues relating to major competitors or market shares or new product expectations could change investor attitudes toward the sector or this stock; (3) Unforeseen developments with respect to the management, financial condition or accounting policies or practices could alter the prospective valuation; or (4) External factors that affect the U.S. economy, interest rates, the U.S. dollar or major segments of the economy could alter investor confidence and investment prospects.

Specific Investment Risks Related to the Industry or Issuer

Oil And Gas Prices And OPEC
Financial and operating performance for companies in the E&P industry is affected by absolute and relative changes in oil and gas prices, which are influenced by a multitude of regional, national, and world factors. As such, future stock price performance will also be influenced by such factors. Agreements among OPEC members, including production limitations, may also affect worldwide commodity prices and financial and operational performance for companies in the E&P industry.

InterOil Corp. Risk Factors:

Share Liquidity Risk
With InterOil's small market capitalization and somewhat limited trading volume, its stock can be illiquid. As a result, for some investors, it may be difficult to buy or sell the company's shares without meaningfully moving its stock price.

Refining Margin Risk
Given that InterOil's midstream business segment currently represents the vast majority of the company's revenues, adverse fluctuations in refining margins in the South Pacific region could negatively affect the company's profitability.

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.

Exploration Risk
InterOil does not currently have any proved oil and gas reserves. The success of its upstream exploration program in Papua New Guinea is dependent on finding commercial quantities of oil and gas on its exploration acreage and on having sufficient funds, whether from internal cash flow or external sources, to fund the drilling program.

The Raymond James Energy Research Team (800) 945-6275

J. Marshall Adkins, Director of Energy Research

Wayne W. Andrews, Exploration & Production

Jeffrey L. Mobley, CFA, Exploration & Production

Jim Rollyson, Oilfield Services

John Tasdemir, Oilfield Services

John Tysseland, Midstream Suppliers

John Freeman, CFA, Sr. Research Associate

Ted Gardner, Research Associate

Darren Horowitz, Research Associate

Edward Minn, Research Associate

Pavel Molchanov, Research Associate

Parag Sanghani, Research Associate

Raymond James Investment Ratings

1. **Strong Buy**.................. Expected to appreciate and produce a total return of at least 15% and outperform the S&P 500 over the next six months. *For higher-yielding and more conservative equities, such as REITs and certain MLPs, a total return of at least 15% is expected to be realized over the next twelve months.*
2. **Outperform** .... Expected to appreciate and outperform the S&P 500 over the next twelve months. *For higher-yielding and more conservative equities, such as REITs and certain MLPs, an Outperform rating is used for securities where we are comfortable with the relative safety of the dividend and expect a total return modestly exceeding the dividend yield over the next twelve months.*
3. **Market Perform**............ Expected to perform generally in line with the S&P 500 over the next twelve months and is potentially a source of funds for more highly rated securities.
4. **Underperform** .... Expected to underperform the S&P 500 or its sector over the next six to twelve months and should be sold.

Suitability ratings are not assigned to stocks rated Underperform. Projected 12-month price targets are assigned only to stocks rated Strong Buy or Outperform.

Suitability Categories

Total Return (TR) .... More conservative investments with dividend yields of 2.5% or more and favorable appreciation prospects.

Growth (G)............................ Quality companies with well-above-average appreciation potential, quarterly earnings consistency, and possibly a small dividend.

Aggressive Growth (AG)....... Companies with rapid growth potential and accompanying higher risks.

Cyclical (C) .... Companies with fundamentals that are unusually sensitive to changes in major economic trends.

Speculative (S) .... Small companies with high risks including variable earnings, financial and competitive factors as well as liquidity issues.

Venture Risk (VR) .... Newer companies with a short, unprofitable operating history, limited revenues, and a much higher-than-normal risk associated with success.

The Raymond James Financial Center
880 Carillon Parkway, St. Petersburg, FL 33716
Institutional clients may call for additional information
Research 800-237-5643 • Trading 800-237-8426

RAYMOND JAMES
& ASSOCIATES, INC.