

InterOil says discovery should spur LNG project

Statement sends short sellers scrambling

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VANCOUVER -- Putting the boom back into what has been a boom-and-bust trajectory, **InterOil Corp.** yesterday announced a gas discovery in Papua New Guinea that the company said bodes well for its plans to pursue a \$3-billion liquefied natural gas project with its investment partners.

"Having this discovery gives us the confidence that there is a resource size to underpin this activity," chief executive officer Phil Mulacek said in an interview.

The report sent shares soaring, and short sellers scrambled to cover their losses, putting more upward pressure on the stock. InterOil shares yesterday climbed by 23.6 per cent or \$5.33 to close at \$27.93 on the Toronto Stock Exchange and gained 22.6 per cent or \$4.51 (U.S.) to close at \$24.45 on the American Stock Exchange.

Short sellers have taken up a large position in InterOil, so any positive news can have a disproportionate effect on the shares, said Ira Zadikow, an analyst with New York-based Great Eastern Securities.

Short sellers make money by selling borrowed stock in the hope of buying it back at a lower price; when a stock begins to climb, some short sellers may buy the stock to cover their losses and exit.

"It's like a snowball, except the snowball's rolling uphill," Mr. Zadikow said.

The company operates in Papua New Guinea, where it is trying to position itself as an integrated energy producer with exploration, refining, and wholesale and distribution assets.

Yesterday, InterOil released a drilling report for its Elk-1 prospect that included results analysts described as encouraging while emphasizing it was too early to say what the commercial value of the find would be. Preliminary tests recorded a gas flow of 21.7 million cubic feet a day.

But the market also appeared to be responding to reports out of Papua New Guinea, where Prime Minister Michael Somare referred to gas reserves estimated at several trillion cubic feet and said the discovery could help drive the country's liquefied natural gas industry.

Frustrated with the lack of progress by major oil and gas companies in the region, the government of Papua New Guinea has been courting smaller, junior players in a bid to boost investment in the region.

The National, a Papua New Guinea newspaper, quoted the Prime Minister as saying, "InterOil's sometimes unorthodox approach to kick-starting projects may be what is needed to bring together some of [Papua New Guinea's] rich but dispersed petroleum assets, and overseas investors who are now looking at [the country] in a new light."

Earlier this year, InterOil formed a joint venture with Merrill Lynch Commodities (Europe) and a unit of Clarion Finanz to look at building an LNG project in the country.

If the gas is destined for LNG production, it may be years before such a project could benefit the company's bottom line, Mr. Zadikow said. And conventional natural gas development could be hampered by the lack of infrastructure. "They could have a natural gas find, but if they do not have a means of shipping it, transporting it, marketing it -- it doesn't help them a whole hell of a lot," Mr. Zadikow said.

The announcement "represents the government's effort to showcase the potential positive economic benefits of the project," John White, an analyst with Natexis Bleichroeder Inc., said in a note to clients.

Raymond James & Associates Inc. analyst Wayne Andrews zeroed in on an absolute open flow potential of 2.86-billion cubic feet a day. "This is an extremely large calculated unrestricted flow rate, and while it is highly unlikely that any well could ever produce at this rate, it implied that the well has encountered a very large reservoir," Mr. Andrews said yesterday in a report.

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