

# **InterOil Corporation**

## **Consolidated Financial Statements**

(Unaudited, Expressed in United States dollars)

Quarter and six months ended June 30, 2009 and 2008



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(Unaudited, Expressed in United States dollars)



**Table of contents**

Consolidated Balance Sheets	1
Consolidated Statements of Operations	2
Consolidated Statements of Cash Flows	3
Consolidated Statements of Shareholders' Equity	4
Consolidated Statements of Comprehensive Income	5
Notes to the Consolidated Financial Statements	6

# InterOil Corporation

## Consolidated Balance Sheets

(Unaudited, Expressed in United States dollars)



As at

	June 30, 2009	December 31, 2008	June 30, 2008
	\$	\$	\$
<b>Assets</b>			
Current assets:			
Cash and cash equivalents (note 5)	96,350,890	48,970,572	28,811,249
Cash restricted (note 7)	14,520,001	25,994,258	26,016,420
Trade receivables (note 8)	40,126,498	42,887,823	127,615,875
Commodity derivative contracts (note 7)	-	31,335,050	-
Other assets	698,090	167,885	225,009
Inventories (note 9)	114,045,411	83,037,326	74,880,778
Prepaid expenses	2,834,453	4,489,574	5,423,470
<b>Total current assets</b>	<b>268,575,343</b>	<b>236,882,488</b>	<b>262,972,801</b>
Cash restricted (note 7)	6,844,439	290,782	361,881
Goodwill (note 14)	5,761,940	-	-
Plant and equipment (note 10)	221,294,736	223,585,559	228,201,543
Oil and gas properties (note 11)	157,877,004	128,013,959	102,072,439
Future income tax benefit	2,057,298	3,070,182	2,819,591
<b>Total assets</b>	<b>662,410,760</b>	<b>591,842,970</b>	<b>596,428,255</b>
<b>Liabilities and shareholders' equity</b>			
Current liabilities:			
Accounts payable and accrued liabilities (note 12)	131,807,259	78,147,736	67,160,639
Commodity derivative contracts (note 7)	-	-	11,847,200
Working capital facility (note 15)	3,962,238	68,792,402	74,058,565
Current portion of secured loan (note 18)	9,000,000	9,000,000	9,000,000
Current portion of indirect participation interest - PNGDV (note 19)	540,002	540,002	540,002
<b>Total current liabilities</b>	<b>145,309,499</b>	<b>156,480,140</b>	<b>162,606,406</b>
Secured loan (note 18)	47,977,305	52,365,333	56,753,361
8% subordinated debenture liability (note 23)	-	65,040,067	76,516,300
Preference share liability (note 22)	-	-	7,797,312
Deferred gain on contributions to LNG project (note 13)	13,076,272	17,497,110	12,203,867
Indirect participation interest (note 19)	70,048,179	72,476,668	87,877,831
Indirect participation interest - PNGDV (note 19)	844,490	844,490	844,490
<b>Total liabilities</b>	<b>277,255,745</b>	<b>364,703,808</b>	<b>404,599,567</b>
Non-controlling interest (note 20)	9,230	5,235	6,151
<b>Shareholders' equity:</b>			
Share capital (note 21)	540,082,767	373,904,356	324,855,607
Authorised - unlimited			
Issued and outstanding - 41,848,889			
(Dec 31, 2008 - 35,923,692)			
(Jun 30, 2008 - 34,000,180)			
Preference shares (note 22)	-	-	6,842,688
(Authorised - 1,035,554, issued and outstanding - nil)			
8% subordinated debentures (note 23)	-	10,837,394	13,036,434
Contributed surplus (note 24)	17,357,873	15,621,767	12,512,478
Warrants (note 25)	2,119,034	2,119,034	2,119,034
Accumulated Other Comprehensive Income	16,551,491	27,698,306	7,800,935
Conversion options (note 19)	17,140,000	17,140,000	19,840,000
Accumulated deficit	(208,105,380)	(220,186,930)	(195,184,639)
<b>Total shareholders' equity</b>	<b>385,145,785</b>	<b>227,133,927</b>	<b>191,822,537</b>
<b>Total liabilities and shareholders' equity</b>	<b>662,410,760</b>	<b>591,842,970</b>	<b>596,428,255</b>

See accompanying notes to the consolidated financial statements. Commitments and contingencies (note 27), Going Concern (note 2(b))

On behalf of the Board - Phil Mulacek, Director Christian Vinson, Director

# InterOil Corporation

## Consolidated Statement of Operations

(Unaudited, Expressed in United States dollars)



	Quarter ended		Six months ended	
	June 30, 2009 \$	June 30, 2008 \$	June 30, 2009 \$	June 30, 2008 \$
<b>Revenue</b>				
Sales and operating revenues	147,570,673	243,657,490	308,411,228	435,029,765
Interest	89,058	439,751	165,119	756,279
Other	836,246	916,110	1,581,957	1,641,404
	<b>148,495,977</b>	<b>245,013,351</b>	<b>310,158,304</b>	<b>437,427,448</b>
<b>Expenses</b>				
Cost of sales and operating expenses	126,007,123	206,213,757	262,417,838	383,197,441
Administrative and general expenses	7,454,273	11,038,893	14,617,065	16,296,642
Derivative losses/(gains)	345,650	9,010,951	(931,060)	10,629,376
Legal and professional fees	2,607,296	3,849,293	3,847,982	5,956,524
Exploration costs, excluding exploration impairment (note 11)	31,075	83,191	247,121	(154,077)
Exploration impairment (note 11)	-	(14,052)	-	11,279
Short term borrowing costs	782,556	2,050,022	1,847,351	3,662,066
Long term borrowing costs	2,861,819	4,083,348	6,432,965	8,485,202
Depreciation and amortization	3,773,772	3,439,684	7,154,347	6,924,442
Gain on sale of oil and gas properties (note 11)	(1,087,483)	(10,245,533)	(1,087,483)	(10,245,533)
Foreign exchange (gain)/loss	(5,284,183)	(3,484,037)	1,105,731	(4,784,214)
	<b>137,491,898</b>	<b>226,025,517</b>	<b>295,651,857</b>	<b>419,979,148</b>
<b>Income before income taxes and non-controlling interest</b>	<b>11,004,079</b>	<b>18,987,834</b>	<b>14,506,447</b>	<b>17,448,300</b>
Income taxes				
Current	(1,686,815)	(3,183,469)	(998,699)	(4,025,799)
Future	122,731	(199,745)	(1,422,203)	(215,428)
	<b>(1,564,084)</b>	<b>(3,383,214)</b>	<b>(2,420,902)</b>	<b>(4,241,227)</b>
<b>Income before non-controlling interest</b>	<b>9,439,995</b>	<b>15,604,620</b>	<b>12,085,545</b>	<b>13,207,073</b>
Non-controlling interest (note 20)	(1,925)	(2,044)	(3,995)	(1,859)
<b>Net income</b>	<b>9,438,070</b>	<b>15,602,576</b>	<b>12,081,550</b>	<b>13,205,214</b>
<b>Basic income per share (note 26)</b>	<b>0.25</b>	<b>0.48</b>	<b>0.32</b>	<b>0.41</b>
<b>Diluted income per share (note 26)</b>	<b>0.24</b>	<b>0.40</b>	<b>0.32</b>	<b>0.36</b>
<b>Weighted average number of common shares outstanding</b>				
Basic	38,244,238	32,720,492	37,216,877	31,873,424
Basic and diluted	38,946,516	38,629,556	37,724,806	36,781,249

See accompanying notes to the consolidated financial statements

# InterOil Corporation

## Consolidated Statement of Cash Flows

(Unaudited, Expressed in United States dollars)



	Quarter ended		Six months ended	
	June 30,	June 30,	June 30,	June 30,
	2009	2008	2009	2008
	\$	\$	\$	\$
Cash flows provided by (used in):				
<b>Operating activities</b>				
Net profit	9,438,070	15,602,576	12,081,550	13,205,214
<b>Adjustments for non-cash and non-operating transactions</b>				
Non-controlling interest	1,925	2,044	3,995	1,859
Depreciation and amortization	3,773,772	3,439,684	7,154,347	6,924,442
Future income tax asset	683,427	76,531	1,012,884	47,721
Gain on sale of plant and equipment	-	-	-	(16,250)
Gain on sale of exploration assets	(1,087,483)	(10,245,533)	(1,087,483)	(10,245,533)
Amortization of discount on debentures liability	484,489	472,700	1,212,262	472,700
Amortization of deferred financing costs	55,986	64,320	111,972	148,428
Gain on unsettled hedge contracts	(283,900)	(154,849)	(208,800)	(154,849)
Timing difference between derivatives recognised and settled	(265,400)	6,824,675	15,074,050	6,554,700
Stock compensation expense	1,892,759	1,536,178	3,317,212	2,241,425
Inventory revaluation	(205,546)	-	-	-
Non-cash interest on secured loan facility	-	605,868	-	2,189,907
Non-cash interest settlement on preference shares	-	186,475	-	186,475
Non-cash interest settlement on debentures	2,352,084	-	2,352,084	-
Oil and gas properties expensed	31,075	69,139	247,121	(142,798)
Loss/(gain) on proportionate consolidation of LNG project	-	-	724,357	(236,666)
Unrealized foreign exchange gain	(1,967,988)	(3,484,037)	(3,901,133)	(4,784,214)
<b>Change in operating working capital</b>				
Decrease/(increase) in trade receivables	3,761,094	(34,394,001)	1,945,982	(58,665,410)
(Decrease)/increase in unrealised hedge gains	(4,008,175)	-	6,268,950	-
Decrease/(increase) in other assets and prepaid expenses	104,229	(3,053,296)	1,124,916	(398,947)
(Increase)/decrease in inventories	(34,020,246)	64,398,765	(27,306,167)	17,072,100
Increase/(decrease) in accounts payable, accrued liabilities and income tax payable	84,367,580	(74,607,339)	58,598,130	3,044,741
<b>Net cash from/(used in) operating activities</b>	<b>65,107,752</b>	<b>(32,660,100)</b>	<b>78,726,229</b>	<b>(22,554,955)</b>
<b>Investing activities</b>				
Expenditure on oil and gas properties	(20,054,923)	(14,880,064)	(43,675,787)	(29,067,251)
Proceeds from IPI cash calls	3,603,284	-	5,575,534	4,340,000
Expenditure on plant and equipment	(5,138,243)	(1,565,972)	(4,863,524)	(2,570,013)
Proceeds received on sale of assets	-	-	-	312,500
Proceeds received on sale of exploration assets	-	1,500,000	-	1,500,000
(Increase)/decrease in restricted cash held as security on borrowings	(3,982,816)	(6,013,771)	4,920,600	(3,993,941)
Change in non-cash working capital				
(Decrease)/increase in accounts payable and accrued liabilities	(11,038,843)	(924,866)	(5,890,357)	1,565,416
<b>Net cash used in investing activities</b>	<b>(36,611,541)</b>	<b>(21,884,673)</b>	<b>(43,933,534)</b>	<b>(27,913,289)</b>
<b>Financing activities</b>				
Repayments of secured loan	(4,500,000)	(4,500,000)	(4,500,000)	(4,500,000)
Repayments of bridging facility, net of transaction costs	-	(70,000,000)	-	(70,000,000)
Proceeds from PNG LNG cash call	-	875,500	-	3,502,000
Proceeds from Clarion Finanz for Elk option agreement	-	4,500,000	3,577,288	4,500,000
Proceeds from Petromin for Elk participation agreement	1,000,000	-	4,435,000	-
(Repayments of)/proceeds from working capital facility	(39,358,309)	41,032,787	(64,830,164)	7,557,193
Proceeds from issue of common shares/conversion of debt, net of transaction costs	68,068,669	(421,496)	73,905,499	(421,496)
Proceeds from issue of debentures, net of transaction costs	-	94,780,034	-	94,780,034
<b>Net cash from financing activities</b>	<b>25,210,360</b>	<b>66,266,825</b>	<b>12,587,623</b>	<b>35,417,731</b>
Increase/(decrease) in cash and cash equivalents	53,706,571	11,722,052	47,380,318	(15,050,513)
Cash and cash equivalents, beginning of period	42,644,319	17,089,197	48,970,572	43,861,762
Cash and cash equivalents, end of period (note 5)	96,350,890	28,811,249	96,350,890	28,811,249

See accompanying notes to the consolidated financial statements

See note 6 for non cash financing and investing activities

**InterOil Corporation**  
**Consolidated Statements of Shareholders' Equity**  
(Unaudited, Expressed in United States dollars)



	Six months ended	Year ended	Six months ended
	June 30,	December 31,	June 30,
	2009	2008	2008
	\$	\$	\$
<b>Share capital</b>			
At beginning of period	373,904,356	259,324,133	259,324,133
Issue of capital stock (note 21)	166,178,411	114,580,223	65,531,474
At end of period	540,082,767	373,904,356	324,855,607
<b>Preference shares</b>			
At beginning of period	-	6,842,688	6,842,688
Converted to common shares (note 22)	-	(6,842,688)	-
At end of period	-	-	6,842,688
<b>8% subordinated debentures</b>			
At beginning of period	10,837,394	-	-
Issue of debentures (note 23)	-	13,036,434	-
Conversion to common shares during the year	(10,837,394)	(2,199,040)	13,036,434
At end of period	-	10,837,394	13,036,434
<b>Contributed surplus</b>			
At beginning of period	15,621,767	10,337,548	10,337,548
Fair value of options exercised transferred to share capital (note 24)	(1,581,105)	(456,867)	(66,495)
Stock compensation expense (note 24)	3,317,211	5,741,086	2,241,425
At end of period	17,357,873	15,621,767	12,512,478
<b>Warrants</b>			
At beginning of period (note 25)	2,119,034	2,119,034	2,119,034
Movement for period	-	-	-
At end of period	2,119,034	2,119,034	2,119,034
<b>Accumulated Other Comprehensive Income</b>			
<i>Deferred hedge gain/(loss)</i>			
At beginning of period	18,012,500	-	-
Deferred hedge movement for period, net of tax (note 7)	(10,200,850)	18,012,500	(3,487,049)
Deferred hedge gain/(loss) at end of period	7,811,650	18,012,500	(3,487,049)
<i>Foreign currency translation reserve</i>			
At beginning of period	9,685,806	6,025,019	6,025,019
Foreign currency translation movement for period, net of tax	(945,965)	3,660,787	5,262,965
Foreign currency translation reserve at end of period	8,739,841	9,685,806	11,287,984
Accumulated other comprehensive income at end of period	16,551,491	27,698,306	7,800,935
<b>Conversion options</b>			
At beginning of period	17,140,000	19,840,000	19,840,000
Movement for period (note 19)	-	(2,700,000)	-
At end of period	17,140,000	17,140,000	19,840,000
<b>Accumulated deficit</b>			
At beginning of period	(220,186,930)	(208,389,853)	(208,389,853)
Net income/(loss) for period	12,081,550	(11,797,077)	13,205,214
At end of period	(208,105,380)	(220,186,930)	(195,184,639)
<b>Shareholders' equity at end of period</b>	<b>385,145,785</b>	<b>227,133,927</b>	<b>191,822,537</b>

See accompanying notes to the consolidated financial statements

# InterOil Corporation

## Consolidated Statements of Comprehensive Income

(Unaudited, Expressed in United States dollars)



	Quarter ended		Six months ended	
	June 30, 2009 \$	June 30, 2008 \$	June 30, 2009 \$	June 30, 2008 \$
<b>Net income as per Statement of Operations</b>	9,438,070	15,602,576	12,081,550	13,205,214
Other comprehensive income/(loss), net of tax	1,090,988	566,812	(11,146,815)	1,775,916
<b>Comprehensive income</b>	<b>10,529,058</b>	<b>16,169,388</b>	<b>934,735</b>	<b>14,981,130</b>

*See accompanying notes to the consolidated financial statements*

# InterOil Corporation

## Notes to Consolidated Financial Statements (Unaudited, Expressed in United States dollars)



### 1. Nature of operations and organization

InterOil Corporation (the "Company" or "InterOil") is a publicly traded, integrated oil and gas company operating in Papua New Guinea ("PNG").

Management has organized the Company's operations into four major segments - Upstream, Midstream, Downstream and Corporate.

Upstream includes Exploration and Production operations for crude oil and natural gas in PNG. Midstream Refining includes refining of products for domestic market in Papua New Guinea and exports, and Midstream Liquefaction includes the work being undertaken to further the LNG project in PNG. Downstream includes Wholesale and Retail Distribution of refined products in PNG. Corporate engages in business development and improvement, common services and management, financing and treasury, government and investor relations. Common and integrated costs are recovered from business segments on an equitable driver basis.

### 2. Significant accounting policies

The principal accounting policies adopted in the preparation of the financial report are set out below. These policies have been consistently applied for all years presented, unless otherwise stated.

#### (a) Basis of preparation

These financial statements are prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") applicable to a going concern.

The consolidated financial statements for the six months ended June 30, 2009 are in accordance with Canadian GAAP which requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying Company's accounting policies. These estimates and judgments may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from these estimates. The effect of changes in estimates on future periods have not been disclosed in these consolidated financial statements as estimating it is impracticable.

#### **Rate Regulation**

InterOil is currently the sole refiner of hydrocarbons in Papua New Guinea under our 30 year agreement with the Papua New Guinea Government, which expires in 2035. The government has undertaken to ensure that all domestic distributors purchase their refined petroleum products from our refinery, or any other refinery which is constructed in Papua New Guinea, at an Import Parity Price ('IPP'). The IPP is regulated by the Papua New Guinea Independent Consumer and Competition Commission ('ICCC'). In general, the IPP is the price that would be paid in Papua New Guinea for a refined product being imported. For all price controlled products (diesel, unleaded petrol, kerosene and aviation fuel) produced and sold locally in Papua New Guinea, the IPP is calculated by adding the costs that would typically be incurred to import such product to the posted price for such product in Singapore. In November 2007, the IPP was modified by interim agreement by changing the Singapore benchmark price from the 'Singapore Posted Prices' which is no longer being updated, to 'Mean of Platts Singapore' ('MOPS') which is the interim benchmark price for refined products in the region in which we operate. As revised, the IPP more closely mirrors changes in the prices of crude feedstocks than the previous formula. In addition, minor adjustments to this interim IPP formula were made in June 2008 based on ongoing discussions with the government with a view to finalizing a permanent replacement to the IPP formula.

InterOil is also a significant participant in the retail and wholesale distribution business in Papua New Guinea. The ICCC regulates the maximum prices that may be charged by the wholesale and retail hydrocarbon distribution industry in Papua New Guinea. Our Downstream business may charge less than the maximum margin set by the ICCC in order to maintain its competitiveness with other participants in the market.

No rate regulated assets or liabilities have been recognized as any gains or losses made due to rate regulation are to the Company's account, and are not repayable/recoverable in the future.



**2. Significant accounting policies (cont'd)**

**(b) Going concern**

These consolidated financial statements have been prepared using Canadian GAAP applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they become due.

For the six months ended June 30, 2009, the Company reported a profit of \$12.1 million as compared to a profit of \$13.2 million for the same period of 2008. The total operating cash inflow was \$78.7 million for the six months compared to an outflow of \$22.6 million in the same period of 2008. The Company reported a net operating cash inflow, before working capital movements, of \$38.1 million for the six months compared to \$16.4 million in the same period of 2008. The net current assets balance as at June 30, 2009 was \$129.8 million compared to \$100.4 million as at June 30, 2008.

The Company has cash, cash equivalents and cash restricted of \$117.7 million as at June 30, 2009 (June 2008 - \$55.2 million), of which \$21.4 million is restricted (June 2008 - \$26.4 million). The Company has a short term working capital facility of \$190.0 million for its Midstream – Refining operation that is renewable annually with BNP Paribas. This facility is secured by the assets it is drawn down against. As at June 30, 2009 only \$72.6 million of this facility has been utilized, and the remaining facility remains available for use. This facility is due to be renewed in August 2009. During 2008 the Company also secured a \$56.0 million (Papua New Guinea Kina 150.0 million) revolving working capital facility for its Downstream operations in Papua New Guinea from Bank of South Pacific Limited and Westpac Bank PNG Limited. Westpac facility limit is Papua New Guinea Kina 80.0 million (approximately \$29.9 million) and BSP facility limit is Papua New Guinea Kina 70.0 million (approximately \$26.1 million). The Westpac facility is for an initial term of three years and is due for renewal in October 2011. The BSP facility is renewable annually and is due for renewal in August 2009. As at June 30, 2009 only \$4.0 million of this combined facility has been utilized, and the remaining facility remains available for use. Management expects these facilities to be renewed in due course as these working capital facilities are fully secured against trade debtors, inventory and cash deposits.

With respect to its Upstream operations, the Company has no obligation to execute exploration activities within a set timeframe and therefore has the ability to postpone these activities in the event sufficient funding is not available.

The Company believes that it has sufficient funds for the Midstream Refinery and Downstream operations; however, existing cash balances and ongoing cash generated from operations will not be sufficient to facilitate further development of the Elk/Antelope well prospect and the Midstream Liquefaction LNG plant development. Therefore the Company must extend or secure sufficient funding through renewed borrowings, equity raising and or asset sales to enable sufficient cash to be available to further its development plans. Management expects that the Company will be able to secure the necessary financing through one of, or a combination of the aforementioned alternatives. Accordingly, these financial statements have been prepared on a going concern basis in the belief that the Company will realize its assets and settle its liabilities and commitments in the normal course of business and for at least the amounts stated.

**(c) Principles of consolidation**

The accounting principles applied to the consolidated interim financial statements are consistent with those described in note 2 of the audited consolidated financial statements for the year ended December 31, 2008. Certain information and disclosures normally required in the notes to the annual financial statements have been condensed or omitted, and therefore, these interim financial statements and notes thereto should be read in conjunction with the audited financial statements for the year ended December 31, 2008.

**(d) Changes in accounting policies**

Based on the detailed review conducted by the Company of the new CICA sections, or revisions to current sections, that are effective January 1, 2009, no items have been identified as having any material impact on the Company's financial statements.

**(e) Reclassification**

Certain prior years' amounts have been reclassified to conform to current presentation.



**3. Financial Risk Management**

The Company's activities expose it to a variety of financial risks; market risk, credit risk, liquidity risk and cash flow interest rate risk. The Company's overall risk management program focuses on the unpredictability of markets and seeks to minimize potential adverse effects on the financial performance of the Company. The Company uses derivative financial instruments to hedge certain price risk exposures. Risk Management is carried out by the Finance Department, and monitored by the Audit Committee, under policies approved by the Board of Directors. The Finance Department identifies, evaluates and hedges financial risks in close cooperation with the Company's operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as use of derivative financial instruments.

**(a) Market risk**

**(i) Foreign exchange risk**

Foreign exchange risk arises when future commercial transactions and recognized assets and liabilities are denominated in a currency that is not the Company's functional currency. The Company operates internationally and is exposed to foreign exchange risk arising from currency exposures to the United States Dollar.

Most of the Company's transactions are undertaken in United States Dollars (USD) and Papua New Guinea Kina (PGK). Currently there are no foreign exchange hedge programmes in place. The Papua New Guinea Kina exposures are minimal at the transactional level as the Downstream sales in local currency are used to adequately cover the operating expenses of the Midstream refinery and Downstream operations. However, the translation of USD intercompany balances in PGK operating entities at period ends can result in material impact on the foreign exchange gains/losses on consolidation.

Changes in the PGK to USD exchange rate can affect our Midstream refinery results as there is a timing difference between the foreign exchange rates utilized when setting the monthly PGK IPP price and the foreign exchange rate used to convert the subsequent receipt of PGK proceeds to USD to repay our crude cargo borrowings. The foreign exchange movement also impacts equity as translation gains/losses of our Downstream operations from PGK to USD is included in other comprehensive income as these are self-sustaining operations. The PGK weakened against the USD during the three months ended March 31, 2009 (from 0.3735 to 0.3400). However, it then strengthened against the USD during the three months ended June 30, 2009 (from 0.3400 to 0.3735).

The financial instruments denominated in Papua New Guinea Kina are as follows:

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
<b>Financial Assets</b>			
Cash and cash equivalents	12,435,693	28,865,339	13,158,616
Receivables	34,668,252	39,307,624	68,990,167
Other financial assets	2,347,852	3,348,716	183,148
<b>Financial liabilities</b>			
Payables	15,606,712	17,766,660	34,140,578
Working capital facility	3,962,238	15,405,627	-

The following table summarizes the sensitivity of financial instruments held at balance sheet date to movement in the exchange rate of the US dollar to the Papua New Guinea Kina, with all other variables held constant. Certain USD debt and other financial assets and liabilities, including intra-group balances, are not held in the functional currency of the relevant subsidiary. This results in an accounting exposure to exchange gains and losses as the financial assets and liabilities are translated into the functional currency of the subsidiary that accounts for those assets and liabilities. These exchange gains and losses are recorded in the consolidated income statement except to the extent that they can be taken to equity under the Company's accounting policy. If PGK strengthens against the USD, it will result in a gain, and vice versa.

**InterOil Corporation**  
**Notes to Consolidated Financial Statements**  
**(Unaudited, Expressed in United States dollars)**



**3. Financial Risk Management (cont'd)**

	Six months ended June 30, 2009		Six months ended June 30, 2008	
	Impact on profit	Impact on equity - excluding profit impact	Impact on profit	Impact on equity - excluding profit impact
	\$	\$	\$	\$
<b>Post-tax gain/(loss)</b>				
USD/PGK - effect of 5% change	1,829,431	1,098,624	5,461,264	3,947,224

**(ii) Price risk**

The Midstream refining operations of the Company are largely exposed to price fluctuations during the period between the crude purchases and the refined products leaving the refinery on sales to Downstream operations and other distributors. The Company actively tries to manage the price risk by entering into derivative contracts to buy and sell crude and finished products.

The derivative contracts are entered into by Management based on documented risk management strategies which have been approved by the Risk Management Committee. All derivative contracts entered into are reviewed by the Risk Management Committee as part of the meetings of the Committee.

The following table summarizes the sensitivity of the crude and finished product inventory held at balance date to \$10.0 movement in benchmark pricing, with all other variables held constant.

	Six months ended June 30, 2009		Six months ended June 30, 2008	
	Impact on profit	Impact on equity - excluding profit impact	Impact on profit	Impact on equity - excluding profit impact
	\$	\$	\$	\$
<b>Post-tax gain/(loss)</b>				
\$10 increase in benchmark pricing	9,548,387	-	7,265,780	-

**(iii) Interest rate risk**

Interest rate risk is the risk that the Company's financial position will be adversely affected by movements in interest rates that will increase the cost of floating rate debt or opportunity losses that may arise on fixed rate borrowings in a falling interest rate environment.

As the Company has no significant interest-bearing assets other than cash and cash equivalents, the Company's income and operating cash flows are substantially independent of changes in market interest rates.

The Company's interest-rate risk arises from borrowings and working capital financing facilities. Borrowings issued at variable rates expose the Company to cash flow interest-rate risk. Borrowings issued at fixed rates expose the Company to fair value interest-rate risk. The Company is actively seeking to manage its cash flow interest-rate risks.

The financial instruments exposed to cash flow and fair value interest rate risk are as follows:

	June 30, 2009	December 31, 2008	June 30, 2008	Cash flow/fair value interest rate risk
	\$	\$	\$	
<b>Financial Assets</b>				
Cash and cash equivalents	4,118,131	6,571,375	3,729,222	fair value interest rate risk
Cash and cash equivalents	92,232,759	42,399,197	25,082,027	cash flow interest rate risk
Cash restricted	341,866	290,782	361,880	fair value interest rate risk
Cash restricted	21,022,574	25,994,258	26,016,421	cash flow interest rate risk
<b>Financial liabilities</b>				
OPIC secured loan	58,000,000	62,500,000	67,000,000	fair value interest rate risk
BNP working capital facility	-	53,386,775	74,058,565	cash flow interest rate risk
Westpac working capital facility	3,962,238	15,405,627	-	cash flow interest rate risk
BSP working capital facility	-	-	-	cash flow interest rate risk
8% subordinated debentures	-	78,975,000	95,000,000	fair value interest rate risk

### 3. Financial Risk Management (cont'd)

The following table summarizes the sensitivity of the cash flow interest-rate risk of financial instruments held at balance date, following a movement to LIBOR, with all other variables held constant. Increase in LIBOR rates will result in a higher expense for the Company.

	Six months ended June 30, 2009		Six months ended June 30, 2008	
	Impact on profit \$	Impact on equity - excluding profit impact \$	Impact on profit \$	Impact on equity - excluding profit impact \$
Post-tax loss/(gain)				
LIBOR +1%	57,566	-	84,930	-

#### (iv) Product risk

The composition of the crude feedstock will vary the refinery output of products. The 2009 year to date output achieved includes gasoline and distillates fuels (which includes diesel and jet fuels) (59%) (Jun 2008 - 58%), and naphtha and low sulphur waxy residue (34%) (Jun 2008 - 38%). The product yields obtained will vary going forward as the refinery operations are optimized and will vary based on the type of crude feedstock used.

Management endeavors to manage the product risk by actively reviewing the market for demand and supply, trying to maximize the production of the higher margin products and also renegotiating the selling prices for the lower margin products.

#### (b) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities. Due to the nature of the Upstream segment of the Company, funding is secured by means of indirect participation interests, capital raisings and other financing sources as required. The Company endeavors to manage the liquidity risk by continually reviewing the liquidity position including cash flow forecasts to determine the forecast cash requirements and maintain appropriate liquidity levels. All accounts payable and accrued liabilities are payable within one year. Changes in crude price environment will have impact on our liquidity position due to our working capital requirements. For further details on our working capital facilities, refer to (e) below.

The ageing of accounts payables and accrued liabilities are as follows:

Accounts payable and accrued liabilities	Total \$	Payable ageing between		
		<30 days \$	30-60 days \$	>60 days \$
June 30, 2009	131,807,259	127,596,576	712,099	3,498,583
December 31, 2008	78,147,736	76,556,334	1,181,334	410,068
June 30, 2008	67,160,639	62,228,311	994,213	3,938,115

#### (c) Credit risk

Credit risk is the risk that a contracting entity will not complete its obligation under a financial instrument that will result in a financial loss to the Company. The carrying amount of financial assets represents the maximum credit exposure.

The Company's credit risk is limited to the carrying value of its financial assets. A significant amount of the Company's export sales are made to two customers in Singapore which represented \$52,457,516 (Jun 2008 - \$110,928,110) or 17% (Jun 2008 - 25%) of total sales in the six months ended June 30, 2009. The Company's domestic sales for the six months ended June 30, 2009 were not dependent on a single customer or geographic region of Papua New Guinea. The export sales to one customer is not considered a key risk as there is a ready market for InterOil export products and the prices are quoted on active markets. The Company actively manages credit risk by routinely monitoring the credit ratings of Company's customers and ageing of trade receivables. The credit terms provided to customers are revised if any changes are noted to customer ratings or payment cycles.

Credit risk on cash and cash equivalents held directly by the Company are minimized as all cash amounts and certificates of deposit are held with large banks which have acceptable credit ratings determined by a recognized rating agency.

**InterOil Corporation**  
**Notes to Consolidated Financial Statements**  
**(Unaudited, Expressed in United States dollars)**



**3. Financial Risk Management (cont'd)**

The maximum exposure to credit risk at the reporting date was as follows:

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
<b>Current</b>			
Cash and cash equivalents	96,350,890	48,970,572	28,811,249
Cash restricted	14,520,001	25,994,258	26,016,420
Trade receivables	40,126,498	42,887,823	127,615,875
Commodity derivative contracts	-	31,335,050	-
<b>Non-current</b>			
Cash restricted	6,844,439	290,782	361,881

The ageing of receivables at the reporting date was as follows (the ageing days relates to balances past due):

Net trade receivables	Total \$	Receivable ageing between		
		Current and <30 days \$	30-60 days \$	>60 days \$
June 30, 2009	40,126,498	34,101,234	2,626,623	3,398,640
December 31, 2008	42,887,823	33,515,675	5,128,127	4,244,022
June 30, 2008	127,615,875	114,979,760	3,171,299	9,464,816

The impairment of receivables at the reporting date was as follows:

Gross trade receivables	Total \$	Current \$	Overdue	Overdue
			(not impaired) \$	(impaired) \$
June 30, 2009	44,273,971	25,082,218	15,044,280	4,147,473
December 31, 2008	47,496,119	18,592,467	24,295,356	4,608,296
June 30, 2008	132,363,066	95,354,236	32,261,639	4,747,191

Impairment is assessed by our Credit department on an individual customer basis, based on customer ratings and payment cycles of the customers. An impairment provision is taken for all receivables where objective evidence of impairment exists. The movement in impairment is also influenced by the translation rates used to convert these amounts from local currency to USD.

The movement in impaired receivables for the six months ended June 30, 2009 was as follows:

	Six months ended June 30, 2009 \$	Year ended December 31, 2008 \$	Six months ended June 30, 2008 \$
<b>Trade receivables - Impairment provisions</b>			
Opening balance	4,608,296	3,176,807	3,176,807
Movement for period	(460,823)	1,431,490	1,570,384
Closing balance	4,147,473	4,608,296	4,747,191

**(d) Geographic risk**

The operations of InterOil are concentrated in Papua New Guinea.

# InterOil Corporation

## Notes to Consolidated Financial Statements (Unaudited, Expressed in United States dollars)



### 3. Financial Risk Management (cont'd)

#### (e) Financing facilities

As at June 30, 2009, the Company had drawn down against the following financing facilities:

- BNP working capital facility (refer note 15)
- Westpac and BSP working capital facility (refer note 15)
- OPIC secured loan facility (refer note 18)

Repayment obligations in respect of the amount of the facilities utilized are as follows:

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
<b>Due:</b>			
No later than one year	12,962,238	77,792,402	83,058,565
Later than one year but not later than two years	9,000,000	9,000,000	9,000,000
Later than two years but not later than three years	9,000,000	9,000,000	9,000,000
Later than three years but not later than four years	9,000,000	9,000,000	9,000,000
Later than four years but not later than five years	9,000,000	87,975,000	104,000,000
Later than five years	13,000,000	17,500,000	22,000,000
	<b>61,962,238</b>	<b>210,267,402</b>	<b>236,058,565</b>

#### (f) Effective interest rates and maturity profile

June 30, 2009	Floating interest rate \$'000	Fixed interest maturing between						Non-interest bearing \$'000	Total \$'000	Effective interest rate %
		1 year or less \$'000	1-2 \$000	2-3 \$'000	3-4 \$'000	4-5 \$'000	more than 5 years \$'000			
<b>Financial assets</b>										
Cash and cash equivalents	92,232,759	4,118,131	-	-	-	-	-	-	96,350,890	1.00%
Cash restricted	21,364,440	341,866	-	-	-	-	-	-	21,706,306	0.00%
Receivables	-	-	-	-	-	-	-	40,126,498	40,126,498	-
Other financial assets	-	-	-	-	-	-	2,834,453	2,834,453	-	-
	<b>113,597,199</b>	<b>4,459,997</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>42,960,951</b>	<b>161,018,147</b>	<b>-</b>
<b>Financial liabilities</b>										
Payables	-	-	-	-	-	-	-	131,807,259	131,807,259	-
Interest bearing liabilities	3,962,238	9,000,000	9,000,000	9,000,000	9,000,000	9,000,000	13,000,000	-	61,962,238	9.77%
Other financial liabilities	-	-	-	-	-	-	-	-	-	-
	<b>3,962,238</b>	<b>9,000,000</b>	<b>9,000,000</b>	<b>9,000,000</b>	<b>9,000,000</b>	<b>9,000,000</b>	<b>13,000,000</b>	<b>131,807,259</b>	<b>193,769,497</b>	<b>-</b>

December 31, 2008	Floating interest rate \$'000	Fixed interest maturing between						Non-interest bearing \$'000	Total \$'000	Effective interest rate %
		1 year or less \$'000	1-2 \$000	2-3 \$'000	3-4 \$'000	4-5 \$'000	more than 5 years \$'000			
<b>Financial assets</b>										
Cash and cash equivalents	42,108,415	6,862,157	-	-	-	-	-	-	48,970,572	3.21%
Cash restricted	26,285,040	-	-	-	-	-	-	-	26,285,040	1.93%
Receivables	-	-	-	-	-	-	-	42,887,823	42,887,823	-
Other financial assets	-	-	-	-	-	-	-	35,824,624	35,824,624	-
	<b>68,393,455</b>	<b>6,862,157</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>78,712,447</b>	<b>153,968,059</b>	<b>-</b>
<b>Financial liabilities</b>										
Payables	-	-	-	-	-	-	-	78,147,736	78,147,736	-
Interest bearing liabilities	68,792,402	9,000,000	9,000,000	9,000,000	9,000,000	9,000,000	17,500,000	-	131,292,402	6.30%
Debentures liability	-	-	-	-	-	78,975,000	-	-	78,975,000	13.50%
	<b>68,792,402</b>	<b>9,000,000</b>	<b>9,000,000</b>	<b>9,000,000</b>	<b>9,000,000</b>	<b>87,975,000</b>	<b>17,500,000</b>	<b>78,147,736</b>	<b>288,415,138</b>	<b>-</b>

# InterOil Corporation

## Notes to Consolidated Financial Statements

(Unaudited, Expressed in United States dollars)



### 3. Financial Risk Management (cont'd)

June 30, 2008	Floating interest rate \$'000	Fixed interest maturing between					Non-interest bearing \$'000	Total \$'000	Effective interest rate %
		1 year or less \$'000	1-2 \$000	2-3 \$'000	3-4 \$'000	4-5 \$'000			
<b>Financial assets</b>									
Cash and cash equivalents	24,720,147	4,091,102	-	-	-	-	-	28,811,249	2.51%
Cash restricted	26,378,301	-	-	-	-	-	-	26,378,301	2.42%
Receivables	-	-	-	-	-	-	127,615,875	127,615,875	-
Other financial assets	-	-	-	-	-	-	5,423,470	5,423,470	-
	51,098,448	4,091,102	-	-	-	-	133,039,345	188,228,895	
<b>Financial liabilities</b>									
Payables	-	-	-	-	-	-	67,160,639	67,160,639	-
Interest bearing liabilities	74,058,565	9,000,000	9,000,000	9,000,000	9,000,000	9,000,000	22,000,000	141,058,565	6.10%
Debentures liability	-	-	-	-	-	95,000,000	-	95,000,000	13.50%
Other financial liabilities	-	-	-	-	-	-	7,797,312	19,644,512	5.00%
	74,058,565	9,000,000	9,000,000	9,000,000	9,000,000	104,000,000	29,797,312	322,863,716	

### (g) Fair values

	June 30, 2009		December 31, 2008		June 30, 2008	
	Carrying amount \$	Fair value \$	Carrying amount \$	Fair value \$	Carrying amount \$	Fair value \$
<b>Financial instruments</b>						
<i>Loans and receivables</i>						
Receivables	40,126,498	40,126,498	42,887,823	42,887,823	127,615,875	127,615,875
<i>Held for trading</i>						
Commodity derivative contracts (note 7)	-	-	31,335,050	31,335,050	(11,847,200)	(11,847,200)
<b>Financial assets</b>						
Cash and cash equivalents	96,350,890	96,350,890	48,970,572	48,970,572	28,811,249	28,811,249
Cash restricted	21,364,440	21,364,440	26,285,040	26,285,040	26,378,301	26,378,301
<b>Financial liabilities at amortized cost</b>						
<i>Current liabilities:</i>						
Accounts payable and accrued liabilities (note 12)	131,807,259	131,807,259	78,147,736	78,147,736	67,160,639	67,160,639
Working capital facility (note 15)	3,962,238	3,962,238	68,792,402	68,792,402	74,058,565	74,058,565
Current portion of secured loan (note 18)	9,000,000	9,002,364	9,000,000	9,012,228	9,000,000	12,956,960
<i>Non-current liabilities</i>						
Secured loan (note 18)	47,977,305	51,490,724	52,365,333	58,753,276	56,753,361	55,204,480
8% Subordinated debenture liability (note 23)	-	-	65,040,067	65,040,067	76,516,300	76,516,300
Preference share liability (note 22)	-	-	-	-	7,797,312	5,236,863

The fair value of the secured loan is based on discounted cash flow analysis using a current market interest rate applicable for similar loan arrangements.

### (h) Capital management

The Finance department of the Company is responsible for capital management. This involves the use of corporate forecasting models which facilitates analysis of the Company's financial position including cash flow forecasts to determine the future capital management requirements. Capital management is undertaken to ensure a secure, cost-effective and flexible supply of funds is available to meet the Company's operating and capital expenditure requirements.

The Company is actively managing the gearing levels and raising capital/debt as required for optimizing shareholder returns. The Company is actively trying to manage its gearing levels by maintaining the Debt-To-Capital Ratio (Long term Debt/(Shareholders' equity + Long term Debt)) at 50% or less, and has made considerable progress in achieving this as at June 30, 2009. The gearing levels were reduced to 13% in June 2009 from 43% in June 2008.

The optimum gearing levels for the Company are set by Management based on the stage of development of the Company, future needs for development and capital market conditions, and will be reassessed as situations change.



### **3. Financial Risk Management (cont'd)**

This reduction in gearing levels as at June 30, 2009 as compared to June 30, 2008 was mainly due to the conversion of \$95,000,000 8% convertible subordinated debentures issued in May 2008 and the completion of the \$70,443,249 registered direct stock offering completed in June 2009.

On May 13, 2008, the Company completed the issue of \$95,000,000 unsecured 8% subordinated convertible debentures with a maturity of five years. The conversion price applicable to these debentures was \$25.00 per share, with mandatory conversion if the daily Volume Weighted Average Price ('VWAP') of the common shares is at or above \$32.50 for at least 15 consecutive trading days. During the period from July 2008 to June 2009 a number of investors voluntarily converted their interest into common shares of the Company. In June 2009, a mandatory conversion was triggered as the VWAP stayed above \$32.50 for 15 consecutive trading days, and the remaining debentures were converted into common shares.

On June 8, 2009 the Company completed a registered direct stock offering of 2,013,815 shares of its common stock to a number of institutional investors at a purchase price of U.S.\$34.98 per share amounting to \$70,443,249.

We will evaluate further opportunities of raising capital in the future for our capital expenditure requirements. In order to achieve this objective, the Company has filed a preliminary short form base shelf prospectus with the Ontario Securities Commission and a corresponding registration statement on Form F-10 with the United States Securities and Exchange Commission (the "SEC") pursuant to the multi-jurisdictional disclosure system. These filings will enable the Company to add financial flexibility in the future and issue, from time to time, up to \$200.0 million of its debt securities (a further \$129.6 million after the \$70.4 million offering completed in June 2009), common shares, preferred shares and/or warrants ("Securities") in one or more offerings. This preliminary short form base shelf prospectus has since been replaced with an omnibus shelf prospectus filed and accepted by the Ontario Securities Commission on August 7, 2008. The corresponding registration statement on Form-10/A has also been filed with the SEC.

### **4. Segmented financial information**

As stated in note 1, management has identified four major business segments - upstream, midstream, downstream and corporate. The corporate segment includes assets and liabilities that do not specifically relate to the other business segments. Results in this segment primarily include financing costs and interest income.

Consolidation adjustments relating to total assets relates to the elimination of intercompany loans and investments in subsidiaries.

#### **Notes to and forming part of the segment information**

Segment information is prepared in conformity with the accounting policies of the entity as disclosed in note 2 in the annual financial statements.

Segment revenues, expenses and total assets are those that are directly attributable to a segment and the relevant portion that can be allocated to the segment on a reasonable basis. Upstream, midstream and downstream include costs allocated from the corporate activities based on a fee for services provided. The eliminations relate to sales and operating revenues between segments recorded at transfer prices based on current market prices and to unrealized intersegment profits in inventories.

**InterOil Corporation**  
**Notes to Consolidated Financial Statements**  
**(Unaudited, Expressed in United States dollars)**



**4. Segmented financial information (cont'd)**

Quarter ended June 30, 2009	Upstream	Midstream - Refining and Marketing	Midstream - Liquefaction	Downstream	Corporate	Consolidation adjustments	Total
Revenues from external customers	-	62,310,818	-	85,259,855	-	-	147,570,673
Intersegment revenues	-	51,961,474	-	30,219	5,491,632	(57,483,325)	-
Interest revenue	2,552	74,963	1,838	3,015	3,148,794	(3,142,104)	89,058
Other revenue	657,049	-	-	179,197	-	-	836,246
<b>Total segment revenue</b>	<b>659,601</b>	<b>114,347,255</b>	<b>1,838</b>	<b>85,472,286</b>	<b>8,640,426</b>	<b>(60,625,429)</b>	<b>148,495,977</b>
Cost of sales and operating expenses	-	103,382,667	-	77,450,335	-	(54,825,879)	126,007,123
Administrative, professional and general expenses	1,357,706	2,580,732	1,432,311	3,553,942	7,226,178	(5,521,851)	10,629,018
Derivative loss	-	345,650	-	-	-	-	345,650
Foreign exchange (gain)/loss	1,027,529	(6,095,968)	(51,177)	318,282	(482,849)	-	(5,284,183)
Gain on sale of exploration assets	(1,087,483)	-	-	-	-	-	(1,087,483)
Exploration costs, excluding exploration impairment	31,075	-	-	-	-	-	31,075
Depreciation and amortisation	150,021	2,800,772	19,676	661,546	174,249	(32,492)	3,773,772
Interest expense	1,562,777	1,709,069	334,320	1,012,869	1,599,995	(3,142,104)	3,076,926
<b>Total segment expenses</b>	<b>3,041,625</b>	<b>104,722,922</b>	<b>1,735,130</b>	<b>82,996,974</b>	<b>8,517,573</b>	<b>(63,522,326)</b>	<b>137,491,898</b>
<b>Income/(loss) before income taxes and non-controlling interest</b>	<b>(2,382,024)</b>	<b>9,624,333</b>	<b>(1,733,292)</b>	<b>2,475,312</b>	<b>122,853</b>	<b>2,896,897</b>	<b>11,004,079</b>
Income tax expense	-	-	(31,721)	(732,887)	(799,476)	-	(1,564,084)
Non controlling interest	-	-	-	-	-	(1,925)	(1,925)
<b>Total net income/(loss)</b>	<b>(2,382,024)</b>	<b>9,624,333</b>	<b>(1,765,013)</b>	<b>1,742,425</b>	<b>(676,623)</b>	<b>2,894,972</b>	<b>9,438,070</b>

Quarter ended June 30, 2008	Upstream	Midstream - Refining and Marketing	Midstream - Liquefaction	Downstream	Corporate	Consolidation adjustments	Total
Revenues from external customers	-	103,518,563	-	140,138,927	-	-	243,657,490
Intersegment revenues	-	94,335,484	-	57,569	6,350,549	(100,743,602)	-
Interest revenue	44,729	5,788	19,431	208,320	1,983,440	(1,821,957)	439,751
Other revenue	849,859	3,705	-	62,546	-	-	916,110
<b>Total segment revenue</b>	<b>894,588</b>	<b>197,863,540</b>	<b>19,431</b>	<b>140,467,362</b>	<b>8,333,989</b>	<b>(102,565,559)</b>	<b>245,013,351</b>
Cost of sales and operating expenses	-	172,655,287	-	126,623,717	-	(93,065,247)	206,213,757
Administrative, professional and general expenses	1,064,832	3,230,511	1,832,280	6,021,275	10,353,142	(6,408,120)	16,093,920
Derivative loss	-	9,010,951	-	-	-	-	9,010,951
Foreign exchange (gain)/loss	(157,632)	(3,363,447)	(28,367)	(70,379)	135,788	-	(3,484,037)
Gain on sale of exploration assets	(10,245,533)	-	-	-	-	-	(10,245,533)
Exploration costs, excluding exploration impairment	83,191	-	-	-	-	-	83,191
Exploration impairment	(14,052)	-	-	-	-	-	(14,052)
Depreciation and amortisation	135,119	2,724,110	15,682	581,620	15,645	(32,492)	3,439,684
Interest expense	840,816	2,262,947	59,700	715,039	2,871,094	(1,821,960)	4,927,636
<b>Total segment expenses</b>	<b>(8,293,259)</b>	<b>186,520,359</b>	<b>1,879,295</b>	<b>133,871,272</b>	<b>13,375,669</b>	<b>(101,327,819)</b>	<b>226,025,517</b>
<b>Income/(loss) before income taxes and non-controlling interest</b>	<b>9,187,847</b>	<b>11,343,181</b>	<b>(1,859,864)</b>	<b>6,596,090</b>	<b>(5,041,680)</b>	<b>(1,237,740)</b>	<b>18,987,834</b>
Income tax benefit	-	-	(48,845)	(3,212,339)	(122,030)	-	(3,383,214)
Non controlling interest	-	-	-	-	-	(2,044)	(2,044)
<b>Total net income/(loss)</b>	<b>9,187,847</b>	<b>11,343,181</b>	<b>(1,908,709)</b>	<b>3,383,751</b>	<b>(5,163,710)</b>	<b>(1,239,784)</b>	<b>15,602,576</b>

**InterOil Corporation**  
**Notes to Consolidated Financial Statements**  
**(Unaudited, Expressed in United States dollars)**



**4. Segmented financial information (cont'd)**

Six months ended June 30, 2009	Upstream	Midstream - Refining	Midstream - Liquefaction	Downstream	Corporate	Consolidation adjustments	Total
Revenues from external customers	-	144,789,300	-	163,621,928	-	-	308,411,228
Intersegment revenues	-	114,983,330	-	68,366	10,310,682	(125,362,378)	-
Interest revenue	7,752	97,383	6,641	35,127	6,082,609	(6,064,393)	165,119
Other revenue	1,263,134	-	-	318,823	-	-	1,581,957
<b>Total segment revenue</b>	<b>1,270,886</b>	<b>259,870,013</b>	<b>6,641</b>	<b>164,044,244</b>	<b>16,393,291</b>	<b>(131,426,771)</b>	<b>310,158,304</b>
Cost of sales and operating expenses	-	224,821,618	-	151,080,704	-	(113,484,484)	262,417,838
Administrative, professional and general expenses	2,571,869	4,872,870	3,804,191	6,236,336	12,520,857	(10,379,048)	19,627,075
Derivative gain	-	(931,060)	-	-	-	-	(931,060)
Foreign exchange loss/(gain)	678,213	2,225,896	(57,666)	(663,866)	(1,076,846)	-	1,105,731
Gain on sale of exploration assets	(1,087,483)	-	-	-	-	-	(1,087,483)
Exploration costs, excluding exploration impairment	247,121	-	-	-	-	-	247,121
Exploration impairment	-	-	-	-	-	-	-
Depreciation and amortisation	262,129	5,412,053	40,276	1,312,821	192,052	(64,984)	7,154,347
Interest expense	3,115,260	3,494,780	492,899	2,154,544	3,925,198	(6,064,393)	7,118,288
<b>Total segment expenses</b>	<b>5,787,109</b>	<b>239,896,157</b>	<b>4,279,700</b>	<b>160,120,539</b>	<b>15,561,261</b>	<b>(129,992,909)</b>	<b>295,651,857</b>
<b>Income/(loss) before income taxes and non-controlling interest</b>	<b>(4,516,223)</b>	<b>19,973,856</b>	<b>(4,273,059)</b>	<b>3,923,705</b>	<b>832,030</b>	<b>(1,433,862)</b>	<b>14,506,447</b>
Income tax expense	-	-	(44,415)	(1,217,588)	(1,158,899)	-	(2,420,902)
Non controlling interest	-	-	-	-	-	(3,995)	(3,995)
<b>Total net income/(loss)</b>	<b>(4,516,223)</b>	<b>19,973,856</b>	<b>(4,317,474)</b>	<b>2,706,117</b>	<b>(326,869)</b>	<b>(1,437,857)</b>	<b>12,081,550</b>
<b>Total assets</b>	<b>160,032,552</b>	<b>325,915,827</b>	<b>10,511,444</b>	<b>109,365,311</b>	<b>505,626,807</b>	<b>(449,041,181)</b>	<b>662,410,760</b>

  

Six months ended June 30, 2008	Upstream	Midstream - Refining	Midstream - Liquefaction	Downstream	Corporate	Consolidation adjustments	Total
Revenues from external customers	-	179,026,413	-	256,003,352	-	-	435,029,765
Intersegment revenues	-	195,784,648	-	79,997	12,222,374	(208,087,019)	-
Interest revenue	88,480	21,431	32,146	218,053	4,642,511	(4,246,342)	756,279
Other revenue	1,424,069	3,705	-	213,630	-	-	1,641,404
<b>Total segment revenue</b>	<b>1,512,549</b>	<b>374,836,197</b>	<b>32,146</b>	<b>256,515,032</b>	<b>16,864,885</b>	<b>(212,333,361)</b>	<b>437,427,448</b>
Cost of sales and operating expenses	-	342,128,205	-	235,864,775	-	(194,795,539)	383,197,441
Administrative, professional and general expenses	2,874,607	4,927,120	3,511,441	8,258,452	17,013,953	(12,302,373)	24,283,200
Derivative loss	-	10,629,376	-	-	-	-	10,629,376
Foreign exchange (gain)/loss	(2,421)	(4,902,551)	(58,922)	(29,759)	209,439	-	(4,784,214)
Gain on sale of exploration assets	(10,245,533)	-	-	-	-	-	(10,245,533)
Exploration costs, excluding exploration impairment	(154,077)	-	-	-	-	-	(154,077)
Exploration impairment	11,279	-	-	-	-	-	11,279
Depreciation and amortisation	288,716	5,484,708	30,933	1,154,860	30,209	(64,984)	6,924,442
Interest expense	1,544,919	5,023,621	112,956	1,720,473	5,961,607	(4,246,342)	10,117,234
<b>Total segment expenses</b>	<b>(5,682,510)</b>	<b>363,290,479</b>	<b>3,596,408</b>	<b>246,968,801</b>	<b>23,215,208</b>	<b>(211,409,238)</b>	<b>419,979,148</b>
<b>Income/(loss) before income taxes and non-controlling interest</b>	<b>7,195,059</b>	<b>11,545,718</b>	<b>(3,564,262)</b>	<b>9,546,231</b>	<b>(6,350,323)</b>	<b>(924,123)</b>	<b>17,448,300</b>
Income tax expense	-	-	(72,978)	(3,965,505)	(202,744)	-	(4,241,227)
Non controlling interest	-	-	-	-	-	(1,859)	(1,859)
<b>Total net income/(loss)</b>	<b>7,195,059</b>	<b>11,545,718</b>	<b>(3,637,240)</b>	<b>5,580,726</b>	<b>(6,553,067)</b>	<b>(925,982)</b>	<b>13,205,214</b>
<b>Total assets</b>	<b>130,247,419</b>	<b>345,942,061</b>	<b>5,844,763</b>	<b>146,450,816</b>	<b>518,494,024</b>	<b>(550,550,828)</b>	<b>596,428,255</b>

# InterOil Corporation

## Notes to Consolidated Financial Statements

(Unaudited, Expressed in United States dollars)



### 5. Cash and cash equivalents

The components of cash and cash equivalents are as follows:

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
Cash on deposit	93,965,959	46,761,362	27,489,652
Bank term deposits			
- Papua New Guinea kina deposits	2,384,931	2,209,210	1,321,597
	96,350,890	48,970,572	28,811,249

### 6. Supplemental cash flow information

	Quarter ended		Six months ended	
	June 30, 2009 \$	June 30, 2008 \$	June 30, 2009 \$	June 30, 2008 \$
Cash paid during the year				
Interest	2,604,387	3,860,689	2,788,284	5,959,812
Income taxes	857,032	2,026,565	995,358	2,074,382
Interest received	89,119	439,780	164,293	750,082
Non-cash investing and financing activities:				
(Decrease)/increase in deferred gain on contributions to LNG project	-	-	(4,420,838)	3,107,330
Loss/(gain) on proportionate consolidation of LNG project	-	-	724,357	(236,666)
Increase in share capital from:				
the exercise of share options	1,179,712	66,495	1,581,105	66,495
buyback of Merrill Lynch interest in LNG Project	-	-	11,250,000	-
conversion of debentures into share capital	77,089,723	-	77,089,723	-
conversion of debt into share capital	-	60,000,000	-	60,000,000
placement fee obligation on conversion of debt	-	1,800,000	-	1,800,000
preference share interest obligation settled in shares	-	186,475	-	186,475
placement fee obligation on debentures issued	-	5,700,000	-	5,700,000
debentures interest obligation settled in shares	2,352,084	-	2,352,084	-

### 7. Financial instruments

#### Cash and cash equivalents

With the exception of cash and cash equivalents and restricted cash, all financial assets are non-interest bearing. In the six months ended June 30, 2009, the Company earned 0.0% (2008 – 2.42%) on the cash on deposit which related to the working capital facility. In the six months ended June 30, 2009, cash and cash equivalents earned an average interest rate of 1.00% per annum (2008 – 2.51%) on cash, other than the cash on deposit that was related to the working capital facility.

Restricted cash, which mainly relates to the working capital facility, is comprised of the following:

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
Cash deposit on working capital facility (0.0%)	14,520,001	25,994,258	26,016,420
Cash restricted - Current	14,520,001	25,994,258	26,016,420
Bank term deposits on Petroleum Prospecting Licenses (1.2%)	124,691	124,097	124,355
Cash deposit on office premises (3.0%)	217,175	166,685	237,526
Cash deposit on secured loan (0.0%)	6,502,573	-	-
Cash restricted - Non-current	6,844,439	290,782	361,881
	21,364,440	26,285,040	26,378,301

# InterOil Corporation

## Notes to Consolidated Financial Statements (Unaudited, Expressed in United States dollars)



### 7. Financial instruments (cont'd)

Cash held as deposit on the working capital facility supports the Company's working capital facility with BNP Paribas. The balance is based on 20% of the outstanding balance of the base facility plus any amounts that are fully cash secured.

The cash held as deposit on secured loan is used to support the Company's secured loan borrowings with the Overseas Private Investment Corporation ("OPIC") and relates to one half yearly installment of \$4.5 million and the related interest that will be payable with the next installment. The waiver in force on this deposit requirement expired in June 2009 with the completion of the capital raising of \$70.4 million.

Bank term deposits on Petroleum Prospecting Licenses are unavailable to the Company while Petroleum Prospecting Licenses 236, 237 and 238 are being utilized by the Company.

#### Commodity derivative contracts

InterOil uses derivative commodity instruments to manage exposure to price volatility on a portion of its refined product and crude inventories.

At June 30, 2009, InterOil had a net payable of \$nil (Dec 2008 – receivable of \$31,335,050, Jun 2008 – payable of \$11,847,200) relating to commodity hedge contracts. Of this total, a receivable of \$nil (Dec 2008 - \$16,261,000, Jun 2008 - payable of \$3,332,200) relates to hedge accounted contracts as at June 30, 2009 and a payable of \$nil (Dec 2008 – receivable of \$15,074,050, Jun 2008 – payable of \$8,515,000) relates to outstanding derivative contracts for which hedge accounting was not applied or had been discontinued. The gain on hedges for which final pricing will be determined in future periods was \$7,811,650 (Dec 2008 - \$18,012,500, Jun 2008 – loss of \$3,487,049 loss) and has been included in comprehensive income. The hedges that have resulted in a gain being included within comprehensive income at June 30, 2009 were settled in January 2009. However, these gains will be released into the Statement of Operations as the anticipated transactions that these hedges were initially taken to cover will occur.

#### a. Hedge accounted contracts:

There was no outstanding hedge accounted contracts on which final pricing were to be determined in future periods as at June 30, 2009.

The following summarizes the effective hedge contracts by derivative type on which final pricing was determined in future periods as at December 31, 2008:

Derivative	Type	Notional Volumes (bbls)	Expiry	Derivative type	Fair Value December 31, 2008 \$
Crude Swap	Buy Brent	300,000	Q1 2009	Cash flow hedge - Manages the crack spread	(25,493,100)
Crude Swap	Buy Brent	300,000	Q2 2009	Cash flow hedge - Manages the crack spread	(19,529,200)
Crude Swap	Buy Brent	300,000	Q3 2009	Cash flow hedge - Manages the crack spread	(18,441,700)
Crude Swap	Buy Brent	300,000	Q4 2009	Cash flow hedge - Manages the crack spread	(17,682,200)
Gasoil Swap	Sell Gasoil	300,000	Q1 2009	Cash flow hedge - Manages the crack spread	29,068,800
Gasoil Swap	Sell Gasoil	300,000	Q2 2009	Cash flow hedge - Manages the crack spread	23,425,400
Gasoil Swap	Sell Gasoil	300,000	Q3 2009	Cash flow hedge - Manages the crack spread	22,461,200
Gasoil Swap	Sell Gasoil	300,000	Q4 2009	Cash flow hedge - Manages the crack spread	21,672,800
					15,482,000
Add: Priced out but unsettled hedge accounted contracts as at December 31, 2008					779,000
					16,261,000

**InterOil Corporation**  
**Notes to Consolidated Financial Statements**  
**(Unaudited, Expressed in United States dollars)**



**7. Financial instruments (cont'd)**

As at June 30, 2008:

Derivative	Type	Notional Volumes (bbls)	Expiry	Derivative type	Fair Value June 30, 2008 \$
Crude Swap	Buy Brent	100,000	Q3 2008	Cash flow hedge - Manages the crack spread	1,859,300
Crude Swap	Buy Brent	300,000	Q4 2008	Cash flow hedge - Manages the crack spread	6,085,000
Crude Swap	Buy Brent	300,000	Q1 2009	Cash flow hedge - Manages the crack spread	6,494,700
Gasoil Swap	Sell Gasoil	100,000	Q3 2008	Cash flow hedge - Manages the crack spread	(2,157,500)
Gasoil Swap	Sell Gasoil	300,000	Q4 2008	Cash flow hedge - Manages the crack spread	(7,360,700)
Gasoil Swap	Sell Gasoil	300,000	Q1 2009	Cash flow hedge - Manages the crack spread	(8,253,000)
					(3,332,200)
Add: Priced out but unsettled hedge accounted contracts as at June 30, 2008					-
					(3,332,200)

A profit of \$9,369,050 was recognized from effective portion of priced out hedge accounted contracts for the six months ended June 30, 2009 (Jun 2008 – \$560,000).

**b. Non-hedge accounted derivative contracts:**

In addition to the above hedge accounted contracts, as at June 30, 2009, the Company had the following open non-hedge accounted derivative contracts outstanding. Any gains/losses on these contracts are disclosed separately in the statement of operations for the period.

As at June 30, 2009, there was no outstanding non-hedge accounted derivative contracts.

As at December 31, 2008:

Derivative	Type	Notional Volumes (bbls)	Expiry	Derivative type	Fair Value December 31, 2008 \$
Brent Swap	Sell Brent	195,000	Q1 2009	Cash flow hedge - Manages the export price risk of LSWR	3,965,000
Brent Swap	Buy Brent	130,000	Q1 2009	Cash flow hedge - Manages the export price risk of LSWR	(1,129,750)
Brent Swap	Sell Brent	165,000	Q2 2009	Cash flow hedge - Manages the export price risk of LSWR	(413,200)
					2,422,050
Add: Priced out non-hedge accounted contracts as at December 31, 2008					12,652,000
					15,074,050

# InterOil Corporation

## Notes to Consolidated Financial Statements (Unaudited, Expressed in United States dollars)



### 7. Financial instruments (cont'd)

As at June 30, 2008:

Derivative	Type	Notional Volumes (bbls)	Expiry	Derivative type	Fair Value June 30, 2008 \$
Crude Swap	Buy Brent	200,000	Q3 2008	Cash flow hedge - Manages the crack spread. Non-hedge accounted as not satisfying the effectiveness criteria	3,532,200
Gasoil swap	Sell Gasoil	200,000	Q3 2008	Cash flow hedge - Manages the crack spread	(4,422,200)
Brent Swap	Sell Brent	270,000	Q3 2008	Cash flow hedge - Manages the export price risk of LSWR	(3,382,600)
Brent Swap	Buy Brent	270,000	Q3 2008	Cash flow hedge - Manages the export price risk of LSWR	908,100
Brent Swap	Sell Brent	30,000	Q3 2008	Cash flow hedge - Manages the export price risk of LSWR	(125,700)
Naphtha Swap	Sell naphtha	125,000	Q3 2008	Cash flow hedge - Manages the export price risk of naphtha	(476,500)
					(3,966,700)
Add: Priced out non-hedge accounted contracts as at June 30, 2008					(4,548,300)
					(8,515,000)

A profit of \$581,260 was recognized on the non-hedge accounted derivative contracts for the six months ended June 30, 2009 (Jun 2008 – loss of \$10,784,225).

### 8. Trade receivables

InterOil has a discounting facility with BNP Paribas on specific monetary receivables under which the Company is able to sell, on a revolving basis, receivables up to \$60,000,000 (refer to note 15). As at June 30, 2009, \$nil (Dec 2008 - \$3,141,238, Jun 2008 - \$50,080,471) in outstanding trade receivables had been sold with recourse under the facility. As the sale is with recourse, the discounted receivables, if any, are retained on the balance sheet and included in the accounts receivable and the proceeds are recognized in the working capital facility. The Company has retained the responsibility for administering and collecting accounts receivable sold. The discounted receivables are usually settled within a month of their discounting and there have not been any collection issues relating to these discounted receivables.

At June 30, 2009, \$31,328,111 (Dec 2008 - \$10,300,542, Jun 2008 - \$98,217,790) of the trade receivables secures the BNP Paribas working capital facility disclosed in note 15. This balance includes \$22,472,429 (Dec 2008 - \$6,912,883, Jun 2008 - \$30,571,438) of intercompany receivables which were eliminated on consolidation.

### 9. Inventories

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
Midstream - refining and marketing (crude oil feedstock)	46,947,071	25,556,463	7,307,454
Midstream - refining and marketing (refined petroleum product)	32,266,635	30,167,417	22,614,927
Midstream - refining and marketing (parts inventory)	277,078	288,643	291,251
Downstream (refined petroleum product)	34,554,627	27,024,803	44,667,146
	114,045,411	83,037,326	74,880,778

As at June 30, 2009 and June 30, 2008 no net realizable value write down was necessary. At December 31, 2008, inventory had been written down to its net realizable value. The write down of \$8,529,016 relating to refined petroleum products is included in 'Cost of sales and operating expenses' within the 'Consolidated Statement of Operations'.

At June 30, 2009, \$79,490,784 (Dec 2008 - \$56,012,523, Jun 2008 - \$30,213,632) of the midstream inventory balance secures the BNP Paribas working capital facility disclosed in note 15.

Inventories recognized as expense during the six months ended June 30, 2009 amounted to \$269,572,185 (Jun 2008 - \$390,121,883).

# InterOil Corporation

## Notes to Consolidated Financial Statements

### (Unaudited, Expressed in United States dollars)



#### 10. Plant and equipment

The majority of the Company's plant and equipment is located in Papua New Guinea, except for items in the corporate segment with a net book value of \$187,730 (Dec 2008 - \$343,069, Jun 2008 - \$348,912) which are located in Australia and Singapore. Amounts in deferred project costs and work in progress are not being amortized.

Consolidation entries relates to midstream assets which were created when the gross margin on 2004 refinery sales to the downstream segment were eliminated in the development stage of the refinery.

June 30, 2009	Upstream	Midstream - Refining	Midstream - Liquefaction	Downstream	Corporate & Consolidated	Totals
Plant and equipment	47,315	247,541,770	176,873	47,354,205	522,280	295,642,443
Deferred project costs and work in progress	-	258,939	2,252,060	5,069,873	-	7,580,872
Consolidation entries	-	-	-	-	(2,664,345)	(2,664,345)
Accumulated depreciation and amortisation	(45,570)	(49,180,351)	(79,229)	(29,624,534)	(334,550)	(79,264,234)
<b>Net book value</b>	<b>1,745</b>	<b>198,620,358</b>	<b>2,349,704</b>	<b>22,799,544</b>	<b>(2,476,615)</b>	<b>221,294,736</b>
Capital expenditure for six months ended June 30, 2009	-	252,936	-	4,145,050	36,652	4,434,638

  

December 31, 2008	Upstream	Midstream - Refining	Midstream - Liquefaction	Downstream	Corporate & Consolidated	Totals
Plant and equipment	47,315	247,520,562	219,315	46,299,775	485,628	294,572,595
Deferred project costs and work in progress	-	27,211	2,134,858	1,979,253	-	4,141,322
Consolidation entries	-	-	-	-	(2,729,327)	(2,729,327)
Accumulated depreciation and amortisation	(43,568)	(43,768,810)	(80,554)	(28,363,540)	(142,559)	(72,399,031)
<b>Net book value</b>	<b>3,747</b>	<b>203,778,963</b>	<b>2,273,619</b>	<b>19,915,488</b>	<b>(2,386,258)</b>	<b>223,585,559</b>
Capital expenditure for year ended December 31, 2008	-	529,033	92,494	4,108,630	95,493	4,825,650

  

June 30, 2008	Upstream	Midstream - Refining	Midstream - Liquefaction	Downstream	Corporate & Consolidated	Totals
Plant and equipment	47,315	247,239,251	173,098	47,309,422	455,252	295,224,338
Deferred project costs and work in progress	-	176,307	2,275,189	2,515,306	-	4,966,802
Consolidation entries	-	-	-	-	(2,794,310)	(2,794,310)
Accumulated depreciation and amortisation	(41,539)	(38,284,419)	(45,466)	(30,717,523)	(106,340)	(69,195,287)
<b>Net book value</b>	<b>5,776</b>	<b>209,131,139</b>	<b>2,402,821</b>	<b>19,107,205</b>	<b>(2,445,398)</b>	<b>228,201,543</b>
Capital expenditure for six months ended June 30, 2008	-	396,818	37,942	1,884,704	65,117	2,384,581

During the six months ended June 30, 2009, InterOil recognized a gain of \$nil on the disposal of assets (Jun 2008 - \$285,206).

**InterOil Corporation**  
**Notes to Consolidated Financial Statements**  
**(Unaudited, Expressed in United States dollars)**



**11. Oil and gas properties**

Costs of oil and gas properties which are not subject to depletion are as follows:

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
Drilling equipment	13,222,275	13,857,772	14,046,280
Inventory	10,929,773	10,113,808	6,039,122
Petroleum Prospecting License drilling programs at cost	133,724,956	104,042,379	81,987,037
	<b>157,877,004</b>	<b>128,013,959</b>	<b>102,072,439</b>

The following table discloses a breakdown of the gain realized on sale of oil and gas properties for the periods ended:

	Quarter ended		Six months ended	
	June 30, 2009 \$	June 30, 2008 \$	June 30, 2009 \$	June 30, 2008 \$
<b>Gain on sale of oil and gas properties</b>				
Sale of PRL 4 interest (43.13% of the property)	-	1,500,000	-	1,500,000
Sale of PRL 5 interest (28.576% of the property)	-	5,000,000	-	5,000,000
Conveyance accounting of IPI Agreement (note 19)	1,087,483	3,745,533	1,087,483	3,745,533
	<b>1,087,483</b>	<b>10,245,533</b>	<b>1,087,483</b>	<b>10,245,533</b>

During the quarter ended June 30, 2008, the Company divested fully its interests in Petroleum Retention Licenses 4 and 5 in Papua New Guinea. As these properties did not have any cost base associated with them carried forward in the balance sheet, the entire sale proceeds was treated as a gain on sale of these properties.

In addition to the above divestments, on May 5, 2008, one of the investors who had a 4.1% interest in the eight well drilling program (19.1% of the IPI Agreement) waived their right to convert their IPI percentage into common shares pursuant to the agreement dated February 25, 2005. On April 17, 2009, another investor who had a 1.2% interest in the eight well drilling program (5.6% of the remaining IPI investors as per the agreement) also waived its right to convert its IPI percentage into common shares.

These waivers have triggered a conveyance under the IPI Agreement for their share of interest in the program. An amount of \$1,087,483 (Jun 2008 - \$3,745,533) was recognized as a gain on conveyance following the guidance in paragraphs 47(h) and 47(j) of SFAS 19 (refer note 19 for further details).

Refer to Note 12 below for details of Petromin's participation in the Elk/Antelope field and the treatment of the \$8,435,000 advance received from them in relation to this participation agreement.

The following table discloses a breakdown of the exploration expenses presented in the statements of operations for the periods ended:

	Six months ended	Year ended	Six months ended
	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
Exploration costs, excluding exploration impairment	247,121	995,532	(154,077)
Exploration impairment			
Costs incurred in prior years	-	-	-
Costs incurred in current year	-	107,788	11,279
Total exploration impairment	-	107,788	11,279
	<b>247,121</b>	<b>1,103,320</b>	<b>(142,798)</b>

**InterOil Corporation**  
**Notes to Consolidated Financial Statements**  
**(Unaudited, Expressed in United States dollars)**



**12. Accounts payable and accrued liabilities**

	June 30, 2009	December 31, 2008	June 30, 2008
	\$	\$	\$
Accounts payable - crude import	75,792,536	25,233,525	-
Accounts payable - diesel import	2,152,663	-	-
Other accounts payable and accrued liabilities	53,862,060	52,914,211	63,523,659
Income tax payable	-	-	3,636,980
<b>Total accounts payable and accrued liabilities</b>	<b>131,807,259</b>	<b>78,147,736</b>	<b>67,160,639</b>

***Petromin participation in Elk/Antelope field***

On October 30, 2008, Petromin PNG Holdings Limited ('Petromin'), a government entity mandated to invest in resource projects on behalf of the Independent State of Papua New Guinea ("the State"), agreed to take a 20.5% direct interest in the Elk/Antelope field. Petromin will contribute an initial deposit and will conditionally fund 20.5% of the costs of developing the Elk/Antelope field. The relevant legislation on the State's right to invest arises upon issuance of the Prospecting Development Licence ('PDL'), which has not yet occurred. The agreement contains certain provisions applicable in the event that the PDL is not issued within a certain timeframe, or the State does not designate Petromin to hold its interest at that time. In the event the PDL is not granted for the Elk/Antelope field, Petromin will be issued InterOil common shares based on a five day Volume Weighted Average Price ('VWAP') immediately prior to the date of issue. As at June 30, 2009, \$8,435,000 advance payment received from Petromin has been held under 'Other accounts payable and accrued liabilities' above. Once the PDL is formed, conveyance accounting following the guidance in paragraphs 47(h) and 47(j) of SFAS 19 will be triggered.

**13. Deferred gain on contributions to LNG Project**

On July 30, 2007, a Shareholders' Agreement was signed between InterOil LNG Holdings Inc., Pacific LNG Operations Ltd., Merrill Lynch Commodities (Europe) Limited and PNG LNG Inc.. As part of the Shareholders' Agreement, five 'A' Class shares were issued by PNG LNG Inc. with full voting rights with each share controlling one board position. Two 'A' Class shares were owned by InterOil, two by Merrill Lynch Commodities (Europe) Limited, and one by Pacific LNG Operations Ltd. All key operational matters require 'Unanimous' or 'Super-majority' Board resolution which confirms that none of the joint ventures is in a position to exercise unilateral control over the joint venture.

InterOil was also provided with 'B' Class shares in the Joint Venture Company with a fair value of \$100,000,000 in recognition of its contribution to the LNG Project at the time of signing the Shareholders' Agreement. The main items contributed by InterOil into the Joint venture Company were infrastructure developed by InterOil near the proposed LNG site at Napa Napa, stakeholder relations within Papua New Guinea, General Supply Agreements secured with other landowners for supply of gas, advanced stage of project development, etc. Fair value was determined based on the agreement between the independent joint venture partners.

The other Joint Venture partners are being issued 'B' Class shares as they contribute cash into the Joint Venture Company by way of cash calls.

To date InterOil has a recognized deferred gain on its contributions to the Joint Venture based on the share of other joint venture partners in the project. As InterOil's shareholding within the Joint Venture Company as at June 30, 2009 is 86.66%, the gain on contribution of non cash assets to the project by InterOil relating to other joint venture partners' shareholding (13.34% - amounting to \$13,076,272) has been recognized by InterOil in its balance sheet as a deferred gain. This deferred gain will increase as the other Joint Venture partners increase their shareholding in the project. The gain has been deferred in accordance with the principles of proportionate consolidation as per CICA 3055 - 'Interests in Joint Ventures' and will be taken to income based on the value to be obtained from their use by the Joint Venture Company in the future. The intangible assets of the Joint Venture Company, contributed by InterOil, have been eliminated on proportionate consolidation of the joint venture balances.

On February 27, 2009, InterOil LNG Holdings Inc. and Pacific LNG Operations Ltd, acquired Merrill Lynch's interest in the Joint Venture Company. InterOil issued 499,834 common shares totaling \$11,250,000 for its share of the settlement. After the completion of this transaction, Merrill Lynch does not retain any ownership in the PNG LNG project.

The two 'A' Class shares held by Merrill Lynch have been transferred equally to InterOil LNG Holdings Inc. and Pacific LNG Operations Ltd. A further 172 'A' Class shares have been issued to InterOil LNG Holdings Inc. and 173 'A' Class shares have been issued to Pacific LNG Operations Ltd bringing the 'A' Class shareholding of both remaining joint venture partners to 175 'A' Class shares each, giving equal voting rights and board positions in the joint venture.

# InterOil Corporation

## Notes to Consolidated Financial Statements (Unaudited, Expressed in United States dollars)



### 14. Goodwill

As noted above in note 13, On February 27, 2009, InterOil LNG Holdings Inc. acquired its portion of Merrill Lynch's interest in the Joint Venture Company for \$11,250,000.

As part of the acquisition, InterOil LNG Holdings Inc. was transferred 548,806 'B' Class shares held by Merrill Lynch. The amount recognized as goodwill of \$5,761,940 represents the amount of purchase consideration paid to Merrill Lynch over and above the fair value of the identifiable net assets acquired.

### 15. Working capital facility

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
BNP Paribas working capital facility - midstream	-	53,386,775	74,058,565
Westpac and BSP working capital facility - downstream	3,962,238	15,405,627	-
<b>Total working capital facility</b>	<b>3,962,238</b>	<b>68,792,402</b>	<b>74,058,565</b>

#### *BNP Paribas working capital facility*

InterOil has a working capital credit facility with BNP Paribas (Singapore branch) with a maximum availability of \$190,000,000. The facility is renewable annually and as part of the current year renewal process, which was completed in the quarter ended September 30, 2008, the overall facility limit was increased by \$20,000,000 to \$190,000,000 to accommodate higher crude prices and resulting increases in working capital requirements.

This financing facility supports the ongoing procurement of crude oil for the refinery and includes related hedging transactions. The facility comprises a base facility to accommodate the issuance of letters of credit followed by secured loans in the form of short term advances. In addition to the base facility, the agreement offers both; cash secured short term facility, and a discounting facility on specific monetary receivables (note 8). The facility is secured by sales contracts, purchase contracts, certain cash accounts associated with the refinery, all crude and refined products of the refinery and trade receivables.

The facility bears interest at LIBOR + 3.5% on the short term advances. During the six month period the weighted average interest rate was 4.39% (Jun 2008 – 5.5%). The following table outlines the facility and the amount available for use at quarter end:

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
Working capital credit facility	190,000,000	190,000,000	200,000,000
Less amounts included in the working capital facility liability:			
Short term advances	-	(50,245,537)	(23,978,094)
Discounted receivables (note 8)	-	(3,141,238)	(50,080,471)
		(53,386,775)	(74,058,565)
Less: other amounts outstanding under the facility:			
Letters of credit outstanding	(72,600,000)	(27,600,000)	(95,000,000)
Bank guarantees on hedging facility	-	-	(11,000,000)
<b>Working capital credit facility available for use</b>	<b>117,400,000</b>	<b>109,013,225</b>	<b>19,941,435</b>

At June 30, 2009, the company had three letters of credit outstanding totalling \$72,600,000. The first letter of credit for \$2,000,000 was for a gasoline cargo and was drawn down on July 1, 2009. The second letter of credit for \$37,100,000 was for a crude cargo and was drawn down on July 6, 2009. The third letter of credit for \$33,500,000 was for a crude cargo and was drawn down on July 16, 2009.

The cash deposit on working capital facility, as separately disclosed in note 7, included restricted cash of \$14,520,001 (Dec 2008 - \$25,994,258, Jun 2008 - \$26,016,420) which is being maintained as a security margin for the facility. In addition, inventory of \$79,490,784 (Dec 2008 - \$56,012,523, Jun 2008 - \$30,213,632) and trade receivables of \$31,328,111 (Dec 2008 - \$10,300,542, Jun 2008 - \$98,217,790) also secured the facility. The trade receivable balance securing the facility includes \$22,472,429 (Dec 2008 - \$6,912,883, Jun 2008 - \$30,571,438) of inter-company receivables which were eliminated on consolidation.

# InterOil Corporation

## Notes to Consolidated Financial Statements (Unaudited, Expressed in United States dollars)



### 15. Working capital facility (cont'd)

#### ***Westpac and Bank South Pacific working capital facility***

On October 24, 2008 the Company secured a Papua New Guinea Kina 150,000,000 (approximately \$56,025,000) combined revolving working capital facility for its wholesale and retail petroleum products distribution business in Papua New Guinea from Bank of South Pacific Limited ('BSP') and Westpac Bank PNG Limited. The Westpac facility limit is Papua New Guinea Kina 80,000,000 (approximately \$29,880,000) and the BSP facility limit is Papua New Guinea Kina 70,000,000 (approximately \$26,145,000). The Westpac facility is for an initial term of three years and is due for renewal in October 2011. The BSP facility is renewable annually and is due for renewal in August 2009. These facilities are secured by a fixed and floating charge over the assets and liabilities of Downstream operations.

### 16. Acquisition of a subsidiary

#### ***InterOil Singapore Pte Ltd***

In May 2009, InterOil Singapore Pte Ltd was incorporated as a 100% subsidiary of InterOil Corporation to facilitate the operation of the LNG Project in Papua New Guinea. All costs incurred by this entity will be recharged to the LNG joint venture and relevant InterOil entities based on an equitable driver basis.

#### ***InterOil New York Inc***

In April 2008, InterOil New York Inc. was incorporated as a 100% subsidiary of InterOil Corporation to evaluate potential financing arrangements in the U.S. The Company had not undertaken any activities as at June 30, 2009.

### 17. Related parties

#### ***Petroleum Independent and Exploration Corporation ("P.I.E")***

P.I.E is controlled by Phil Mulacek, an officer and director of InterOil and acts as a sponsor of the Company's oil refinery project. Articles of association of SPI InterOil LDC ("SPI") provide for the business and affairs of the entity to be managed by a general manager appointed by the shareholders of SPI and its U.S. sponsor under the Overseas Private Investment Corporation ("OPIC" - which is an agency of the U.S. Government) loan agreement. SPI does not have a Board of Directors, instead P.I.E. has been appointed as the general manager of SPI. Under the laws of the Commonwealth of The Bahamas, the general manager exercises all powers which would typically be exercised by a Board of Directors, being those which are not required by laws or by SPI's constituting documents to be exercised by the members (shareholders) of SPI. InterOil is the majority shareholder of SPI and therefore has the power to appoint the general manager.

During the six months ended June 30, 2009, \$75,000 (Jun 2008 - \$75,000) was expensed for the sponsor's legal, accounting and reporting costs. These costs were included in accrued liabilities at June 30, 2009.

#### ***Breckland Limited***

This entity is controlled by Roger Grundy, a director of InterOil, and provides technical and advisory services to the Company on normal commercial terms. Amounts paid or payable to Breckland for technical services during the six month period amounted to \$nil (Jun 2008 - \$nil). An amount of \$4,145 (Jun 2008 - \$9,562) was reimbursed by the Company during the six months ended June 30, 2009 for expenses associated with Mr. Grundy's travel for board meetings.

#### ***Director fees***

Amounts due to Directors at June 30, 2009 totaled \$26,000 for Directors fees (Dec 2008 - \$27,750, Jun 2008 - \$30,500) and \$nil for Executive Director bonuses (Dec 2008 - \$nil, Jun 2008 - \$nil). These amounts are included in accounts payable and accrued liabilities. An amount of \$64,000 (Dec 2008 - \$120,000, Jun 2008 - \$61,000) was paid or payable to the Directors for Directors fees during the six months.

#### ***BNP Paribas***

One of our Directors, Edward Speal, is the Managing Director of BNP Paribas (New York). InterOil has a working capital facility with BNP Paribas (Singapore) of \$190,000,000 (as per note 15) - Management does not consider this to be related party transaction as the Director does not have the ability to exercise, directly or indirectly, control, joint control or significant influence over BNP (Singapore).

**InterOil Corporation**  
**Notes to Consolidated Financial Statements**  
**(Unaudited, Expressed in United States dollars)**



**18. Secured loan**

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
Secured loan (OPIC) - current portion	9,000,000	9,000,000	9,000,000
Total current secured loan	9,000,000	9,000,000	9,000,000
Secured loan (OPIC) - non current portion	49,000,000	53,500,000	58,000,000
Secured loan (OPIC) - deferred financing costs	(1,022,695)	(1,134,667)	(1,246,639)
Total non current secured loan	47,977,305	52,365,333	56,753,361
Total secured loan	56,977,305	61,365,333	65,753,361

**OPIC Secured Loan**

On June 12, 2001, the Company entered into a loan agreement with OPIC to secure a project financing facility of \$85,000,000. The loan agreement was last amended under which the half yearly principal payments of \$4,500,000 due in December 2006 and June 2007 each were deferred to the end of the loan agreement, being June 30, 2015 and December 31, 2015. The loan is secured over the assets of the refinery project which have a carrying value of \$198,620,358 at June 30, 2009 (Dec 2008 - \$203,778,963, Jun 2008 - \$209,131,138).

The interest rate on the loan is equal to the treasury cost applicable to each promissory note (at the date of draw down) outstanding plus the OPIC spread (3%). During the six months ended June 30, 2009 the weighted average interest rate was 6.92% (Jun 2008 - 7.10%) and the total interest expense included in long term borrowing costs was \$2,149,324 (Jun 2008 - \$2,382,495).

As at June 30, 2009, two installment payments amounting to \$4,500,000 each which will be due for payment on December 31, 2009 and June 30, 2010 have been reclassified into the current portion of the liability. The agreement contains certain financial covenants which include the maintenance of minimum levels of tangible net worth and limitations on the incurrence of additional indebtedness. A deposit is also required to be maintained to cover the next installment and interest payment. As of June 30, 2009, the company was in compliance with all applicable covenants.

Deferred financing costs relating to the OPIC loan of \$1,022,695 (Dec 2008 - \$1,134,667, Jun 2008 - \$1,246,639) are being amortized over the period until December 2014.

The accrued financing costs of \$nil (Dec 2008 \$nil, Jun 2008 - \$362,500) included discounting of the liability and costs in relation to the modification of the loan repayments. The total liability of \$1,450,000 was due for payment in four quarterly installments of \$362,500 commencing on December 31, 2007. The installments due for payment within twelve months were included within accounts payable and accrued liabilities. All four of these installments have been made as at June 30, 2009.

Bank covenants under the above facility currently restrict the payment of dividends by the Company.

**19. Indirect participation interests**

**Indirect participation interest ("IPI")**

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
Indirect participation interest ("IPI")	70,048,179	72,476,668	87,877,831

The IPI balance relates to \$125,000,000 received by InterOil subject to the terms of the agreement dated February 25, 2005 between the Company and a number of investors. In exchange InterOil has provided the investors with a 25% interest in an eight well drilling program to be conducted in InterOil's petroleum prospecting licenses 236, 237 and 238.



**19. Indirect participation interests (cont'd)**

Under the IPI agreement, InterOil is responsible for drilling the eight exploration wells, four of which will be in PPL 238, one in PPL 236, and one in PPL 237. The investors will be able to approve the location of the final two wells to be drilled. In the instance that InterOil proposes appraisal or completion of an exploration or development well, the investors will be asked to contribute to the completion work in proportion to their IPI percentage and InterOil will bear the remaining cost. Should an investor choose not to participate in the completion works of an exploration well, the investor will forfeit their right to the well in question as well as their right to convert into common shares. InterOil has drilled four exploration wells under the IPI agreement as at June 30, 2009.

The non-financial liability has been valued at \$105,000,000, being the estimated expenditures to complete the eight well drilling program, and the residual value of \$20,000,000 has been allocated to the conversion option presented under Shareholder's equity. InterOil paid financing fees and transaction costs of \$8,138,741 related to the indirect participation interest on behalf of the indirect participation interest investors in 2005. These fees have been allocated against the non-financial liability, reducing the liability to \$96,861,259. InterOil will maintain the liability at its initial value until conveyance is triggered on the lapse of the conversion option available to the investors and they elect to participate in the Petroleum Development License ('PDL') for a successful well. InterOil will account for the exploration costs relating to the eight well program under the successful efforts accounting policy adopted by the Company. All Geological & Geophysical ('G&G') costs relating to the exploration program will be expensed as incurred and all drilling costs will be capitalized and assessed for recovery at each period. When conveyance is triggered on election by the investors to participate in a PDL or when the investor forfeits the conversion option, conveyance accounting will be applied. This would entail determination of proceeds for the interests conveyed and the cost of that interest as represented in the 'Oil and gas properties' in the balance sheet. The difference between proceeds on conveyance and capitalized costs to the interests conveyed will be recognized as gain or loss in the Statement of operations following the guidance in paragraphs 47(h) and 47(j) of SFAS 19.

Under the agreement, all or part of this indirect participation interest may be converted to a maximum of 3,333,334 common shares in the company between June 15, 2006 and the later of December 15, 2006, or until 90 days after the completion of the eighth well at a price of \$37.50 per share. Should the option to convert to shares not be exercised, the indirect participation interest in the eight well drilling program will be maintained and distributions from success in these wells will be paid in accordance with the agreements. Any partial conversion of an indirect participation interest into common shares will result in a corresponding decrease in the investors' interest in the eight well drilling program. The balance of the indirect participation interest that may be converted into shares is a maximum of 2,000,000 common shares (Dec 2008 – 2,160,000, Jun 2008 – 2,760,000) due to the conversion of 476,667 shares and waiver of rights to 856,667 shares as explained below.

During 2007, one of the IPI investors exercised their right to convert their interest into 26,667 common shares. During the quarter ended September 30, 2008 two IPI investors also exercised their conversion rights into 450,000 InterOil common shares. The conversions during quarter ended September 30, 2008 reduced the IPI liability balance by \$13,076,270 and the conversion option balance by \$2,700,000 as compared to the balance at December 31, 2007.

During the year ended December 31, 2008, two of the investors' with a combined 5.225% interest in the eight well drilling program waived their right to convert their IPI percentage into 696,667 common shares. On April 17, 2009, one of the investors who has a 1.2% interest in the eight well drilling program has waived its right to convert its IPI percentage into common shares. These waivers have resulted in conveyance being triggered on this portion of the IPI agreement.

The Company has applied the guidance in paragraph 47(h) of SFAS 19 in relation to sale of these unproved properties and directly apportioned the proceeds to each of the 8 wells in the program. Based on the guidance, the proceeds attributed to each well have been assessed against the capitalized costs relating to each of these properties. Proceeds of \$1,087,483 (Dec 2008 - \$4,735,084) relating to wells that have no capitalized costs on the balance sheet, which have been expensed in previous years, have been recognized as a gain in the Statement of Operations in the six months ended June 30, 2009. Proceeds of \$7,139,352 have been allocated to the capitalized costs in relation to the conveyance of wells that do have capitalized costs on the balance sheet. The proceeds on conveyance for the portion relating to the remaining obligations under the IPI Agreement, is still being maintained as part of the IPI liability.

**InterOil Corporation**  
**Notes to Consolidated Financial Statements**  
**(Unaudited, Expressed in United States dollars)**



**19. Indirect participation interests (cont'd)**

**Indirect participation interest – PNGDV**

	June 30, 2009 \$	December 31, 2008 \$	June 30, 2008 \$
Current portion	540,002	540,002	540,002
Non current portion	844,490	844,490	844,490
Total indirect participation interest - PNGDV	1,384,492	1,384,492	1,384,492

As at June 30, 2009, the balance of the PNG Drilling Ventures Limited ("PNGDV") indirect participation interest in the Company's phase one exploration program within the area governed by petroleum prospecting licenses 236, 237 and 238 is \$1,384,492 (Dec 2008 - \$1,384,492, Jun 2008 - \$1,384,492). In 2006 an amendment was made to the original agreement whereby PNG Drilling Ventures Limited converted their remaining balance of \$9,685,830 into 575,575 InterOil common shares and also retained a 6.75% interest in the next four exploration wells (the first of the four wells is Elk-1, with an additional two exploration wells to be drilled after Elk-4/A). PNGDV also has the right to participate in the 16 wells that follow the first four mentioned above up to an interest of 5.75% at a cost of \$112,500 per 1% per well (with higher amounts to be paid if the depth exceed 3,500 meters and the cost exceeds \$8,500,000).

The accounting for the amendment to the agreement resulted in the fair value of the shares issue of \$7,948,691 being recognized as share capital. The Company has also recognized an initial liability relating to its obligation to drill the above four wells on behalf of the investors of \$3,588,560. The difference between the opening balance and the amount allocated to share capital and the revised amount allocated to the liability of \$1,851,421 has been expensed as a cost of amending the original transaction.

During the six months ended June 30, 2009, \$nil (Jun 2008 – \$540,002) of geological and geophysical costs and drilling costs in relation to the Elk-4A exploratory well have been allocated against the liability bringing the remaining balance to \$1,384,492. PNGDV liability has been accounted using conveyance accounting as there are no conversion options attached to the liability, unlike the IPI non-financial liability noted above.

**Other**

In addition to the above, PNG Energy Investors ("PNGEI"), an indirect participation interest investor who converted all of its interest to common shares in fiscal year 2004, has the right to participate up to a 4.25% interest in 16 wells commencing from exploration wells numbered 9 to 24. As at the end of June 30, 2009 we have drilled 6 exploration wells since inception of our exploration program within PPL 236, 237 and 238 in Papua New Guinea. In order to participate, PNGEI would be required to contribute a proportionate amount of drilling costs related to these wells.

**20. Non controlling interest**

The non controlling interest as at June 30, 2009 relates to Petroleum Independent and Exploration Corporation's ("PIE Corp.") 0.02% minority shareholding in SPI InterOil LDC. InterOil has entered into an agreement with PIE Corp. under which PIE Corp. can exchange its remaining 5,000 shares of SPI InterOil LDC for Common Shares on a one-for-one basis. This election may be made by PIE Corp. at any time.

# InterOil Corporation

## Notes to Consolidated Financial Statements

### (Unaudited, Expressed in United States dollars)



#### 21. Share capital

The authorized share capital of the Company consists of an unlimited number of common shares with no par value. Each common share entitles the holder to one vote.

**Common shares** - Changes to issued share capital were as follows:

	Number of shares	\$
January 1, 2008	31,026,356	259,324,133
Shares issued on Private Placement	2,728,477	58,938,305
Shares issued on exercise of options	58,000	1,413,587
Shares issued on preference share conversion and interest payments	532,754	15,012,950
Share issued as placement fee on debenture issue	228,000	5,700,000
Share issued on debenture conversions	641,000	15,118,483
Shares issued on debenture interest payments	259,105	2,620,628
Shares issued on conversion of indirect participation interest	450,000	15,776,270
December 31, 2008	35,923,692	373,904,356
Shares issued on exercise of options	182,000	5,043,355
Shares issued on buyback of LNG Interest (note 13)	499,834	11,250,000
Shares issued on debenture conversions (note 23)	3,159,000	77,089,722
Shares issued on debenture interest payments (note 23)	70,548	2,352,084
Shares issued on common stock offering	2,013,815	70,443,249
June 30, 2009	41,848,889	540,082,767

#### 22. Preference Shares

In November 2007, the Company authorized the issue of 1,035,554 convertible preference shares at an issue price of \$28.97 to investors amounting to a total of \$30,000,000. 517,777 of the authorized preference shares were issued to an investor in November 2007 for \$15,000,000. The preferred stock carried a fixed dividend of 5% per annum payable quarterly in arrears in cash or stock at the issuers' option on March 31, June 30, September 30 and December 31 of each year, commencing on December 31, 2007. The holder can convert into common shares at any time.

Based on guidance under CICA 3863, the preference shares were assessed based on the rights attached to those shares in determining whether it exhibited the fundamental characteristic of a financial liability or equity. Management has assessed that although the preference shares issued exhibit some characteristics of an equity instrument, the fixed interest right is in the nature of a liability. Management had applied residual basis and has valued the liability component first and assigned the residual value to the equity component. Management has fair valued the liability component by discounting the expected interest payments using a nominal rate of 8.9% being Management's estimate of the expected interest payments for a similar instrument without the conversion feature. The liability component was valued at \$7,797,312 and the remaining balance of \$7,202,688 was allocated to the equity component before offsetting transaction costs. The transaction costs relating to the preference share issue amounting to \$750,000 has been split based on the percentages allocated to the liability and equity components; the costs relating to the liability component has been expensed, and costs relating to the equity component have been allocated against the equity component recognized.

The preference dividend payment of 5% per annum is treated as an interest expense and is expensed in the Statement of Operations for the year. The preference dividend paid for the six months ended June 30, 2009 was \$nil (Jun 2008 - \$372,950). During the quarter ended September 30, 2008 all preference shares issued (517,777 shares) were converted into common shares.

#### 23. 8% subordinated debentures

On May 13, 2008, the Company completed the issue of \$95,000,000 unsecured 8% subordinated convertible debentures with a maturity of five years. The debenture holders had the right to convert their debentures into common shares at any time at a conversion price of \$25.00 per share. The Company had the right to require the debenture holders to convert if the daily Volume Weighted Average Price ('VWAP') of the common shares is at or above \$32.50 for at least 15 consecutive trading days. Accrued interest on these debentures were to be paid semi-annually in arrears, in May and November of each year, commencing November 2008.

# InterOil Corporation

## Notes to Consolidated Financial Statements (Unaudited, Expressed in United States dollars)



### 23. 8% subordinated debentures (cont'd)

Based on guidance under CICA 3863, the debentures was assessed based on the substance of the contractual arrangement in determining whether it exhibits the fundamental characteristic of a financial liability or equity. Management had assessed that the debenture instrument mainly exhibited characteristics that are liability in nature; however, the embedded conversion feature was equity in nature and needed to be bifurcated and disclosed separately within equity. Management applied residual basis and had valued the liability component first and assigned the residual value to the equity component.

Management had fair valued the liability component by discounting the expected interest payments using a nominal rate of 13.5% being Management's estimate of the expected interest payments for a similar instrument without the conversion feature. The liability component was valued at \$81,933,311 and the remaining balance of \$13,066,689 was allocated to the equity component before offsetting transaction costs.

The placement fee of \$5,700,000 paid to the investors in common shares of the Company was treated to be in the nature of a debt discount and was offset against the liability component. The transaction costs relating to the issue amounting to \$219,966 has been split based on the percentages allocated to the liability and equity components; the costs relating to the liability component of \$189,711 has been offset against the liability component, and costs relating to the equity component of \$30,255 have been allocated against the equity component recognized.

The liability component on initial recognition after adjusting for the placement fee and transaction costs amounted to \$76,043,600 and the equity component amounted to \$13,036,434. The liability component will be accreted over the five year maturity period to bring the liability back to the carrying value. The accretion expense relating to the debenture liability for the six months ended June 30, 2009 was \$1,212,262 (Jun 2008 - \$472,700). In addition to the accretion, interest at 8% per annum has been expensed for the six months ended June 30, 2009 amounting to \$2,712,936 (Jun 2008 - \$1,055,556). The interest payable up to May 9, 2009 was paid in a combination of cash and shares.

During the year ended December 31, 2008, certain debenture holders exercised their conversion rights for \$16,025,000 resulting in issue of 641,000 common shares of the Company. During May 2009, a further 755,000 debentures amounting to \$18,875,000 were converted into common shares of the Company. On June 8, 2009, all remaining debentures outstanding were converted into common shares due to a mandatory conversion resulting from the daily VWAP of the common shares being above \$32.50 for at least 15 consecutive trading days. The remaining book value of the liability and equity portion on the date of mandatory conversion was transferred to share capital to record this conversion. As at June 30, 2009, of the 3,800,000 convertible debentures issued, nil (Jun 2008 - 3,800,000), were outstanding.

### 24. Stock compensation

Options are issued at no less than market price to directors, certain employees and to a limited number of contractor personnel. Options are exercisable on a 1:1 basis. Options vest at various dates in accordance with the applicable option agreement, vesting generally between one to four years after the date of grant, have an exercise period of three to five years after the date of grant, and are subject to the option plan rules. Upon resignation or retirement, vested options must be exercised within 90 days or before expiry of the options if this occurs earlier.

	Quarter ended June 30,				Six months ended June 30,			
	2009		2008		2009		2008	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Stock options outstanding								
Outstanding at beginning of period	1,805,500	20.44	1,295,000	23.58	1,839,500	20.18	1,200,500	23.70
Granted	93,000	26.01	270,000	33.82	213,000	20.25	370,000	30.16
Exercised	(122,000)	(21.16)	(8,000)	(15.94)	(182,000)	(18.96)	(8,000)	(15.94)
Forfeited	-	-	(5,000)	(28.68)	(49,000)	(30.39)	(10,500)	(28.68)
Expired	-	-	(200,000)	(26.53)	(45,000)	(34.18)	(200,000)	(26.53)
Outstanding at end of period	1,776,500	20.68	1,352,000	25.21	1,776,500	20.68	1,352,000	25.21

At June 30, 2009, in addition to the options outstanding as per the above table, there were an additional 96,500 (Dec 2008 - 309,500, Jun 2008 - 886,000) common shares reserved for issuance under the Company's 2009 stock option plans as approved on June 19, 2009.

# InterOil Corporation

## Notes to Consolidated Financial Statements (Unaudited, Expressed in United States dollars)



### 24. Stock compensation (cont'd)

Range of exercise prices \$	Options issued and outstanding			Options exercisable		
	Number of options	Weighted average exercise price \$	Weighted average remaining term (years)	Number of options	Weighted average exercise price \$	
8.01 to 12.00	545,000	9.81	4.82	40,000	9.92	
12.01 to 24.00	563,000	17.07	3.40	300,000	16.76	
24.01 to 31.00	321,000	28.38	3.28	265,250	28.32	
31.01 to 41.00	272,500	34.65	4.39	75,000	33.82	
41.01 to 51.00	75,000	43.22	1.21	75,000	43.22	
	1,776,500	20.68	3.64	755,250	24.78	

Aggregate intrinsic value of the 1,776,500 options issued and outstanding as at June 30, 2009 is \$21,906,654. Aggregate intrinsic value of 755,250 options exercisable as at June 30, 2009 is \$10,884,000.

The weighted-average grant-date fair value of options granted during the six months ended June 30, 2009 was \$13.32 (Jun 2008 - \$16.71). The total intrinsic value of options exercised during the six months ended June 30, 2009 was \$1,581,105 (Jun 2008 - \$66,495). Cash received from option exercise under all share-based payment arrangements for the six months ended June 30, 2009 was \$3,450,490 (Jun 2008 - \$127,520).

The fair value of the 213,000 (Jun 2008 - 370,000) options granted subsequent to January 1, 2009 has been estimated at the date of grant in the amount of \$2,837,407 (Jun 2008 - \$6,182,309) using a Black-Scholes pricing model. An amount of \$3,317,211 (Jun 2008 - \$2,241,425) has been recognized as compensation expense for the six months ended June 30, 2009. The current year compensation expense of \$3,317,211 (Jun 2008 - \$2,241,425) was adjusted against contributed surplus under equity, out of which \$1,581,105 (Jun 2008 - \$66,495) was transferred to share capital on exercise of options, leaving a net impact of \$1,736,105 (Jun 2008 - \$2,174,930) on contributed surplus.

The assumptions contained in the Black Scholes pricing model are as follows:

Year	Period	Risk free interest rate (%)	Dividend yield	Volatility (%)	Weighted average expected life for options
2009	Apr 1 to Jun 30	1.4	-	83	5.0
2009	Jan 1 to Mar 31	1.1	-	83	5.0
2008	Oct 1 to Dec 31	1.5	-	83	4.3
2008	Apr 1 to Sep 30	2.7	-	80	5.0
2008	Jan 1 to Mar 31	2.2	-	73	5.0

### 25. Warrants

In 2004, InterOil issued five-year warrants to purchase 359,415 common shares at an exercise price equal to \$21.91. A total of 337,252 (Dec 2008 - 337,252, Jun 2008 - 337,252) were outstanding at June 30, 2009. The warrants are exercisable between August 27, 2004 and August 27, 2009. The warrants are recorded at the fair value calculated at inception as a separate component of equity. The fair value was calculated using a Black-Scholes pricing model with the following assumptions: risk-free interest rate of 2.5%, dividend yield of nil, volatility factor of the expected market price of the Company's common stock of 45% and a weighted average expected life of the warrants of five years.

### 26. Earnings/(Loss) per share

Preferred stock, warrants, conversion options and stock options totaling 4,118,752 common shares at prices ranging from \$9.80 to \$43.22 were outstanding as at June 30, 2009 and were included in the computation of the diluted earnings per share at June 30, 2009.

**InterOil Corporation**  
**Notes to Consolidated Financial Statements**  
**(Unaudited, Expressed in United States dollars)**



**26. Earnings/(Loss) per share (cont'd)**

Potential dilutive instruments outstanding	Number of shares June 30, 2009	Number of shares June 30, 2008
Preferred stock	-	517,777
Employee stock options	1,776,500	1,352,000
IPI Indirect Participation interest - conversion options	2,000,000	2,760,000
8% Convertible debentures	-	3,800,000
Warrants	337,252	337,252
Others	5,000	5,000
<b>Total stock options/shares outstanding</b>	<b>4,118,752</b>	<b>8,772,029</b>

The reconciliation between the income available to the common shareholders and the income available to the dilutive shareholders, used in the calculation of the numerator in the EPS calculation is as follows:

	Quarter ended		Six months ended	
	June 30,	June 30,	June 30,	June 30,
	2009	2008	2009	2008
	\$	\$	\$	\$
<b>Income/(loss) available to the common shareholders</b>	<b>9,438,070</b>	<b>15,602,576</b>	<b>12,081,550</b>	<b>13,205,214</b>
Interest expense on Preference shares	-	186,475	-	372,951
Interest expense on debentures	-	1,055,556	-	1,055,556
Accretion expense on debentures	-	472,700	-	472,700
Non-controlling interest	-	2,044	-	1,859
<b>Income/(loss) available to dilutive holders</b>	<b>9,438,070</b>	<b>17,319,351</b>	<b>12,081,550</b>	<b>15,108,280</b>

The income available to the common shareholders and the income available to the dilutive holders, used in the calculation of the numerator in the EPS calculation is the net profit/loss as per Consolidated Statement of Operations same as inclusion of convertible securities under 'if-converted' method would result in the EPS being anti-dilutive.

The reconciliation between the 'Basic' and 'Basic & Diluted' shares, used in the calculation of the denominator in the EPS calculation is as follows:

	Quarter ended		Six months ended	
	June 30,	June 30,	June 30,	June 30,
	2009	2008	2009	2008
<b>Basic</b>	<b>38,244,238</b>	<b>32,720,492</b>	<b>37,216,877</b>	<b>31,873,424</b>
Employee options (using treasury stock method)	590,644	165,990	450,233	132,122
Warrants (using treasury stock method)	111,634	42,862	57,696	10,874
Preference shares	-	517,777	-	517,777
Debentures	-	2,213,187	-	1,106,593
Indirect Participation interest	-	2,964,249	-	3,135,458
Other	-	5,000	-	5,000
<b>Diluted</b>	<b>38,946,516</b>	<b>38,629,556</b>	<b>37,724,806</b>	<b>36,781,249</b>

# InterOil Corporation

## Notes to Consolidated Financial Statements (Unaudited, Expressed in United States dollars)



### 27. Commitments and contingencies

#### Commitments

Payments due by period contractual obligations are as follows:

	Total	Less than 1					More than 5 years
		year	1-2 years	2-3 years	3-4 years	4-5 years	
	'000	'000	'000	'000	'000	'000	'000
Secured loan and debenture obligations	58,000	9,000	9,000	9,000	9,000	9,000	13,000
Indirect participation interest - PNGDV (note 19)	1,384	540	844	-	-	-	-
PNG LNG Inc. Joint Venture (proportionate share of commitments)	1,070	1,044	26	-	-	-	-
Petroleum prospecting and retention licenses (a)	95,000	16,500	4,500	23,333	35,333	15,334	-
	155,454	27,084	14,370	32,333	44,333	24,334	13,000

(a) The amount pertaining to the petroleum prospecting and retention licenses represents the amount InterOil has committed as a condition on renewal of these licenses. Of this commitment, as at June 30, 2009, management estimates that \$45,761,032 would satisfy the commitments in relation to the IPI investors.

#### Contingencies:

The Company's Chief Executive Officer, Phil Mulacek, and his controlled entities Petroleum Independent & Exploration Corporation and P.I.E. Group, LLC, together with the Company and certain of its subsidiaries, are defendants in Todd Peters, et. al. v. Phil Mulacek et. al.; Cause No. 05-040-03592-CV; pending in the 284th District Court of Montgomery County, Texas. The plaintiffs are members of a partnership that bought a modular oil refinery that was subsequently, through a series of transactions, sold to a subsidiary of the Company. Plaintiffs contend that Mr. Mulacek and his controlled entities breached fiduciary duties owed to the plaintiffs and also assert claims for common law fraud, fraudulent inducement, statutory fraud, securities fraud, breach of contract, and investor oppression. Plaintiffs seek to impose liability on the Company and certain of its subsidiaries for those alleged acts through claims of ratification, conspiracy and knowing participation in the breach of another's fiduciary duty. In late July 2009, plaintiffs amended their petition adding sixteen new plaintiffs. Plaintiffs seek actual damages in excess of \$125,000,000 and unspecified punitive damages, attorneys' fees, expenses and court costs. In late July 2009, the trial setting was continued with a new trial date to be set in the spring of 2010. The Company and other defendants are vigorously contesting the matter. If however, plaintiffs succeed in obtaining a judgment in the amount they seek, it could have a material adverse effect on the Company or its subsidiaries.

In addition to the above, from time to time the Company is involved in various claims and litigation arising in the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Company's favor, the Company does not currently believe that the outcome of adverse decisions in any pending or threatened proceedings related to these and other matters or any amount which it may be required to pay by reason thereof would have a material adverse impact on its financial position, results of operations or liquidity.

#### Regulatory Actions

During the second half of the 2008 year, the Ontario Securities Commission (the "Commission") directed that the Company undertake a review of its option granting practices from January 1, 2001 and provide the Commission with certain specific information and documentation.

A Special Committee of InterOil, comprised solely of independent directors, completed the internal review of InterOil's historical option granting practices in February 2009. The Special Committee concluded its review and found some irregularities with respect to the administration of certain historical stock options grants, with the majority of these irregularities occurring prior to 2002 and well prior to the retention of those currently responsible for administration of stock options at InterOil. The Special Committee determined that these irregularities were not the result of any internal misconduct, but due to the failure to maintain adequate internal and accounting controls and some lack of understanding by those involved at the time. The Special Committee concluded that the total value of such errors is small and, relative to the InterOil's current operations, not material. No restatement of the Company's financial statements was required as a result of these determinations.



**27. Commitments and contingencies (cont'd)**

Based on the results of its investigation, the Special Committee provided a report to the Board of Directors and recommended to the Board of Directors that it adopt a number of remedial actions, which the Board, by vote, promptly accepted. These remedial actions have been implemented by management. A report of the results of the review and containing the information and documentation requested was provided to the Commission at the end of February 2009 and confirmation that all remedial actions had been fully implemented was provided in June 2009.

***Import Parity Price ('IPP') formula***

The Company has also been negotiating with the Papua New Guinea government to revise the Import Parity Price ('IPP') formula which governs refined product sales in Papua New Guinea. Since the period beginning November 30, 2007, an interim arrangement has been in place with the PNG Government to apply a revised IPP formula for all sales from that date. This interim formula was adjusted in June 2008 based on ongoing discussions with the government with a view to finalizing a permanent replacement to the IPP formula as is required under our agreement.

**28. Subsequent events**

There are no subsequent events that require disclosure.

**29. Explanation of key reconciling items to accounting principles generally accepted in the United States**

The consolidated financial statements of the Company for the quarter and six months ended June 30, 2009 and 2008 have been prepared in accordance with generally accepted accounting principles in Canada ("Canadian GAAP") which, in most respects, conforms to generally accepted accounting principles in the United States ("U.S. GAAP"). Detailed reconciliations and other information in relation to the differences between the two GAAP are presented in note 29 of the audited consolidated financial statements for the year ended December 31, 2008, 2007 and 2006. This note has summarized some of the key differences and the impact of any new transactions or U.S. GAAP developments that are applicable to the Company for the current six month period ended June 30, 2009.

**(1) Operations**

The Company determined that refinery operations commenced under U.S. GAAP at December 1, 2004, which is the date management assessed that construction of the refinery was substantially complete and ready for its intended use. The Company ceased capitalization of certain costs to the refinery project at this date and recognized one month's results from sales, related costs of sales and operating expenses and administrative and general expenses in the statement of operations for the year ended December 31, 2004. Operations of the refinery commenced on January 1, 2005 under Canadian GAAP. Therefore, the Company continued to capitalize December 2004's results to the refinery project. Due to the difference in the cost basis of the refinery, the depreciation expense recorded under U.S. GAAP differs from that recorded under Canadian GAAP during the period.

**(2) Indirect participation interest**

As disclosed in note 19 in the consolidated financial statements, the Company entered into an indirect participation interest agreement in exchange for proceeds of \$125,000,000. Under Canadian GAAP, this amount was apportioned between non financial liabilities and equity. Under U.S. GAAP, the Company has not bifurcated the amount as the Company has opted to utilize the scope exception under SFAS 133 Para 10(f) for 'derivatives that serve as impediments to sales accounting'.

As explained in note 19, on April 17, 2009, one of the investor who has a 1.2% interest in the eight well drilling program waived its right to convert its IPI percentage into 160,000 common shares. This waiver has resulted in conveyance being triggered on this portion of the IPI agreement for the six months ended June 30, 2009. As the initial IPI proceeds were not bifurcated under U.S. GAAP, the total conveyance proceeds available for the conveyed interest, the amounts offset against oil and gas properties, and the gain recognised in the Statement of operations will be higher than the CGAAP balance).



**29. Explanation of key reconciling items to accounting principles generally accepted in the United States (cont'd)**

**(3) 8% subordinated debentures:**

As disclosed in Note 23, on May 13, 2008, the Company completed the issue of \$95,000,000 unsecured 8% subordinated convertible debentures with a maturity of five years. Under Canadian GAAP, these debentures were assessed based on the rights attached to the instrument and Management valued the equity and liability component of the instrument using the residual value basis.

Under U.S. GAAP, Management assessed the debentures following the guidance under FAS 133 to determine whether the embedded conversion option needs to be bifurcated and disclosed separately. The embedded conversion option did not satisfy the condition of embedded derivatives that requires separation due to the scope exception under FAS 133 Para 11(a) as the option is indexed to the Company's own stock and would have been classified in Shareholder's equity if it had been separated.

As FAS 133 bifurcation is not applicable, the provisions of EITF 00-27 requires that the instrument be assessed for any 'Beneficial Conversion Features ('BCF')' included in the instrument, which should be separated using the intrinsic value method as noted in EITF 98-5. Based on the guidance, the BCF has been valued at \$8,821,320 which was separated and classified separately under equity as Contributed Surplus. After separation, the liability component was being accreted over the life of the debentures, being 5 years till May 2013.

During the six months ended June 30, 2009, all remaining debenture holders either exercised their conversion rights or were mandatorily converted into common shares due to a mandatory conversion resulting from daily VWAP of the common shares being above \$32.50 for at least 15 consecutive trading days.

As U.S. GAAP requires the expensing of all unamortized deferred financing costs, placement fee, and the remaining accretion relating to debentures converted prior to its maturity in the period of the conversion. No such expensing is required under Canadian GAAP. This amounts to an additional expense of \$9,849,833 under U.S. GAAP during the six month period ended June 30, 2009.

**(4) Investment in LNG Project/Deferred gain on contributions to LNG Project:**

As disclosed in Note 13, a Shareholders Agreement was signed on July 30, 2007 which converted PNG LNG Inc. and its subsidiaries into a joint venture project from being a subsidiary of InterOil. Under Canadian GAAP, joint ventures are proportionately consolidated into the Company's consolidated financials based on the shareholding in the joint venture.

Applying the guidance under APB 18, a corporate joint venture has to be equity accounted under U.S. GAAP. InterOil has also followed the guidance under SAB Topic 5H wherein a gain on contributions to the joint venture is not recognised, however, a gain is recognised as a result of a change in economic interest.

InterOil will account for the joint venture using equity accounted method. In addition to the gain or loss recognised as part of the operations, InterOil will also recognise any difference between the Investment carried in its balance sheet and the underlying equity in net assets of the joint venture in the statement of operations and the investment balance will increase/decrease in line with this difference.

**(5) Deferred Financing costs**

Deferred financial costs are offset against the respective liabilities under Canadian GAAP; however, the same is disclosed as a separate item on the face of the balance sheet under US GAAP in accordance with guidance under APB 21.

**(6) Income tax effect of adjustments**

The income tax effect of any U.S. GAAP adjustments would have to be recorded and would be a reconciling item for U.S. GAAP reporting.