Trickle Research

Every raging river, every great lake, every deep blue sea starts … with a trickle

Price Target Increase

ALVOPETRO

Alvopetro Energy Ltd.

(TSXV:ALV.V; OTC:ALVOF)

http://alvopetro.com/

Report Date: 05/26/20

12- 24 month Price Target: * USD $1.25

Allocation: 5

Closing Stock Price at Initiation (Closing Px: 11/07/18): USD $.38

Closing Stock Price at Allocation Upgrade (Closing Px: 05/17/19): USD $.42

Closing Stock Price at This Report Date (Closing Px: 05/22/20): USD $.52

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Disclosure: Portions of this report are excerpted from Alvopetro's filings, website(s), presentations or other public collateral. We have attempted to identify those excerpts by *italicizing* them in the text.

Our research updates on Alvopetro have been less regular than those of some of or other coverage companies. In retrospect that is largely because we have been waiting on the completion of the gas gathering infrastructure, which essentially marks their transition to revenues and cashflow, which is a **transformational milestone** for the Company. In short, absent that catalyst, there has not been much else to discuss other than their progress to that end, which we did address in some general research notes as opposed to specific updates. Further, the completion of the gas gathering system was delayed a bit, which we think may have provided some headwinds for the stock, and while certainly topical, we didn't view the delays as particularly negative. Succinctly, in our world of microcap research, most projects of this nature have some hitches along the way and in Alvopetro's case, we didn't think any of the delays were indicative of a problem, which as it has turned out has proven to be a correct assessment.

Recently, the Company announced an amendment to their Bahiagás agreement. That amendment included some nuances we will discuss further below. That said, setting aside the amendment for a moment, in our view the most telling thing about the announcement was that they indicated that they would be selling gas into the city gate at scale through the entire second half of calendar 2020. That data point represents the successful culmination of several years of development at Alvopetro, as well as the Company's transition to the commercialization of its resource base. This is a "crowning achievement" for the Company, its management and its shareholders and it includes a handful of positive connotations that we think are worth briefly reviewing. Before we address those, we will first revisit the amendment to the Bahiagás agreement.

We are assuming that certainly a portion of the Bahiagás amendment was precipitated by the stark compression in energy prices prompted in part by the recent pandemic and corresponding decrease in worldwide energy consumption. Recall, the original agreement called for Bahiagás to purchase gas from Alvopetro with collars on both delivery prices and delivery amounts. In short, the new agreement provides for early prepayment of revenues to commence effective May 1, 2020 (Alvopetro agreed to provide a 15% price discount on pre-paid volumes), raised (doubled) the firm or committed volumes upon start of supply (expected by end of June), and significantly reduced any potential supply failure penalties. Keep in mind, the agreement has always involved favorable relative pricing arrangements largely because that pricing was comparative to that previously provided by (majority) state owned Petrobras. We won't rehash the initial coverage in detail, but briefly, part of our initial thesis was/is that Alvopetro is positioned to fill some of the domestic energy void left by state owned energy incumbent Petrobras, which has gone through some restructuring as a result of widespread corruption involving the company and Brazilian officials. That restructuring has included a more competitive domestic energy environment as well, which has provided an opening for Alvopetro and other domestic players. While lower energy prices have impacted Alvopetro, considering they are protected by a price floor in their gas sales agreement, they are impacted much less than their peers. Considering Alvopetro has been able to secure twice the demand from Bahiagás while reducing supply failure penalties during the pandemic we certainly think this is a very positive amendment. Again, as we see it, the respective collars have always essentially provided a better/lower risk profile for the project and Alvopetro and we think the amendment provides additional net benefits.

In addition to the above amendment, the Company also recently provided some increased reserve data with respect to the Caburé resource. In short, it got 30% bigger. In terms of our model (as well as the Company's guidance if our assessment therein is accurate), we have limited our production assumptions around the exhaustion of the existing reserve estimates. As a result, since the reserves increased, we in turn increased the forward production assumptions of our model. That event has increased our NPV/target assumptions as well. Further, as we alluded to in the initial coverage, we rely heavily on DCF analysis to arrive at our price targets and that typically includes marked discount rates to account for delays or other shortfalls between our future cash flow assumptions and the ultimate reality of the same. Succinctly, we have lowered our assumed discount rates because we think the commissioning of the infrastructure clearly reflects a further de-risking of the project and in lockstep the appropriate reduction of those rates. On the flip side, there are energy prices.

To reiterate, we submit that lower energy prices are not a positive development for Alvopetro, but again, the collard nature of their pricing arrangements were designed in part with this type of event in mind. More to the point, like everyone else, we have no idea where energy prices are going, and we suspect some of that will be driven by worldwide energy demand in the face of potentially lower general economic activity as a result of the pandemic. We have no idea how that plays out either. Further, oil prices specifically may continue to face additional headwinds from the demise of OPEC. We think the recent Russia/Saudi price war is function of that demise and we suspect volatility around that notion will continue to impact pricing. However, we also continue to believe that oil prices and natural gas prices could decouple more going forward. That is, we are not energy experts, but we think there are several reasons to believe that going forward, gas prices could certainly rise in the face of declining oil prices, especially in particular markets. That said, we believe our model assumptions in terms of forward pricing are more modest than those embedded in the Company's guidance, so perhaps that could provide a basis for upside surprises to our estimates.

To summarize, we think Alvopetro has arrived. In retrospect, management has delivered on the project and that should translate into growing cashflow and better corresponding valuations. Further, while as we noted the analysis here is largely limited to the delivery of *identified* Caburé reserves, we think the story remains open-ended. Specifically, there is the potential for *additional* increases to Caburé reserves as well as perhaps the delineation of Gomo reserves and/or others that may emerge. Each of those opportunities could result in added reserves and associated value. Moreover, as we covered in the initial research, we believe the completed infrastructure could lead to additional midstream opportunities for Alvopetro as well. To translate, we expect other opportunities, perhaps on various fronts, to emerge as we move forward. In our opinion, those and other emerging opportunities coupled with management's now proven ability to accomplish what they set out to do could provide a basis for additional valuation legs for the stock price.

As a result of the recent milestones, we are establishing a new (higher) 12-24 month price target of $1.25 per share. We will revisit our new price target as well as our allocation as additional data points emerge, especially on the commodity price front.

Projected Operating Model

Alvopetro Energy Ltd.							
Projected Operating Model (in USD - '000s)							
By Trickle Research LLC							
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
	3/31/20	6/30/20	9/30/20	12/31/20	Fiscal 2020	Fiscal 2021	Fiscal 2022
Oil & Gas Sales	$ 61	$ 17	$ 5,618	$ 5,779	$ 11,476	$ 24,477	$ 25,073
Royalties and Production Taxes	$ (8)	$ (2)	$ (618)	$ (636)	$ (1,264)	$ (2,693)	$ (2,758)
					$ -	$ -	$ -
Oil & Gas Revenue	$ 53	$ 15	$ 5,000	$ 5,144	$ 10,212	$ 21,785	$ 22,315
Midstream Transportation Revenues	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Other Income	$ 24	$ -	$ -	$ -	$ 24	$ -	$ -
Total Revenue and Other Income	$ 77	$ 15	$ 5,000	$ 5,144	$ 10,236	$ 21,785	$ 22,315
					$ -	$ -	$ -
Production	$ 44	$ 125	$ 483	$ 492	$ 1,144	$ 2,001	$ 2,028
Transportation	$ -	$ 3	$ 37	$ 38	$ 77	$ 159	$ 162
General & Administrative	$ 640	$ 640	$ 662	$ 666	$ 2,608	$ 2,690	$ 2,701
Depletion and Depreciation	$ 62	$ 108	$ 888	$ 879	$ 1,937	$ 3,324	$ 3,060
Impairment	$ 1,381	$ -	$ -	$ -	$ 1,381	$ -	$ -
Exploration and Evaluation	$ -	$ 52	$ 52	$ 52	$ 157	$ 177	$ 80
Finance Expenses (UPGN)	$ 276	$ 270	$ 270	$ 270	$ 1,086	$ 1,080	$ 1,080
Accretion of Decommissioning Liabilities	$ -	$ 10	$ 10	$ 10	$ 30	$ 40	$ 40
Share Based Compensation	$ 28	$ 20	$ 50	$ 50	$ 148	$ 80	$ 80
Foreign Exchange Loss	$ 9	$ -	$ -	$ -	$ 9	$ -	$ -
Loss on Disposition of Assets	$ -	$ -	$ -	$ -	$ -	$ -	$ -
0	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Operating Expenses	$ 2,440	$ 1,228	$ 2,453	$ 2,457	$ 8,578	$ 9,551	$ 9,232
Interest Expenses	$ -	$ 393	$ 351	$ 393	$ 1,137	$ 1,320	$ 984
Other Non-Operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total non-operating Expenses	$ -	$ 393	$ 351	$ 393	$ 1,137	$ 1,320	$ 984
Gain (Loss) Before Taxes	$ (2,363)	$ (1,606)	$ 2,197	$ 2,294	$ 522	$ 10,914	$ 12,099
Income Tax Charge (Recovery)	$ -	$ -	$ -	$ -	$ -	$ 1,184	$ 1,313
Net Loss	$ (2,363)	$ (1,606)	$ 2,197	$ 2,294	$ 522	$ 9,730	$ 10,786
Exchange (loss) gain on translation of foreign operations	$ (8,352)	$ -	$ -	$ -	$ (8,352)	$ -	$ -
Comprehensive (loss) gain	$ (10,715)	$ (1,606)	$ 2,197	$ 2,294	$ (7,830)	$ 9,730	$ 10,786
Net Gain (Loss) per share							
Basic	$ (0.02)	$ (0.02)	$ 0.02	$ 0.02	$ (0.08)	$ 0.10	$ 0.11
Diluted	$ (0.02)	$ (0.02)	$ 0.02	$ 0.02	$ (0.08)	$ 0.09	$ 0.10
Shares O/S - Basic	98,432,818	98,467,301	98,544,271	98,612,995	98,514,346	98,668,126	98,731,526
Shares O/S - Diluted	99,151,563	99,455,171	100,756,517	102,202,696	100,391,487	105,103,040	108,509,802

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Rating System Overview:

There are no letters in the rating system (Buy, Sell Hold), only numbers. The numbers range from 1 to 10, with 1 representing 1 "investment unit" (for my performance purposes, 1 "investment unit" equals $250) and 10 representing 10 investment units or $2,500. Obviously, a rating of 10 would suggest that I favor the stock (at respective/current levels) more than a stock with a rating of 1. As a guideline, here is a suggestion on how to use the allocation system.

Our belief at Trickle is that the best way to participate in the micro-cap/small cap space is by employing a diversified strategy. In simple terms, that means you are generally best off owning a number of issues rather than just two or three. To that point, our goal is to have at least 20 companies under coverage at any point in time, so let's use that as a guideline. Hypothetically, if you think you would like to commit $25,000 to buying micro-cap stocks, that would assume an investment of $1000 per stock (using the diversification approach we just mentioned, and the 20-stock coverage list we suggested and leaving some room to add to positions around allocation upgrades. We generally start initial coverage stocks with an allocation of 4. Thus, at $1000 invested per stock and a typical starting allocation of 4, your "investment unit" would be the same $250 we used in the example above. Thus, if we initiate a stock at a 4, you might consider putting $1000 into the position ($250 * 4). If we later raise the allocation to 6, you might consider adding two additional units or $500 to the position. If we then reduce the allocation from 6 to 4 you might consider selling whatever number of shares you purchased with 2 of the original 4 investment units. Again, this is just a suggestion as to how you might be able to use the allocation system to manage your portfolio.

For those attached to more traditional rating systems (Buy, Sell, Hold) we would submit the following guidelines.

A Trickle rating of 1 thru 3 would best correspond to a "Speculative Buy" although we would caution that a rating in that range should not assume that the stock is necessarily riskier than a stock with a higher rating. It may carry a lower rating because the stock is trading closer to a price target we are unwilling to raise at that point. This by the way applies to all of our ratings.

A Trickle rating of 4 thru 6 might best (although not perfectly) correspond to a standard "Buy" rating.

A Trickle rating of 7 thru 10 would best correspond to a "Strong Buy" however, ratings at the higher end of that range would indicate something that we deem as quite extraordinary..... an "Extreme Buy" if you will. You will not see a lot of these.