

May 14, 2004



## Management Discussion and Analysis

The following discussion and analysis by management of the 1st Quarter 2004 financial condition and financial results for InterOil Corporation should be read in conjunction with the unaudited Consolidated Financial Statements for the three months ended March 31, 2004 in this Interim Report and the audited Consolidated Financial Statements and Management Discussion and Analysis for the year ended December 31, 2003. The financial statements and the financial information herein have been prepared in accordance with generally accepted accounting principles in Canada and are presented in United States dollars.

### Forward Looking Statements

All statements, other than statements of historical facts, included in this release, including without limitation, statements regarding our drilling plans, business strategy, plans and objectives of management for future operations and those statements preceded by, followed by or that otherwise include the words "believe", "expects", "anticipates", "intends", "estimates" or similar expressions or variations on such expressions are forward-looking statements. The Company can give no assurances that such forward-looking statements will prove to be correct. Risks and uncertainties include, but are not limited to, the existence of underground deposits of commercial quantities of oil and gas; fluctuations in prices for oil and gas production; curtailments or delays in development due to mechanical, operating, marketing or other problems; capital expenditures that are either significantly higher or lower than anticipated because the actual cost of identified projects varied from original estimates; and from the number of exploration and development opportunities being greater or fewer than currently anticipated. InterOil currently has no reserves as defined in Canadian National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities ("NI 51-101"). All information contained herein regarding resources are references to undiscovered resources under NI 51-101, whether stated or not. See the Company's filings with the Canadian securities regulators for additional risks and information about the Company's business.

### Upstream Activities

**During the first quarter of 2004, InterOil's exploration program was focused on drilling, prospect generation, and other exploration activities.**

On December 9, 2003 InterOil spudded its second exploration well the Moose-2 located in Petroleum Prospecting License ("PPL") 238 to appraise the extent of the limestone reservoir that had oil shows in the Moose-1 well and to explore the Late Cretaceous Pale and Subu quartz sandstones primary target. As at May 11, 2004 the Moose -2 has been drilled to a depth of 1,160 meters (3,805 feet). Live oil was confirmed in Moose - 2 in the limestone reservoir, which was estimated to have been sourced from up to four possible oil sources in age. No commercial opinion on the limestone is made until further drilling and development work is undertaken on this potential reservoir.

On January 6, 2004 InterOil spudded the Sterling Mustang-1 exploration well. This will target the Late Cretaceous Pale and Subu quartz sandstones (primary) and Eocene "Mendi" Limestone with fracture porosity (secondary) target. As of May 11, 2004 the Sterling Mustang -1 has been drilled to a depth of 2,708 meters (8,884 feet). The well has encountered drilling breaks in (sandstone and possible limestone) sections above the secondary target with associated gas shows, (concentrations as high as 6.8%) in the drilling mud to surface. The gas samples have reflected a

shift in composition to heavier gas as the well is drilling deeper. The heavier composition is based on the recovery of I-Pentane and N-Pentane from samples returned to surface and recorded by Baker Hughes INTEQ. The gas shows do not confirm a commercial well, just an indication of hydrocarbon potential.

InterOil also undertook two seismic acquisition programs beginning late 2003 and extending into 2004. The seismic acquisition program commenced with the Hadina survey in November 2003 (Rhino to Mastodon) and was concluded with the completion of the Orloli program (Stegosaurus) in January 2004. The Hadina survey in PPL 238 consisted of 29 line-km (17 line-miles) covering the Rhino, Mammoth and Mastodon structures. The Orloli survey across the Stegosaurus structure in PPL 237 consisted of 8 line-kms (5 line-miles). Initial data processing was completed in February 2004, showing good to excellent 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 this method can be used to high-grade prospects for future seismic acquisition or drilling. The benefit of gravity data is that it can be acquired at a fraction of the cost of seismic data. As a result of this effort, work was done on the Marlin prospect in PPL236 to upgrade the prospect to drillable by the company.

Additional drill site locations on two structures located in PPL 238 have been identified for drilling and the preparations of the drill sites have been completed.

### [Midstream Activities](#)

**The refinery construction is almost complete.**

As at March 31, 2004 the refinery construction had progressed to overall 95 percent complete, and has progressed to 97 percent complete at May 2004. Progress in pre-commissioning activities continued throughout the quarter and is assessed at 69 percent complete at May 2004. The program to completion currently targets initial start-up in June and the EPC (Engineering Procurement, & Construction) contractor has indicated their preparedness to accept the first shipment of crude oil for the start-up of the Crude Distillation unit in early June.

The first crude oil shipment has been scheduled to arrive at the refinery in early June to meet the contractors schedule and will be PNG sourced Kutubu Blend crude. A second crude oil shipment has also been scheduled for later in June and will subsequently be followed by regular shipments as the refinery moves towards full production.

### [Downstream Activities](#)

**InterOil Products Limited (IPL) formed after BP transaction finalized.**

On March 10, 2004 InterOil announced that it had entered into a share sale agreement with BP plc to acquire BP's PNG subsidiary, BP Papua New Guinea Limited, including all its petroleum distribution assets and operations in Papua New Guinea. This transaction is valued at US\$11.3 million for assets and inventory, consisting of US\$4 million in assets and US\$7.3 million in inventory. A down payment of US\$1 million was due upon transfer date (after satisfaction of all statutory approvals), with the balance of funds payable twelve months from the effective date (March 1, 2004). Included in the purchase are the 2003 retained profits of approximately US\$4.3 million (Kina 14 million), and retained profits for the first two months of 2004. These amounts will be repaid to BP, no later than twelve months after the effective date, from proceeds obtained in

collecting the closing accounts receivable balance. The asset portfolio comprises 3 terminals, 7 depots and over 40 retail sites. InterOil will be assisted in assuming management and control of the company by the secondment of existing key BP management to ensure a seamless transfer over the following year.

On April 29, 2004 InterOil announced that, after receiving all necessary PNG Government approvals and completing all other required conditions, it's wholly owned subsidiary, S.P.I. Distribution Limited, has finalized the acquisition of BP Papua New Guinea Limited. The date of transfer of shares was April 28, 2004. The company has been renamed InterOil Products Limited.

BP Papua New Guinea Limited financial information for the current period and year ending December 31, 2003:

	3 months ended March 31, 2004		Year ended December 31, 2003	
	Kina	USD <sup>(1)</sup>	Kina	USD <sup>(1)</sup>
Total Revenue	60,881,504	18,769,768	243,707,206	75,134,932
Income from Operations	60,453,291	18,637,750	242,360,861	74,719,853
Net Income (loss)	4,076,827	1,256,886	30,276,293	9,334,181
Total Assets	88,340,974	27,235,522	82,728,000	25,505,042
Long-term Debt	nil	nil	nil	nil

<sup>(1)</sup>Kina/USD exchange rate at March 31, 2004 is 0.308

### InterOil Corporation Consolidated Results Summary

InterOil is considered to be in the construction and pre-operating stage of development of the refinery in Papua New Guinea. No significant operating activities have been undertaken to date. InterOil's revenue generated to date is primarily interest on investments as the company is presently in the construction and development stage. There was a net loss of \$1,644,927 in the first quarter of 2004 compared to a net gain of \$171,073 for the same period in 2003 which difference was mainly attributable to P.I.E. Corporation, a related party, waiving prior years' management fees totaling US\$840,000 in the first quarter 2003, and the current period not recognizing an adjustment of this nature. Legal and professional fees were \$592,127 in the first quarter of 2004 compared with \$168,993 in the first quarter 2003. The higher costs were associated with expenses related to the equity capital raisings completed in the prior year that matured subsequent to December 31, 2003. The foreign exchange loss was minimal in the first quarter of 2004 due to both the Australian Dollar and the Papua New Guinea Kina exchange rates to the US Dollar at March 31, 2004 being alike the rates at December 31, 2003.

Quarters Ended	31-Mar-04	31-Dec-03	30-Sep-03	30-Jun-03	31-Mar-03	30-Dec-02	30-Sep-02	30-Jun-02
Total Revenue	155,596	203,964	13,349	27,717	14,250	(4,373)	92,922	133,037
Income from Operations	nil	nil	nil	nil	nil	nil	nil	nil
Net Profit (loss)	(1,644,927)	(1,489,036)	(1,510,516)	(689,090)	171,073	(228,404)	(1,148,882)	(40,154)
<b>Net Profit (loss) per Share</b>	<b>(0.07)</b>	<b>(0.06)</b>	<b>(0.06)</b>	<b>(0.03)</b>	<b>0.01</b>	<b>(0.01)</b>	<b>(0.06)</b>	<b>(0.00)</b>

Total assets increased to \$265,510,805 at March 31, 2004 compared to \$260,339,851 at December 31, 2003. The predominant portion of the assets is the capital expenditures related to the refinery development and construction costs along with the capitalized oil and gas exploration expenditures. A total of \$5.7 million of refinery development and construction costs were capitalized in the period compared to \$14 million capitalized in the prior quarter. The level of capitalized construction costs will be lower as the refinery construction nears completion.

InterOil follows the successful efforts method of accounting for expenditures related to oil and gas exploration and development activities, which are capitalized and carried forward where they are expected to be recouped through successful development, or by sale, or where exploration and evaluation activities have not reached a stage to allow reasonable assessment regarding the existence of economical reserves. The company capitalized \$9.7 million of drilling and exploration costs in the period.

InterOil's long-term debt consists of amounts drawn under the US\$85 million Project Financing Facility obtained in June 2001 from the Overseas Private Investment Corporation ("OPIC"), an agency of the US Government, to support the development of the refinery, and the indirect participation interests in the company's Phase One Exploration Program. OPIC is the primary lender of capital to the refinery project. US\$83 million had been drawn under the facility as at March 31, 2004. Semi-annual interest and principal repayments of US\$4.5 million are currently scheduled to commence on June 30, 2004. The interest rate is equal to the US treasury cost applicable to each promissory note established at time of disbursement plus 3.0% per annum prior to the refinery completion and 3.5% per annum on and after refinery completion. In 2003, two separate indirect participation interests totaling US\$19.8 million were granted to independent investors, PNG Energy Investors LLC and PNG Drilling Ventures Limited, each of which may elect to convert their interests into a working interest in the drilling program, debt or InterOil common shares.

#### Liquidity and Capital Resources

InterOil ended the March 31, 2004 quarter with approximately US\$24.0 million in cash and temporary investments compared to approximately US\$34.0 million in cash at December 31, 2003.

OPIC remains the primary lender of capital to the refinery project. To provide funding for InterOil's ongoing exploration and production activities in PNG and general corporate purposes capital has been raised through three private placements in 2003. In addition to the private placements, capital was raised from indirect participation interests in InterOil's Phase One Exploration Program, of which the balance of \$3.2 million was received in the first quarter of 2004. During the period cash was spent on refinery construction, development costs, oil and gas exploration expenses, and administrative and general costs.

The capital budget of the refinery project is currently:

	US\$ (millions)
Capital Costs	\$197.4
Finance Costs	\$8.0
Funded Debt Service Reserve Account	\$9.0
Total	\$ 214.4

Of the \$214.4 million capital budget, approximately \$202 million in equipment and development costs have been paid as of March 31, 2004.

InterOil remains confident that it has the resources to complete the refinery as well as meet all its requirements associated with the obligations for the refinery and exploration program in the fiscal year of 2004.

In March 2004 InterOil obtained final credit approval to structure and arrange, on an exclusive basis, a US\$60 million revolving crude oil procurement facility with BNP Paribas (Singapore) to

finance the crude feedstock for the refinery, and is currently working on final documentation of the facility.

## Share Capital

The authorized share capital of the company consists of an unlimited number of common shares with no par value. The issued and outstanding shares of InterOil, and reconciled to January 1, 2003, are set out below:

	Number of Shares	\$
<b>Balance, 31 December 2002</b>	<b>20,585,943</b>	\$94,120,609
Shares issued for Cash	3,817,500	<b>\$61,060,640</b>
Shares issued for Debt	31,240	<b>\$316,359</b>
Shares issued on exercise of Options	381,278	<b>\$1,951,592</b>
<b>Balance, 31 December 2003</b>	<b>24,815,961</b>	\$157,449,200
Shares issued for Cash	Nil	<b>Nil</b>
Shares issued for Debt	5,000	<b>75,500</b>
Shares issued on exercise of Options	10,500	<b>60,125</b>
Balance, 31 March 2004	24,831,461	\$157,584,825

## Risks and Uncertainties

Please refer to the 2003 Annual Report for detailed information as the economic and industry factors are substantially unchanged.

## Outlook

The refinery project is now overall 97 percent complete and pre-commissioning activities are well advanced. The first shipment of crude oil supply for the refinery is scheduled for to arrive at the refinery for the start-up of the Crude Distillation unit in early June.

Other oil exploration prospects, such as Rhino and Mastodon, have been confirmed with seismic and field geology. Drilling sites have been prepared at Longhorn and Bison and site work has also begun on Elk. InterOil has established the organization, infrastructure and inventory of materials to support the drilling program. Whilst the early signs are encouraging, the well results will determine the direction of the drilling program and appraisal work will be required to determine the timing of development of any discoveries.

The acquisition of BP Papua New Guinea Limited has been finalized following the date of transfer of shares which was April 28, 2004 and the company has been renamed InterOil Products LTD.

Additional information, including is available on the InterOil website at: [www.interoil.com](http://www.interoil.com) and on SEDAR at: [www.sedar.com](http://www.sedar.com).