Trickle Research

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

Allocation Increase

ALVOPETRO

Alvopetro Energy Ltd.

(TSXV:ALV.V; OTC:ALVOF)

http://alvopetro.com/

Report Date: 03/16/22

12- 24 month Price Target: USD $7.00

Allocation: *7

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 Target Upgrade (Closing Px: 09/29/21): USD $3.57

Closing Stock Price at This Allocation Update (Closing Px: 03/15/22): USD $3.75

Prepared By:
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Senior Analyst, Managing Partner
Trickle Research

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.

On March 8, 2022, Alvopetro announced their updated reserve data. We recognize that they will be reporting their yearend earnings soon but frankly, given that they have provided the street with most of the data we need to figure out what their numbers will be (or at least within reasonable proximity) we think this reserve update is probably the more topical of the two in terms of visibility that we did not already have a good picture of. With that said, here a few of our observations.

First, here are the Company's highlights from the updated reserve report. The entirety of the announcement encompassing the report can be accessed here: https://alvopetro.com/News-Events

December 31, 2021 GLJ Reserves and Resource Report Highlights

- 2P net present value before tax discounted at 10% increased 52% to $297.0 million primarily due to higher forecasted commodity prices.
- Proved reserves ("1P") and 2P reserves decreased to 4.4 mmboe (-13%) and 8.7 mmboe (-9%) respectively, due to 2021 production volumes.
- This represents a 2P Net Asset Value of CAD$11.20/share ($8.77/share).
- Risked best estimate contingent and risked best estimate prospective resource of 3.5 mmboe and 12.1 mmboe, respectively were consistent with prior year with an increase of 61% and 44% respectively on risked best estimate before tax net present value discounted at 10%, due primarily to higher forecasted commodity prices.

As the Company describes in the update, the increases in reserves are largely driven by corresponding increases in commodity prices (as opposed to new resource data). Specifically, the report notes that *"…In addition, Alvopetro announces the December 31, 2021, assessment of the Company's Murucututu natural gas resource (previously referred to as the Gomo natural gas resource) with risked best estimate contingent resource of 3.5 mmboe and risked best estimate prospective resource of 12.1 mmboe,* ***both of which are virtually unchanged from December 31, 2020…".*** We submit, that doesn't appear to fit our narrative that the reserve data is "topical" to visibility since we already knew most of it. However, what we think *is topical* is the new highlighted 2P NAV of US$8.77, or 225% of the current stock price.

PRICING ASSUMPTIONS – FORECAST PRICES AND COSTS

GLJ employed the following pricing and inflation rate assumptions as of January 1, 2022 in the GLJ Reserves and Resources Report in estimating reserves and resources data using forecast prices and costs.

Year	Brent Blend Crude Oil FOB North Sea ($/Bbl)	National Balancing Point (UK)($/mmbtu)	NYMEX Henry Hub Near Month Contract($/mmbtu)	Alvopetro-Bahiagas Gas Contract$/mmbtu(Current Year)
2022	76.00 $112.12	20.75 $40.70	3.80 $4.77	9.51
2023	72.51	12.00	3.50	10.09
2024	71.24	8.50	3.15	9.86
2025	72.66	8.67	3.21	9.00
2026	74.12	8.84	3.28	8.89
2027	75.59	9.02	3.34	8.99
2028	77.11	9.20	3.41	9.15
2029	78.66	9.39	3.48	9.33
2030	80.22	9.57	3.55	9.52
2031*	81.83	9.76	3.62	9.71

**Escalated at 2% per year thereafter*

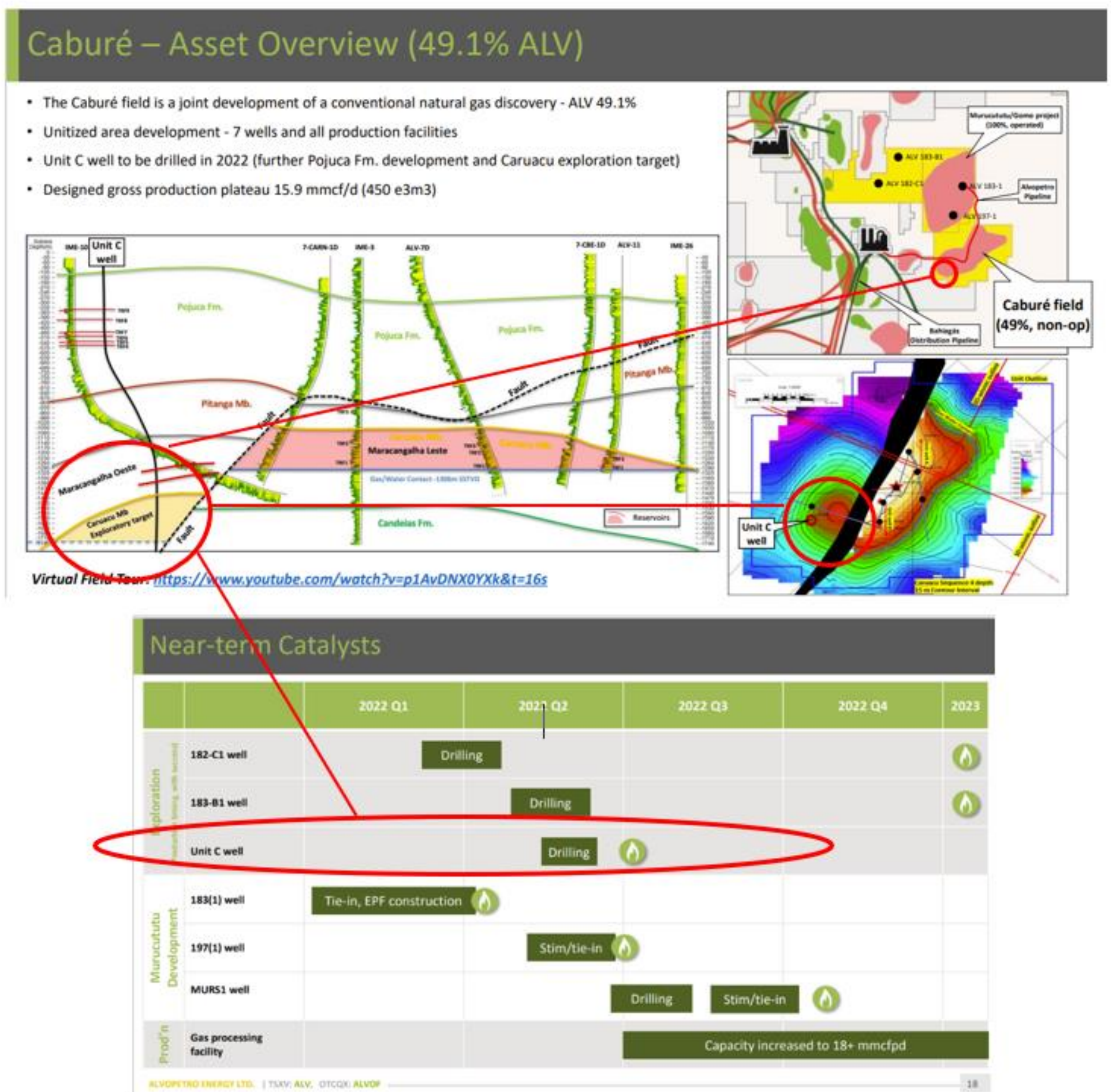
As of February 1, 2022, Alvopetro's contracted natural gas price under the terms of our long-term gas sales agreement is based on the ceiling price within the contract and is forecasted to remain at the ceiling price until 2024. The forecasted prices in the GLJ Reserves and Resource Report do not reflect the most recent increase in global commodity prices which further extends the period under which Alvopetro's contracted price will be at the ceiling in the contract. The ceiling price incorporates assumed US inflation of 5% in 2022, 3% in 2023 and 2% thereafter.

To edify, the chart above is also from the reserve report and it provides the forward commodity pricing assumptions used to compute the 2P-NAV of $8.77. Notice, the data are from January 1, 2022. As the chart below illustrates, while oil and other relevant energy prices have been exploding of late, much of that move has come *after the completion of the reserve report/calculations*. That is apparent from the table above as well, which is why we provided more recent closing prices for each of the 3 proxy prices used to compute Alvopetro's contracted price (the green boxes above). As we look at the chart above, the report's authors are assuming decreasing energy prices through 2022, 2023 and 2024, with modest increases thereafter. In addition, recall, Alvopetro's recent price reset (February 1, 2022) was beyond the ceiling price, and the reserve report has imputed ceiling price thresholds in their calculations. However, as the highlight above notes, they are anticipating sequentially decreasing US inflation rates for 2022, 2023 and 2024, with a 2% ongoing rate thereafter. That said, we submit, none of us know where energy prices are going in the future, nor do any of us know where inflation rates are going in the future. However, what we do know is that today, each of those is considerably higher than the assumptions of the reserve report. Therefore, since Alvopetro's calculated pricing and its ceiling prices are both computed based on trailing data, for at least some of the period(s) encompassed by the reserve report, those prices will be higher than the report assumed. By extension, if the reserve report were recalculated today, the 2P NPV would be higher again.

More importantly, since we are already beyond the ceiling price, which is likely to be the case for the foreseeable future, it seems to us that the current situation (rapidly rising energy prices) is also providing a higher likely floor to the 2P NPV value, which in our view speaks to the mitigation of the type of macro risks that often impair the valuations of commodity producers. On the flip side, we think it is reasonable to assume that if energy prices continue to stay elevated, or advance further for that matter, the impact of that could be continued inflationary pressures perhaps beyond the assumptions of the reserve report. That would of course lead to higher ceilings and by extension, higher pricing and higher NPV assessments. Our point here is given where we are today, we think the bias is tilting toward higher future prices than those contemplated by the reserve report, rather than lower.

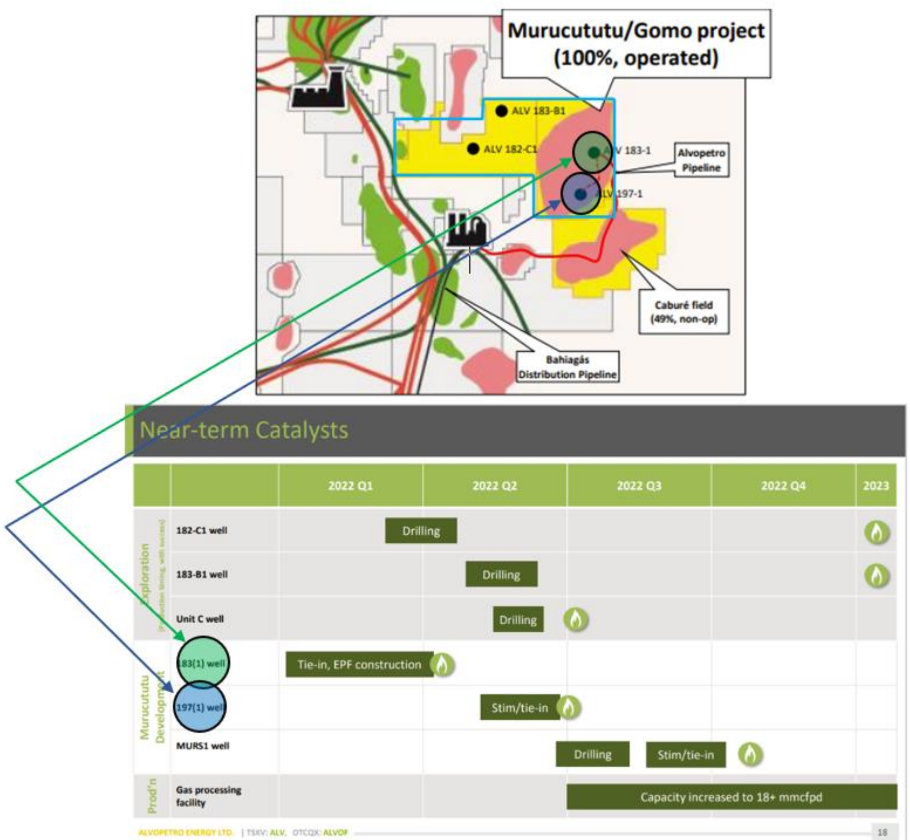
As described, we view the new reserve report as a positive development, but it seems to us ***new*** reserves continue to be the "elephant in the room" when it comes to what we view as the valuation disconnect in the street. To clarify, we are going to provide some graphics from the Company's most recent presentation, to which we have added some color. To preface that, we are of the view that the street does not fully understand the potential and/or the scenarios around the Company's current exploration and development platform. We will try to provide some more granular clarity therein, but from the 10,000 foot view, recognize there are three different reserve development legs that are emerging right now at Alvopetro, and some combination of those will contribute to future production. The question is, what will that combination be, and what will that combination collectively contribute to future production?

First, as most are aware, the Company's current production comes from their 49.1% ownership in Caburé. Caburé is a conventional natural gas field that originally was designed to produce approximately 15.9 mmcf/day but has in fact been producing up to 20 mmcf/day. Of that portion Alvopetro has been selling between 14 and 15 mmcf/day, which again currently makes up all their production. The 2P reserves associated with the existing wells in Caburé are 5.1 million boe, which equates to roughly 26,826,000 mcf. In the context of the daily production, that reserve implies that they can produce from the existing Caburé wells until they are depleted around the end of 2027. However, as the Company has disclosed in their most recent presentation (but we are not sure the street has noticed) Alvopetro and their partner are planning to drill an additional portion of Caburé which they refer to as Unit Well C. We have highlighted the various views of that project below from the presentation. To edify, the expectation is that we should have some clarity on that endeavor in the second half of this year and the expectation is that it will yield additional production:



The second major development piece they are working on is "Murucututu". We think this has perhaps caused some confusion so we will try to unpack it. Recall, we used to describe Alvopetro in terms of "Caburé" (the producing piece of the story) and "Gomo" (the exploration/development piece of the story). In short, Murucututu is what was previously referred to as Gomo and is distinct from Alvopetro's "conventional" "exploration" piece. In short, Murucututu includes tight gas formations while the conventional piece, as the name implies is believed to be a more conventional reservoir system and is more exploratory in nature. Generally, the latter, if successful, will likely produce higher rates of oil or natural gas on an unstimulated basis than the tight gas wells they are pursuing at Murucututu (but Murucututu has less exploration risk and would likely have a longer effective reserve life).

The graphics below provide a similar look to what we provided above for Caburé. First, we outlined in **LIGHT BLUE AND LIGHT GREEN** what we have traditionally called Gomo. In addition, as the Company's graphic delineates Murucututu is the pink oval shaped portion they labeled as such within Gomo. The second graphic below is the same timeline we used above. Notice, they have drilled two if these wells already (ALV 183-1 and ALV 197-1). In addition, they also extended the pipeline north from the existing infrastructure then connected these wells (and perhaps future wells) to enable delivery of gas to the city gate by tying into the original Caburé line. Further, as the timeline indicates, they intend to tie in each of these wells in the first half of 2022. We have a good idea that these wells will produce gas, we just do not know how much and/or what the production and decline data might look like. They have however provided some guidance in that regard which we have addressed further below as well.



The graphic below reflects the Company's independent reserve evaluator's best estimates of the production they could generate from these first two wells along with the next two undeveloped locations to be drilling as included in the 2P reserves report, as well as perhaps from others they may bring on-line at Murucututu. Recognize, the "existing 2 development wells" referenced below are the ALV 183-1 and ALV 197-1 wells referenced above, the two undeveloped locations include the MURS-1 development well (planned for H2 2022) and the next Murucututu/Gomo well to be drilled (directionally north from the 183-1 well pad).

- Reserves: 2 existing wells + 2 undeveloped locations
- Contingent Resource: 4 development wells
- Prospective Resource: 10 additional wellbores

- Reserves: 2 development wells
- Contingent Resource: 4 development wells
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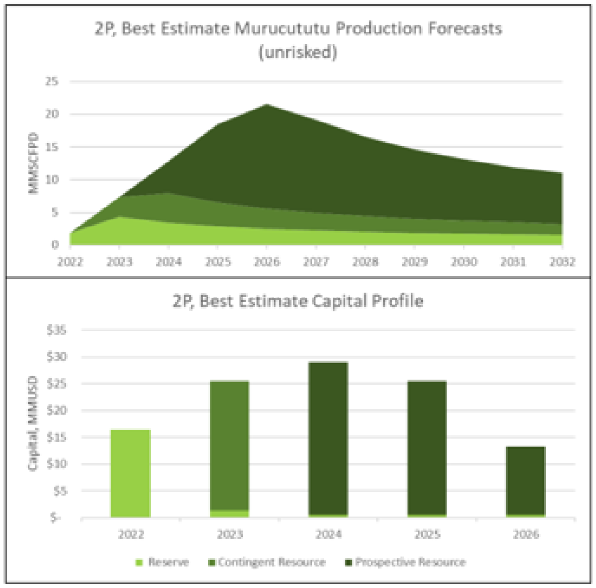
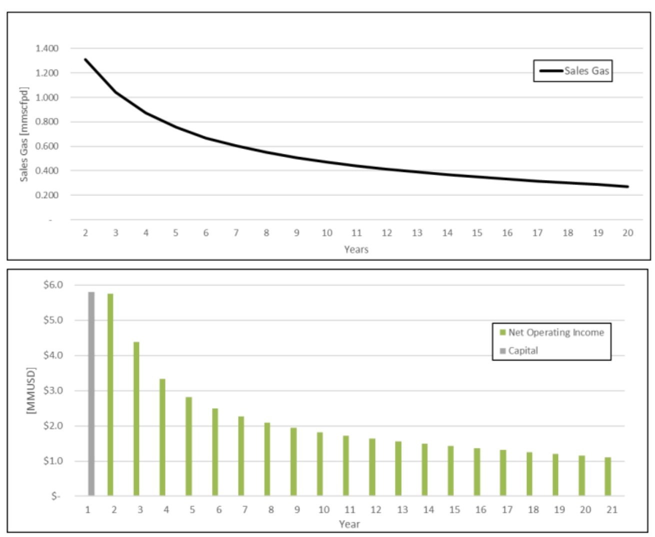


Once these wells are tied in and producing, we will have better visibility regarding their economics around the assumptions of the same in the chart above. But, assuming the estimates above hold, these two development wells could see peak production of something around 1.34 mmcf/day each and declining thereafter. Extending the assumption, the Company has also assumed $5.8 million of capex per well. We would add, this additional production would push the Company closer to its current operating capacity of 18 mmcf per day, which would be *another* company milestone. The illustration below provides some of the Company's well economics associated with the wells at Murucututu:

Gomo Development: Single Well Economics

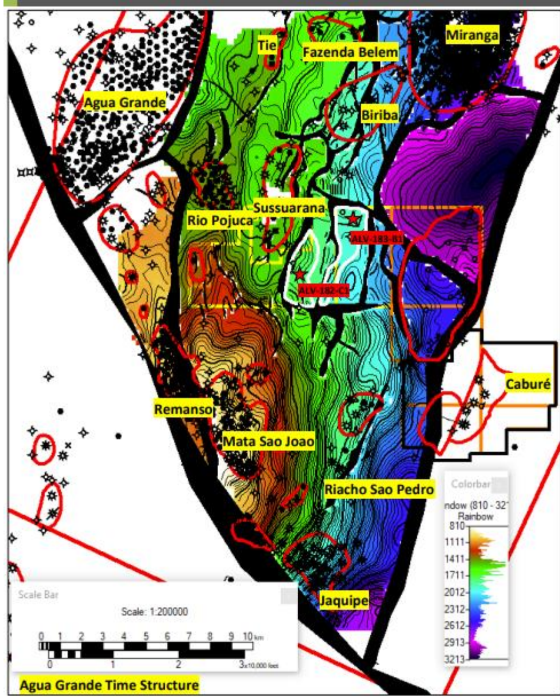
2P assessment (GLJ):

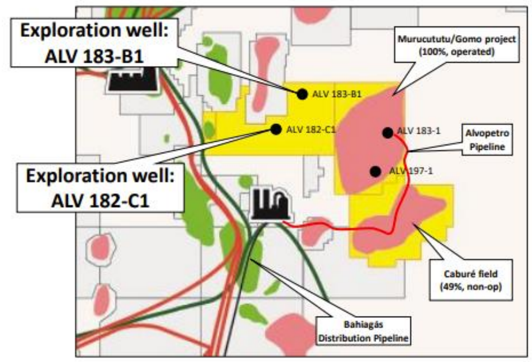
- 4.7 Bcf sales gas + 115 mbbls of condensate = 0.9 mmboe
- Year 1 average production rate:
  - 1.34 mmcfpd, 257 boepd (including condensate)
- Field condensate rate is 24 bbl/mmcf
- Higher heating value 1.22 mmbtu/mcf
- Capex: $5.8 million
- F&D: $6.50/boe
- First year net operating income: $5.7 million
- Full cycle IRR: 78%
- Simple payout: 1 years



As the timeline we provided above indicates, we should know considerably more about these wells as we move through the summer (2022). We believe they will be productive, and certainly at current contract prices, they will likely be highly additive. That said, we think the pace at which Murucututu gets developed will likely depend on what happens with the wells being drilled in the conventional portion of Gomo. The Company's graphic below provides a perspective of the conventional resources they are planning to drill in the near term:

2022 Gas Exploration Drilling Program (100% ALV)





- ALV-182-C1 & ALV-183-B1 Pre-Rift natural gas prospects (100% WI)
- Unrisked prospective resource evaluated by GLJ (best estimate)(8)
  - ALV-182-C1 4.6 mmboe (47% COS), spud on March 2, 2022
  - ALV-183-B1 5.9 mmboe (44% COS)
- Prospects defined on reprocessed 3D seismic data
- Key analog fields
  - Biriba OGIP 55 BCF (9.2 mmboe)
  - Sussuarana OGIP 26 BCF (4.3 mmboe)

2022 100% WI Conventional Exploration Recoverable Resource (mboe)	Low	Best	High
Unrisked Prospective – 183-B1(8)	2,065	5,901	13,429
Unrisked Prospective – 182-C1(8)	1,168	4,618	16,757
Risked Prospective – 183-B1(8)	901	2,574	5,859
Risked Prospective – 182-C1(8)	545	2,157	7,825

Here again, we will break this down into so more granular parts.

First, to reiterate from something prior, these are more conventional exploration projects and as such the expectation is that if they are successful in discovering the resource, they could replace the production from Caburé, which again in our view, is the issue providing headwinds for the valuation of the Company. To that point, keep in mind, whereas Alvopetro owns 49.1% of Caburé, they own 100% of this area. Further, based on prior guidance (the timeline above), we anticipate the first of these wells (182-C1) to be completed in mid-April, while the second (183-B1) should be approximately two months (including rig move) following the completion of the first well (late May or early June 2022). With that said, here is a bit of historic information regarding some of the projects surrounding the area. These projects are highlighted in yellow on the map above.

The Company provided information above about two of these projects: Biriba and Sussuarana, which reflect resources of 9.2 mmboe and 4.3 mmboe respectively. For the sake of comparison, we believe the total resource from Caburé, will end up being something around 12 mmboe (of which Alvopetro will have received 49.1%). Recognize, we circled the "high" end of the *risked* estimates for each of the two conventional wells Alvopetro is drilling to illustrate that **each of these** prospects has the potential to deliver BOEs roughly equal to that of Alvopetro's share of Caburé. We would add, these two particular fields were part of a Petrobras divestiture in February 2021. that divestiture included a group of fields collectively referred to as "Miranga", and included the fields of Miranga, Fazenda Onça, Riacho São Pedro, Jacuípe, Rio Pipiri, Biriba, Miranga Norte, Apraiús, and Sussuarana. That transaction was valued at **$220 million**.

Here are some additional figures from some of the other surrounding projects highlighted on the map above:

In July 2021 Petrobras sold its stake in the Rio Ventura "cluster". The cluster includes eight fields: Água Grande, Bonsucesso, Fazenda Alto das Pedras, Rio Pojuca, Tapiranga, Pedrinhas, Pojuca, and Tapiranga Norte. The transaction was valued at $**96.9 million**.

In December 2021, Petrobras sold the Remanso cluster which includes 13 fields: Brejinho, Canabrava, Cassarongongo, Fazenda Belém, Gomo, Mata de São João, Norte Fazenda Caruaçu, Remanso, Rio dos Ovos, Rio Subaúma, São Pedro and Sesmaria. The transaction was valued at **$30 million**.

To summarize the conventional piece, Alvopetro's conventional assets are surrounded by producing assets that have realized (collectively) considerable transaction value over the recent past. However, while we have pounded the table about the current disconnect between the $8.77 P2-NPV value assessed by the recent reserve report relative to the current price of the shares, we think there is also considerable value in the conventional piece that is not being recognized. Keep in mind, the reserve report currently does not provide for any value from the conventional assets, so *from our perspective*, Alvopetro buyers are not only buying the resources delineated by the reserve report at a marked discount, but they are also in essence getting the conventional exploration potential for nothing.

We submit, we do not know what the results from 182-C1 and 183-B1 will be, *but we will soon enough*. As we just suggested, at these levels, it is hard for us to rationalize how disappointing results would hurt the value of the shares, since it does not look to us like the market is assigning these assets any value in the first place. on the other hand, positive result from these wells would be a watershed event for Alvopetro. As we illustrated above, these assets have the potential, *on a risked basis*, to provide Alvopetro with over 2X of the total production they have, and likely will, extract from Caburé.

Clearly, these drilling results could be quite topical to Alvopetro, and in our view, they encompass the issues/outcomes that investors should be considering with respect to the Company.

First, let's assume the conventional results are successful. we think most would agree, this is the optimal scenario given all we have described above. Again, in our view, this event would be a watershed for the value of Alvopetro. That said, as we see it, this scenario would also require an entirely new set of assumptions regarding new infrastructure required to deliver gas to their current costumer, or perhaps entirely new arrangements to deliver it elsewhere. Further, that plan would include new capital budgets and in lock step likely additional capital in one form or another. Frankly, while we have argued that according to the Company's prior guidance regarding distributions to stakeholders their dividend should be increasing as we move forward, success on the conventional side could impact those distributions as access to capital to potentially more than double current production could take precedence over those distributions at least for some period. That is just our speculation by the way, but we think that is a reasonable assessment. We would add, in this scenario we would expect the Company to focus on the conventional assets, and likely push further development at Murucututu down the road a bit.

Second, lets assume the conventional results are not successful. Again, given the current discount to the 2P-PV10 assessment we discussed above, it seems to us that the street is already anticipating this, or perhaps just ignoring it altogether. Regardless, this is essentially the outcome that is contemplated by the reserve report. In this case, we would expect the Company to accelerate the development at Murucututu to eventually replace the production from Caburé, although as we noted, we also soon see results from the Caburé extension (Unit C) which could extend Caburé production but is also NOT included in the reserve calculations.

To summarize, we continue to believe Alvopetro is undervalued and in our view, the updated reserve report supports that view. In addition, the Company has lined up other opportunities to extend the resource base and associated production, that are not part of that calculation, and have to potential to be transformative in that regard. Further, visibility with respect to those opportunities is poised to improve likely before the end of the first half of this year. In the meantime, energy prices remain elevated, and inflation looks like its going higher, which should lead to increasing price resets through August 1 (2022) and likely February 1, 2023, and perhaps beyond. All the above considered, we are raising our allocation from 6 to 7 based on what looks to us like higher price adjustments and/or ceilings than we previously estimated, as well as emerging clarity on potential new reserves and production profiles. We are inclined to raise our price target in light of the new reserve calculations and we will likely do so in the near future, but we will yield to the yearend numbers and perhaps revisit a target adjustment thereafter.

Projected Operating Model

Alvopetro Energy Ltd.						
Projected Operating Model (in USD - '000s)						
By Trickle Research LLC						
	Actual	Actual	Actual	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	$ 9,963	$ 10,673	$ 35,756	$ 65,470
Royalties and Production Taxes	$ (645)	$ (607)	$ (910)	$ (961)	$ (3,123)	$ (5,892)
					$ -	$ -
Oil & Gas Revenue	$ 6,294	$ 7,575	$ 9,053	$ 9,712	$ 32,634	$ 59,577
Midstream Transportation Revenues	$ -	$ -	$ -	$ -	$ -	$ -
Other Income	$ 8	$ 7	$ 915	$ -	$ 930	$ -
Total Revenue and Other Income	$ 6,302	$ 7,582	$ 9,968	$ 9,712	$ 33,564	$ 59,577
					$ -	$ -
Production	$ 710	$ 791	$ 824	$ 923	$ 3,248	$ 0
Transportation	$ -	$ -	$ -	$ -	$ -	$ -
General & Administrative	$ 851	$ 1,036	$ 1,139	$ 1,117	$ 4,143	$ 5,037
Depletion and Depreciation	$ 1,674	$ 2,092	$ 2,667	$ 3,143	$ 9,577	$ 14,021
Impairment	$ -	$ -	$ -	$ -	$ -	$ -
Exploration and Evaluation	$ -	$ -	$ -	$ -	$ -	$ -
Finance Expenses and Interest	$ 994	$ 833	$ 686	$ 604	$ 3,117	$ 2,028
Accretion of Decommissioning Liabilities	$ -	$ -	$ -	$ -	$ -	$ -
Share Based Compensation	$ 89	$ 92	$ 120	$ 560	$ 861	$ 2,585
Foreign Exchange Loss	$ 2,065	$ (2,811)	$ 1,813	$ -	$ 1,067	$ -
Loss on Disposition of Assets	$ (3)	$ (13)	$ (23)	$ -	$ (39)	$ -
Risk Management Expenses	$ (58)	$ 166	$ (115)	$ -	$ (7)	$ -
Total Operating Expenses	$ 6,322	$ 2,186	$ 7,111	$ 6,348	$ 21,967	$ 23,671
Interest Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Other Non-Operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Total non-operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Gain (Loss) Before Taxes	$ (21)	$ 5,396	$ 2,857	$ 3,365	$ 11,597	$ 35,907
Income Tax Charge (Recovery)	$ 1,068	$ 1,759	$ 1,367	$ 513	$ 4,707	$ 5,476
Net Income	$ (1,089)	$ 3,637	$ 1,490	$ 2,852	$ 6,890	$ 30,431
Exchange (loss) gain on translation of foreign operatio	$ (987)	$ 4,341	$ (633)	$ -	$ 2,721	$ -
Comprehensive (loss) gain	$ (2,076)	$ 7,978	$ 857	$ 2,852	$ 9,611	$ 30,431
Net Gain (Loss) per share						
Basic	$ (0.01)	$ 0.04	$ 0.04	$ 0.08	$ 0.14	$ 0.90
Diluted	$ (0.01)	$ 0.03	$ 0.04	$ 0.08	$ 0.14	$ 0.83
Shares O/S - Basic	99,726,311	99,794,077	33,710,000	33,751,667	66,745,514	33,855,833
Shares O/S - Diluted	93,760,594	104,701,493	35,947,256	36,182,402	67,647,936	36,501,108

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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.