

# Trickle Research

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



## Research Update



### Alvopetro Energy Ltd.

(TSXV:ALV.V; OTC:ALVOF)

<http://alvopetro.com/>

**Report Date: 11/17/20**

**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 Target Upgrade (Closing Px: 05/26/20): USD \$.52**

**Closing Stock Price at This Report Date (Closing Px: 11/17/20): USD \$.63**

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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.

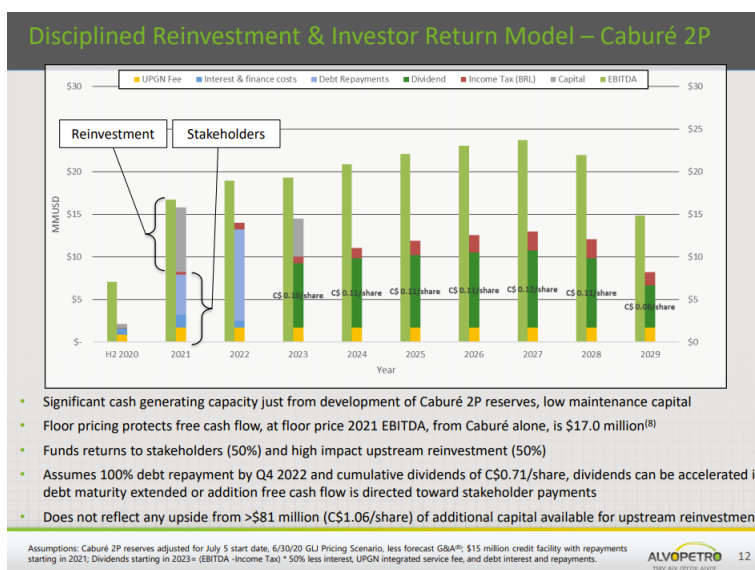
AlvoPetro reported late last week and the numbers were largely in-line with our estimates save some accounting nuances we did not account for (a non-cash \$4.9 million deferred tax recovery for instance). Recognize, this is their first *full quarter* of gas deliveries, and since we know most of the inputs (within some reasonable variance) there really should not be too many (foreseeable) surprises in terms of this piece/phase of the business. To reiterate, this is a major milestone for the Company, and represents the (favorable) culmination of the efforts to monetize their Caburé resources. Moreover, given that gas sales in this particular quarter were done at the floor price of the agreement, there is in effect (the floor price begin the current reality) “nowhere to go but up” from here.

In case it is not clear, we believe the intrinsic value of the associated cash flows is double the current price of the shares. Moreover, with the advent of gas sales, the visibility of those cash flows is now clear. That said, we think some of the narrative will now focus on some of the upstream endeavors. Recall, (with a few exceptions) the Company has not prioritized building resources, because it has been focused on monetizing the resources it had/has at Caburé. We do not think anyone would argue about the prescience of that approach given the commercialization of those assets. However, we also understand the street’s next question about AlvoPetro, which we think is something like” what do they do for an encore”?

Clearly, there needs to be a plan beyond the production and sale of identified resources at Caburé, and that plan will likely determine the next valuation leg in the stock. Before we go there, we would just reiterate that while again, we understand investors’ desire to understand what is next, keep in mind “*we believe the intrinsic value of the associated cash flows is double the current price of the shares*”. That is another way of saying we think the stock is undervalued *even if nothing happens next*. Setting that aside, here are a few items to consider:

- We submit the simplest path to an additional valuation leg is to develop more resources in or around their existing midstream infrastructure. Recall, they have some prospects in that regard including two GOMO wells, which we believe they are currently running productions tests on. In addition, they have 2 additional GOMO wells they plan to drill in 2021 as well as “6 additional prospects identified across 23,527 acres, all with 100% AlvoPetro working interests. Obviously, the hope here is to identify additional resources to feed the midstream infrastructure and downstream agreements. While certainly no guarantee, success in identifying additional exploitable resource will clearly provide an added catalyst and our sense is that lack of visibility thereof, has provided a headwind for the stock.

- As the Company notes in its presentation, AlvoPetro is the “*first 100% independently controlled natural gas pipeline and treatment facility in Brazil*”. Recall, the Brazilian energy industry was dominated by government-controlled Petrobras until scandal caused the country (and other related parties) to reassess the complex. We have argued that the unwinding of some of that control would create opportunities for other industry players, most notably those with some sort of established beachhead. AlvoPetro is clearly one of those



players, and frankly, we do not think the stock reflects appropriate value for that posture on the face. That said, as the illustration here notes, the cash flow from the current operations should yield CAD\$80 million of capital that could be used to acquire production and/or otherwise develop upstream assets. That could

include, for instance, Petrobras divestitures/sales. Keep in mind, the Company's effort in Brazil started with them identifying upstream assets, rather than with them initially trying to establish a midstream/downstream business. That is, **they do have a history of success in identifying and developing upstream assets.**

- Hypothetically, if they are in fact unable to develop additional upstream resources, they still have \$18 million worth of established midstream infrastructure and associated downstream agreements that they can likely leverage. As they have also noted, those opportunities could include monetizing adjacent producers' stranded/flared gas production in terms of direct participation, tolling arrangements or both. We are not sure current valuations reflect the commercial potential and/or intrinsic value of their midstream assets.

To summarize, we understand the street's focus on where AlvoPetro goes beyond the current operations. We just don't understand the 50% discount it seems to be applying because it doesn't have an answer yet. In our view, the stock trades at a valuation that implies that they are going to squander the spoils of their success, which seems odd since they just put the finishing touches on a plan that is now generating marked cashflow, with good visibility and essentially marks the culmination of management executing as it said it would. Rodney Dangerfield got more respect.

Obviously, we remain bullish on AlvoPetro and while recent strength in the stock has been encouraging, we will likely reassess our allocation if the stock fails to move higher. We think others should consider the same.

## Projected Operating Model

Alvopetro Energy Ltd.						
Projected Operating Model (in USD - '000s)						
By Trickle Research LLC						
	Actual	Actual	Actual	Estimate	Estimate	Estimate
	3/31/20	6/30/20	9/30/20	12/31/20	Fiscal 2020	Fiscal 2021
Oil & Gas Sales	\$ 61	\$ 40	\$ 5,320	\$ 5,611	\$ 11,032	\$ 22,665
Royalties and Production Taxes	\$ (8)	\$ (5)	\$ (456)	\$ (505)	\$ (974)	\$ (2,040)
					\$ -	\$ -
Oil & Gas Revenue	\$ 53	\$ 35	\$ 4,864	\$ 5,106	\$ 10,058	\$ 20,626
Midstream Transportation Revenues	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other Income	\$ 24	\$ 20	\$ 14	\$ -	\$ 58	\$ -
Total Revenue and Other Income	\$ 77	\$ 55	\$ 4,878	\$ 5,106	\$ 10,116	\$ 20,626
					\$ -	\$ -
Production	\$ 44	\$ 36	\$ 648	\$ 671	\$ 1,399	\$ 2,663
Transportation	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
General & Administrative	\$ 640	\$ 1,032	\$ 654	\$ 662	\$ 2,988	\$ 2,653
Depletion and Depreciation	\$ 62	\$ 50	\$ 931	\$ 1,043	\$ 2,086	\$ 3,970
Impairment	\$ 1,381	\$ -	\$ -	\$ -	\$ 1,381	\$ -
Exploration and Evaluation	\$ -	\$ -	\$ -	\$ 52	\$ 52	\$ 177
Finance Expenses and Interest	\$ 276	\$ 69	\$ 996	\$ 977	\$ 2,318	\$ 3,656
Accretion of Decommissioning Liabilities	\$ -	\$ -	\$ -	\$ 10	\$ 10	\$ 40
Share Based Compensation	\$ 28	\$ 39	\$ 74	\$ 50	\$ 191	\$ 80
Foreign Exchange Loss	\$ 9	\$ (3)	\$ (15)	\$ -	\$ (9)	\$ -
Loss on Disposition of Assets	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Operating Expenses	\$ 2,440	\$ 1,223	\$ 3,288	\$ 3,466	\$ 10,417	\$ 13,239
Interest Expenses	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other Non-Operating Expenses	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total non-operating Expenses	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Gain (Loss) Before Taxes	\$ (2,363)	\$ (1,168)	\$ 1,590	\$ 1,640	\$ (301)	\$ 7,387
Income Tax Charge (Recovery)	\$ -	\$ -	\$ (4,893)	\$ -	\$ (4,893)	\$ 801
Net Loss	\$ (2,363)	\$ (1,168)	\$ 6,483	\$ 1,640	\$ 4,592	\$ 6,585
Exchange (loss) gain on translation of foreign operations	\$ (8,352)	\$ (1,412)	\$ (1,056)	\$ -	\$ (10,820)	\$ -
Comprehensive (loss) gain	\$ (10,715)	\$ (2,580)	\$ 5,427	\$ 1,640	\$ (6,228)	\$ 6,585
Net Gain (Loss) per share						
Basic	\$ (0.02)	\$ (0.01)	\$ 0.07	\$ 0.02	\$ (0.06)	\$ 0.07
Diluted	\$ (0.02)	\$ (0.01)	\$ 0.06	\$ 0.02	\$ (0.06)	\$ 0.06
Shares O/S - Basic	98,432,818	98,442,412	99,122,412	99,195,597	98,798,310	99,254,307
Shares O/S - Diluted	99,151,563	99,455,171	99,880,275	101,420,337	99,976,837	104,508,965

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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.**