Trickle Research

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

Price Target Upgrade

ALVOPETRO

Alvopetro Energy Ltd.

(TSXV:ALV.V; OTC:ALVOF)

http://alvopetro.com/

Report Date: 09/30/21

12- 24 month Price Target: *USD $7.00

Allocation: 6

Closing Stock Price at Initiation (Closing Px: 11/07/18): USD $1.14 (Post Split)

Closing Stock Price at Allocation Upgrade (Closing Px: 05/17/19): USD $1.26 (Post Split)

Closing Stock Price at Target Upgrade (Closing Px: 05/26/20): USD $1.56 (Post Split)

Closing Stock Price at Price Target and Allocation Upgrade (Closing Px: 02/11/21): USD $1.87 (Post Split)

Closing Stock Price at Price Target Upgrade (Closing Px: 05/13/21): USD $2.34 (Post Split)

Closing Stock Price at This Target Upgrade (Closing Px: 09/29/21): USD $3.57

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We initiated our coverage of Alvopetro in November 2018 and in retrospect, we must acknowledge that of all the companies we have covered over the past 25 years or so, Alvopetro management has been one of the better at doing what they say they are going to do and doing it *when* they say they are going to do it. As most microcap enthusiasts will probably admit, few things in this business happen the way they are supposed to, when they are supposed to and with the anticipated amount of capital they are supposed to require. Alvopetro has been an exception in that regard. That said, the street still seems to have trouble believing Alvopetro is going to end up where management tells us they are headed. That may be starting to change.

Regardless, the Company is now selling gas into their Bahiagas sales agreement at rates that have been consistently at the high end(s) of their guidance (and beyond our initial and subsequent projections), and now other macro issues are also beginning to create marked tailwinds for Alvopetro.

To refresh, the Company sells gas into the Bahia City Gate (Bahia, Brazil) via an agreement that includes among other things, a minimum (floor) and maximum (ceiling) price collar. When the Company first started delivering gas under the agreement (July 2020) they were selling gas at or near the floor of that agreement (about $5.40 per mmbtu). During the period, Brent crude was trading around $40 per barrel, while Henry Hub natural gas prices were around $1.70 per mmbtu (roughly 1 Mcf). At the time, the floor pricing was probably advantageous for Alvopetro.

Recall, the Company's pricing collar is determined by a formula derived from three primary energy prices, which we will delineate in a moment. The collar also includes "reset" periods (February 1 and August 1) whereby that formula is recalculated to determine the new price at which Alvopetro will sell gas to the City Gate. The collar is then applied to that calculated pricing such that if the calculated pricing is lower than the established floor then Alvopetro is paid the floor price. Conversely, if the calculated pricing is higher than the collar ceiling, then Alvopetro is paid the ceiling price. By elimination then, if the calculated price falls between the floor price and the ceiling price, they are paid the calculated price.

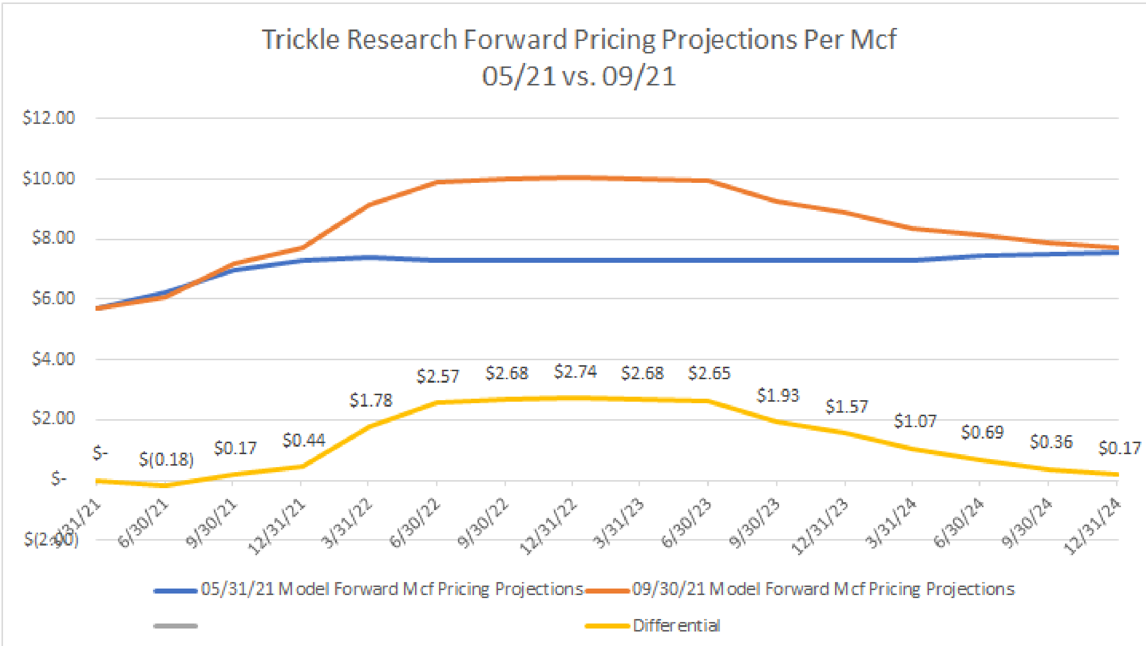
As noted, the calculated price is derived from three primary energy commodities: Brent Crude, Henry Hub Natural Gas and UK NBP Gas (a European proxy). the weighting of the three is 40%, 35% and 25% respectively. Further, the pricing is weighted by past pricing as well, wherein more recent pricing (the past 6-month period) is afforded a heavier weighting, while older periods are assigned decreasingly lower weights. However, the weighting extends back over several 6-month periods. As a result, the recent increases in the prices of these energy components (especially UK NBP Gas as of late), will impact Alvopetro's reset pricing **over the next several quarters**. The following charts provide some perspective on the magnitude of those price increases:

These are extraordinary moves, and in the case of UK NBP, the advance is whatever is more extraordinary than extraordinary. Again, this pricing matters beyond today, because it will be a part of the reset calculation for several periods to come. Moreover, to be honest, our prior analysis/projections of forward reset pricing was relatively cursory. We submit, we did not know or anticipate that energy prices were headed to these levels in this period of time, but in the same breath, we do not know where they are headed tomorrow either. Nonetheless, we have gone back and recast our approach and our resulting reset assumptions to include what will now most certainly be better pricing for the foreseeable future, due to the backward-looking nature of the reset formula. That noted, our reset forecast does not assume that this pricing environment will become the "new normal". On the contrary, our forecast is for these prices to trend back to levels that look more like pre-pandemic energy prices than they do the current environment. Obviously, if we are wrong about that, it will be a watershed for Alvopetro, and they will be incrementally more profitable as those prices remain elevated or continue to trade higher.

On another level there is one additional element to the pricing reset formula that is becoming more topical. The floor and ceiling levels of the pricing collar also include adjustments for annual inflation that we believe is pegged to the U.S. inflation rate. As we intimated, in prior analysis we took a relatively benign approach to this, but if current inflation data continue to hold, this could provide meaningful increases to the underlying boundaries of the collar. To be clear, *we are currently anticipating that Alvopetro will be selling gas at the collar ceiling through much of calendar 2022*. If inflation proves more robust than our estimates (which are currently below the short-term trends), the result could be higher collar ceilings and by extension, higher prices for Alvopetro. As we said, there are currently multiple macro issues creating meaningful tailwinds for Alvopetro.

From another angle, on Sept. 21, 2021, Alvopetro announced the declaration of their first ever quarterly dividend of $.06 per share. Recall, that has been a milestone they have been guiding towards, and that we think the street has been anticipating. While as we recall that timing may be in line with some prior guidance, it is a few months early with respect to more recent guidance. The inaugural dividend is in our view, another watershed moment for the Company and a definitive win for management. Further, while certainly a milestone for Alvopetro, we think the initial dividend is a starting point for what will likely be much bigger distributions. To put that into some *back-of-the-napkin* terms, in prior (year) presentations the Company indicated that their longer-term plan ultimately called for dividend distributions in the realm of 40% of EBITDA. We will revisit that.

Recognize, the Company recently reported that in the month of August they produced (sold) 2,431 boe per day. Roughly, 1 boe is equal to 6 Mcf, so in Mcf terms, Alvopetro produced approximately 14,500 Mcf per day or around 1.3 million Mcf per quarter and 5.2 million Mcf per year. By extension, that means that each additional dollar per Mcf the Company receives for its gas contributes an additional $5.2 million in incremental EBITDA or about $.16 per share. Succinctly, the chart below reflects our own pricing projections from our 05/21 model versus our current/revised (09/21) projections. Obviously, we have revised these projections in conjunction with our narrative above.



As the above chart notes, we are projecting Alvopetro's pricing to be over $2.50 higher than our prior projections across most of fiscal 2022 and 2023. Feeding that data into our math above, an additional $2.50 in price per Mcf would create and additional $13 million of EBITDA. Revisiting our dividend distribution notion above (dividends equal to 40% of EBITDA), that would imply that they might perhaps distribute an additional $5.2 million *based on that differential alone*, or about $.16 per share. If they are currently distributing a dividend with an annual run rate of $.24, and we add this incremental dividend of $.16, we get to an annual dividend rate of $.40 or a dividend yield of 11.2% based on Alvopetro's recent close of $3.57. At this point, we believe 2022 and 2023 dividends of $.40 per share are more likely than $.25 per share.

Lastly, we think this leads to the next most obvious question, and the other leg of the Alvopetro story, which centers on its search for additional resources at Gomo. We will save the detail of that analysis for another update when we may have some additional Gomo data points. However, in additional back-of-the-napkin terms, we think Alvopetro could maintain the type of dividend we just described well into the future if Gomo can ultimately produce something around 20% to 30% of the current production rate from Caburé. Clearly, results from Gomo remain topical to our new targets.

As a result of what we think is a bit of a perfect storm putting wind at Alvopetro's back, as well as the crystallizing of what we believe has been a well-made plan, we are establishing a new 12-24 month price target for Alvopetro of $7.00 per share. Given that our allocation is already at 6, which is among the highest allocations in our coverage universe, we will let that be for now. However, with that in mind, we would view any technical weakness in the stock as an opportunity.

Projected Operating Model

Alvopetro Energy Ltd.						
Projected Operating Model (in USD - '000s)						
By Trickle Research LLC						
	Actual	Actual	Estimate	Estimate	Estimate	Estimate
	3/31/21	6/30/21	9/30/21	12/31/21	Fiscal 2021	Fiscal 2022
Oil & Gas Sales	$ 6,939	$ 8,182	$ 10,401	$ 11,259	$ 36,781	$ 54,163
Royalties and Production Taxes	$ (645)	$ (607)	$ (936)	$ (1,013)	$ (3,201)	$ (4,875)
					$ -	$ -
Oil & Gas Revenue	$ 6,294	$ 7,575	$ 9,465	$ 10,246	$ 33,579	$ 49,288
Midstream Transportation Revenues	$ -	$ -	$ -	$ -	$ -	$ -
Other Income	$ 8	$ 7	$ -	$ -	$ 15	$ -
Total Revenue and Other Income	$ 6,302	$ 7,582	$ 9,465	$ 10,246	$ 33,594	$ 49,288
					$ -	$ -
Production	$ 710	$ 791	$ 914	$ 924	$ 3,339	$ 3,322
Transportation	$ -	$ -	$ -	$ -	$ -	$ -
General & Administrative	$ 851	$ 1,036	$ 1,060	$ 1,081	$ 4,029	$ 4,554
Depletion and Depreciation	$ 1,674	$ 2,092	$ 2,091	$ 2,090	$ 7,947	$ 7,662
Impairment	$ -	$ -	$ -	$ -	$ -	$ -
Exploration and Evaluation	$ -	$ -	$ 750	$ 13	$ 763	$ 50
Finance Expenses and Interest	$ 994	$ 833	$ 604	$ 604	$ 3,035	$ 2,163
Accretion of Decommissioning Liabilities	$ -	$ -	$ -	$ -	$ -	$ -
Share Based Compensation	$ 89	$ 92	$ 115	$ 129	$ 424	$ 594
Foreign Exchange Loss	$ 2,065	$ (2,811)	$ -	$ -	$ (746)	$ -
Loss on Disposition of Assets	$ (3)	$ (13)	$ -	$ -	$ (16)	$ -
Risk Management Expenses	$ (58)	$ 166	$ -	$ -	$ 108	$ -
Total Operating Expenses	$ 6,322	$ 2,186	$ 5,534	$ 4,840	$ 18,883	$ 18,346
Interest Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Other Non-Operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Total non-operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Gain (Loss) Before Taxes	$ (21)	$ 5,396	$ 3,931	$ 5,405	$ 14,712	$ 30,943
Income Tax Charge (Recovery)	$ 1,068	$ 1,759	$ 427	$ 586	$ 3,840	$ 3,357
Net Income	$ (1,089)	$ 3,637	$ 3,505	$ 4,819	$ 10,872	$ 27,586
Exchange (loss) gain on translation of foreign operatio	$ (987)	$ 4,341	$ -	$ -	$ 3,354	$ -
Comprehensive (loss) gain	$ (2,076)	$ 7,978	$ 3,505	$ 4,819	$ 14,226	$ 27,586
Net Gain (Loss) per share						
Basic	$ (0.01)	$ 0.04	$ 0.04	$ 0.15	$ 0.17	$ 0.84
Diluted	$ (0.01)	$ 0.03	$ 0.03	$ 0.14	$ 0.16	$ 0.83
Shares O/S - Basic	99,726,311	99,794,077	98,698,200	32,895,997	82,778,646	33,000,163
Shares O/S - Diluted	103,674,932	104,701,493	105,083,378	33,236,966	86,674,192	33,171,362

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Alvopetro has paid fees to present at investor conferences that Trickle Research Co-sponsored.

Portions of this publication excerpted from company filings or other sources are noted in *italics* and referenced throughout the report.

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.