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: 08/19/22

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 Upgrade (Closing Px: 03/15/22): USD $3.75

Closing Stock Price at This Update (Closing Px: 08/18/22): USD $5.40

Prepared By:
David L. Lavigne
Senior Analyst, Managing Partner
Trickle Research

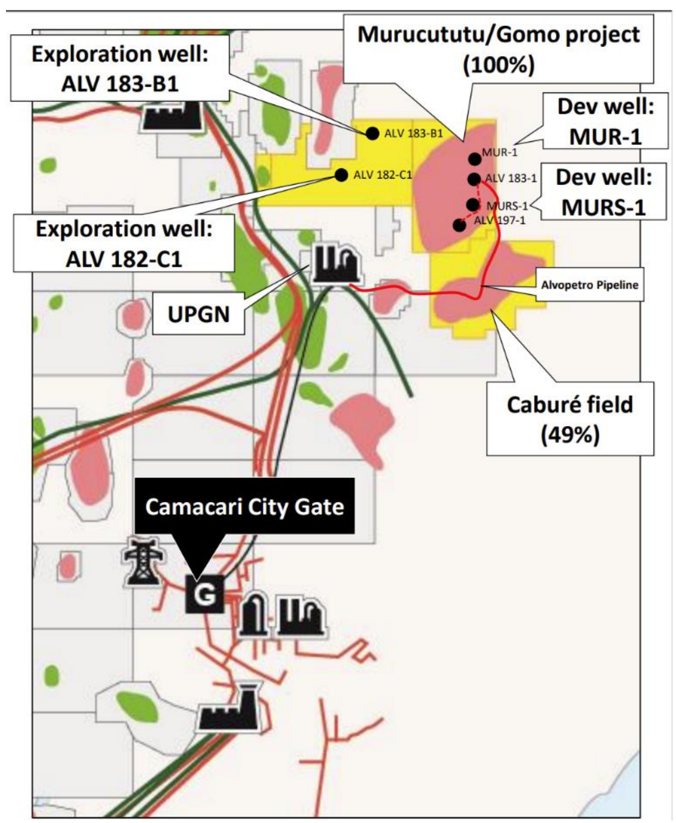
Disclosure: Portions of this report are excerpted from Alvopetro's filings, website(s), presentations or other public collateral. We have attempted to identify those excerpts by *italicizing* them in the text.

We provided a relatively detailed update and allocation increase on Alvopetro a few months ago. Since that time, they reported both Q1 and Q2 results, and collectively, those numbers outperformed our estimates, with revenues for 1HF22 coming in about $1.5 million higher. Frankly, given some of the foreign exchange adjustments, which apply both to the Company's ultimate pricing (revenues) as well as to a separate operating expense line item, the period was well in line with our estimates. As we have noted, with respect to Caburé production, we *should* get relatively close to the numbers since they provide good production guidance (and update it monthly) and we have a good sense of pricing (ex-forex adjustments) given the pricing collar around the 6 month threshold resets. We would encourage readers to take a moment and view the 2QF22 overview, which they have posted to YouTube:

https://youtu.be/qG9mjZdhwJ0

The above noted, while the math has been relatively simple to this point, it is about to get a bit more complex as they add capacity and new production. Recall, the Company negotiated/added gas plant capacity which they began delivering in the current quarter (Q3-F22). That plant capacity is being augmented by the addition of new production from the Company's Murucututu production unit. As we understand it, production from the first Murucututu well (183-1) commenced recently. Further, we believe they should see contribution from the second Murucututu well (197-1) in 2H-F22. Conversely, it sounds like they may be sending a bit less Caburé gas to the city gate than in the recent past, largely because their partner at Caburé expects to access a larger portion of their share. The net of these developments is that the second half of F22 should reflect lower Caburé sales than the first half, but contributions from new Murucututu production that did not exist in prior quarters. We expect the latter to outrun the prior, so we are expecting increased sequential production for the second half, which we have reflected in our model.

Looking ahead, while we conceded that the math for the next few quarters will be a bit harder to nail down, what is becoming clear to us is that as Alvopetro exits F22 and moves through F23, they will be adding Murucututu production from 183-1 and 197-1 and likely from MUR-1 and MURS-1. Further, the Company indicates that they are also currently drilling the Unit C well with their partner at Caburé, which may also provide added production into 2023. (For reference to these wells, we provided the Company's graphic to the left). As we have discussed before, we suspect the pace of additional wells at Murucututu may depend on progress/success on the conventional unit to the west of Murucututu.



Beyond Murucututu, the Company also discussed the drill results they have gathered from their conventional unit and specifically wells 183-B1 and 182-C1. Succinctly, we think it is fair to say that they are encouraged by those results, (especially 183-B1 if we are reading the tea leaves correctly), and they will be doing additional testing on each, with other subsequent wells likely. As we have noted before, we think success in this unit would provide a new valuation leg to the story, and from preliminary results, it appears as though success is becoming more likely than less. Moreover, in our view, we do not think the street has afforded this asset any value (as reflected by the share price), so again, we think continued testing success will make discounting the asset much harder to defend.

To summarize, we think the focus, (both on and at), Alvopetro is shifting gears. Since we initiated our coverage nearly 4 years ago, the focus was on getting their share of the Caburé gas asset to the marketplace. That endeavor led to their gas sales agreement, the building of infrastructure to deliver it, and ultimately, sales, cashflow, profits and dividends. However, the Company is now set on developing additional production assets, and as we delineated above, they currently have a handful of projects in various stages of development, some of which will contribute to 2022 results. That new path requires some added thought.

First, while admittedly, this analysis has considerable nuance to it, (since they are not managing the business to just run out the clock at Caburé), our modeling suggests that the current value of the stock roughly reflects the ultimate cash generating potential of the currently identified asset at Caburé, and essentially little else. We would add, that is based on assumptions of considerably lower future energy prices as well. Put another way, while it is clear the Company is poised to add production beyond the current Caburé footprint, and we have some near-term visibility regarding at least some of those assets (183-1 and 197-1 for instance), we do not think the current value of the shares reflect these assets or their emerging visibility. We will likely revisit our price targets as we gather some additional production and/or testing data from the Company, which will likely come from multiple units.

Second, we thought some of the Q&A on the conference call was spot on in terms of some of the emerging issues investors are going to need to begin paying attention to. For instance, as noted, the Company was recently able to modify (increase) the limits of their gas sales agreement, but if we add up some of the new production potential, it seems likely to us that they may be revisiting the ceiling of that agreement sooner rather than later. To translate, we do not think it will be long before they are bumping up against that "new" threshold. That begs the question, "what needs to be done to enable them to deliver *even more gas* into the sales agreement or otherwise"? The Company addressed that on the call, and the answer includes some "chicken or the egg" scenarios, which is likely to complicate visibility. For example, if we understand it correctly, while the recent expansion was relatively simple, additional expansions may be a bit more complex. Further, the configuration of additional gas plant expansions may depend on the characteristics of the gas they ultimately produce. That is, apparently, the gas they may produce from the conventional unit may differ from gas at Murucututu, which in turn may be different from Caburé and/or the Caburé C unit they are currently drilling. As a result, new plant capacity decisions may require more clarity on where (and what) future production will be.

Third, another issue that came up in the Q&A was the status of the dividend, or more specifically, the likelihood that it will be increased. To that end, the Company reiterated its goal to distribute measurable (roughly half) of its cash flow back to shareholders. However, they also noted (which we addressed in prior research as well) that the levels of future distributions could be impacted by their exploration and development efforts. That is, if their exploration efforts prove especially successful, shareholders should probably expect management to direct more resources to accelerating the development and that will likely come at the expense of increased dividends at least for some period. We have no idea how to handicap that, but if management chooses to redirect more resources to developing and producing identified resources, it is hard for us to imagine that will be a bad thing for shareholders. To reiterate, our view is that the current share price does not reflect the potential of the collective resource development program, so anything that provides clarity with respect to that value will ultimately enhance shareholder value.

Lastly, as the Company transitions into some of the items we addressed above (more exploration and development, the addition of gas processing facilities and perhaps new sales agreements, tie-in and production of new wells etc.) the timing and the breadth of these additions are going to complicate the modeling. For instance, we do not know when they may (or may not) add new production, nor do we know what the levels of that production will be one unit and/or one well to the next. That is another way of saying, we expect our model to miss some numbers for the foreseeable future, as we gather more information regarding what is likely to be several new moving parts. That said, regardless of the ultimate mix, we are comfortable suggesting that the financial performance will continue to improve, which we think will provide a path to higher valuations that, as we noted, are not in our view currently reflected in the share price.

We reiterate our allocation of 7 as well as our 12-24 month price target of $7.00, although as we said, we may revisit this as more production clarity emerges.

Projected Operating Model

Alvopetro Energy Ltd.		$ 29,759				
Projected Operating Model (in USD - '000s)						
By Trickle Research LLC						
	Actual	Actual	Estimate	Estimate	Estimate	Estimate
	3/31/22	**6/30/22**	**9/30/22**	**12/31/22**	**Fiscal 2022**	**Fiscal 2023**
Oil & Gas Sales	$ 13,972	$ 15,787	$ 15,043	$ 17,623	$ 62,424	$ 86,442
Royalties and Production Taxes	$ (979)	$ (1,148)	$ (1,354)	$ (1,586)	$ (5,067)	$ (7,780)
					$ -	$ -
Oil & Gas Revenue	$ 12,993	$ 14,639	$ 13,689	$ 16,037	$ 57,357	$ 78,662
Midstream Transportation Revenues	$ -	$ -	$ -	$ -	$ -	$ -
Other Income	$ 141	$ 185	$ -	$ -	$ 326	$ -
Total Revenue and Other Income	$ 13,134	$ 14,824	$ 13,689	$ 16,037	$ 57,683	$ 78,662
					$ -	$ -
Production	$ 853	$ 907	$ 763	$ 872	$ 3,394	$ 4,054
Transportation	$ -	$ -	$ -	$ -	$ -	$ -
General & Administrative	$ 1,208	$ 1,094	$ 1,226	$ 1,291	$ 4,819	$ 5,561
Depletion and Depreciation	$ 1,819	$ 1,279	$ 1,407	$ 1,563	$ 6,068	$ 7,234
Impairment	$ -	$ -	$ -	$ -	$ -	$ -
Exploration and Evaluation	$ -	$ -	$ -	$ -	$ -	$ 3,000
Finance Expenses and Interest	$ 650	$ 595	$ 486	$ 486	$ 2,217	$ 1,692
Accretion of Decommissioning Liabilities	$ -	$ -	$ -	$ -	$ -	$ -
Share Based Compensation	$ 250	$ 184	$ 200	$ 200	$ 834	$ 800
Foreign Exchange Loss	$ (5,009)	$ 2,967	$ -	$ -	$ (2,042)	$ -
Loss on Disposition of Assets	$ -	$ -	$ -	$ -	$ -	$ -
Risk Management Expenses	$ 90	$ 2	$ -	$ -	$ 92	$ -
Total Operating Expenses	$ (139)	$ 7,028	$ 4,082	$ 4,411	$ 15,382	$ 22,341
Interest Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Other Non-Operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Total non-operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Gain (Loss) Before Taxes	$ 13,273	$ 7,796	$ 9,607	$ 11,625	$ 42,302	$ 56,320
Income Tax Charge (Recovery)	$ 2,158	$ 1,165	$ 1,465	$ 1,773	$ 6,561	$ 8,589
Net Income	$ 11,115	$ 6,631	$ 8,142	$ 9,852	$ 35,741	$ 47,732
Exchange (loss) gain on translation of foreign operations	$ 3,951	$ (2,587)	$ -	$ -	$ 1,364	$ -
Comprehensive (loss) gain	$ 15,066	$ 4,044	$ 8,142	$ 9,852	$ 37,105	$ 47,732
Net Gain (Loss) per share						
Basic	$ 0.33	$ 0.20	$ 0.24	$ 0.29	$ 1.09	$ 1.40
Diluted	$ 0.30	$ 0.18	$ 0.22	$ 0.27	$ 1.01	$ 1.30
Shares O/S - Basic	33,942,744	33,973,000	33,985,771	33,998,291	33,974,951	34,019,591
Shares O/S - Diluted	36,546,229	36,637,000	36,645,156	36,684,808	36,628,298	36,771,314

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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.