Trickle Research

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

Fiscal 2022 Earnings Update
and
Price Target Increase

Alvopetro Energy Ltd.

(TSXV:ALV.V; OTC:ALVOF)

http://alvopetro.com/

Report Date: 03/28/23

12- 24 month Price Target: USD *$7.75

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 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 Price Target Increase (Closing Px: 03/27/23): USD $5.30

Prepared By:
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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.

Alvopetro's fiscal 2022-year end results were stellar, they also held few surprises. That is not a revelation since their monthly volume reporting provides considerable insight into where results for related reporting periods should end up. The one large item we missed was a $6.4 million impairment related to the abandonment of development well 182-C. Here again, while we did not know the timing or extend of the impairment, we knew about the disposition of the well. (Just to edify, in terms of exploration and development, that spend is generally capitalized, and then written off (impaired) if it is not fruitful. In our models, we attempt to estimate that spend around guided budgeting. When/if an impairment is in order, the capitalized asset is reduced and conversely expensed, so the cash impact of the impairment is born when it is initially capitalized). More specifically, Alvopetro reported revenues for fiscal 2022 of $63.5 million versus our estimate of $63.8 million. They also reflected pretax income of $37.5 million versus our estimate of $42.9 million. If we adjust out the (non-cash) impairment of $6.4 million, they would have reflected pretax income of $43.9 million, or a bit better than we projected, which we think is indicative of the operating leverage we have harped on it the past.

Aside from net income, the Company also reported "funds flow from operations" (essentially EBITDA) of just under $50 million, and cash and equivalents at yearend of $19.8 million. As a result, the current enterprise value represents *about 3.5X EBITDA.* As reflected by our price target, we continue to believe the shares are undervalued.

While the operating results held no surprises, the yearend announcement did include some additional constructive news for investors as the Company used the occasion to announce an increase in the dividend from US$.12 to US$.14, as well as reiterating their share repurchase approval for up to 2,876,414 via "normal course issuer bid", which essentially means (with a few minor caveats) that they can repurchase the shares whenever they deem appropriate. The new annual dividend of US$.56 per share represents a **current yield of about 11%**, however, (while an admittedly shameless plug), it represents a 49% yield to our initiating price of US$1.14.

Setting aside the results, as we have noted along the way, we think some of the focus on Alvopetro has segued from production/operations to exploration/reserves. However, before we go down that path, we would reiterate some of the high-level, year-end reserve data that also accompanied the year end reporting:

December 31, 2022 Reserves and Net Asset Value

(On February 28, 2023, Alvopetro announced its December 31, 2022 reserves based upon the independent reserve assessment and evaluation prepared by GLJ Ltd. ("GLJ") dated February 27, 2023 with an effective date of December 31, 2022)...

- *Key highlights from the GLJ Reserves and Resources Report1:*
- *2P net present value before tax discounted at 10% ("NPV10") increased 17% to $348.2 million.*
- *Proved reserves ("1P") decreased 12% to 3.9 MMboe and 2P reserves increased 3% to 9.0 MMboe after 0.9 MMboe of production in 2022.*
- *2P production replacement ratio of 132%.*
- *2P F&D costs of $28.66/boe.*
- *2P recycle ratio of 2.1 times.*
- *2P Net Asset Value of CAD$13.70/share ($9.99/share) before any potential from contingent or prospective resources.*
- *Risked best estimate contingent resource of 2.9 MMboe (NPV10 $62.2 million) and risked best estimate prospective resource of 12.5 MMboe (NPV10 $259.1 million).*

Again, as we reflected above, the current enterprise value of the Company is around US$175 million or about US$4.85 per share, versus whatever metric one would like to pull from above. From another perspective, our new US$7.75 price target represents and enterprise value of about US$280 million. We continue to believe the shares are undervalued from multiple perspectives.

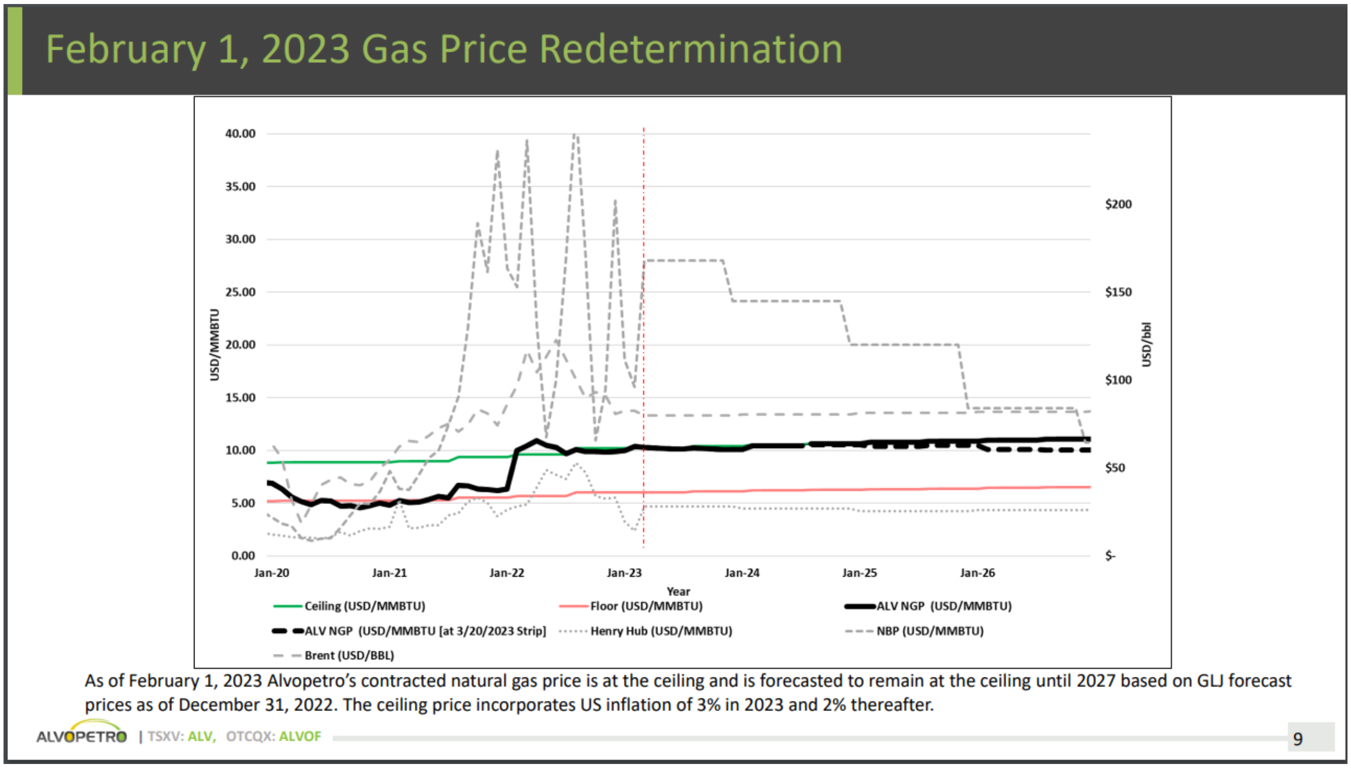
The above said, while we believe the current reserve profile (in the context of their established production profile) speaks to better valuations, it is not lost on us that the street remains focused at least in part on exploration and development activities beyond the current reserves. We submit, some of those results have been mixed as evidenced by, for instance, the impairment of 182-C. However, the Company has a variety of exploration targets it is currently advancing including some we have not discussed in the past (two development wells at their legacy Bon Lugar project for example). We are not going to delve in to the specifics of these programs here, but rather would encourage people to visit Alvopetro's site (https://alvopetro.com/) which includes both a presentation as well as a replay of the year end call. Each provide overviews of these individual projects. Succinctly, as we noted above, we do not think the stock currently reflects the full value of *existing reserves* much less those that they may add through these various projects. Moreover, our models (and resulting targets) are not built around assumptions beyond the current reserve profile either.

Looking ahead, the Company continues to post constructive (and growing) production/delivery results. Specifically, the Company announced January sales of 2,754 boepd and February sales of 2,866 boepd. The February tally was a record and translates into 16.4 MMcfpd. Recall, in our last update we noted that we expected them to approach their (new) delivery levels of 18MMcfbd, and it appears they are on that trajectory. As they alluded to on the call, at some point, they will need to revisit that threshold again. Just to reiterate, we believe the *current reserve profile* will support the production projections of our current model. That brings us to another major variable, pricing.

The following pricing guidance was provided on the yearend update:

"All natural gas sales from February 1 to July 31, 2023 are at our new contracted price of BRL2.00/m3 or $11.88/Mcf (based on our average heat content to date and the January 31, 2023 BRL/USD foreign exchange rate of 5.10), an increase of 3.6% from our prior contracted price. Including recently approved and enhanced sales tax credits, our realized gas price, net of sales taxes, for the month of February was approximately $12.23/Mcf (based on our average heat content to date and the average February 2023 BRL/USD foreign exchange rate of 5.17)".

In addition to the above narrative, they also provide the following chart in the presentation which provides a good visual of their pricing mechanism and its impact on future collars and associated prices. Notice, the forward assumptions include US inflations estimates of 3% for 2023 and 2% thereafter. Translation: we think the chart may be lite in terms of projected collars. Obviously, inflation remains a wildcard going forward, as do prevailing energy prices, however, for the foreseeable future, because of the backward-looking nature of the forward pricing mechanism, we have good visibility into pricing at least in the near(ish) term. On the other hand, to be clear, our model also assumes considerably lower energy prices going forward than those used to compute the most recent reset. Frankly, while we took that approach as a means of hedging the model assumptions a bit, we are not convinced that significantly lower energy prices (beyond current levels) are in the cards.



To summarize, Alvopetro continues to fire on all cylinders while at the same time following through on their promises to deliver dividends and other stakeholder value such as share buybacks. At the same time, they also continue to operate at highly efficient levels as reflected by extraordinary relative margins, while also setting the stage for growth by advancing exploration and associated reserves. As a result, we reiterate our allocation of 7, and we are establishing a new 12-24 month price target of *US$7.75, based on what we believe is improving production visibility largely from Murucututu. Moreover, we also think additional progress on the exploration/development front could provide valuation catalysts beyond what we see as the current valuation disconnect. We continue to believe the shares are undervalued.

Projected Operating Model

Alvopetro Energy Ltd.						
Projected Operating Model (in USD - '000s)						
By Trickle Research LLC						
	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate
	3/31/23	**6/30/23**	**9/30/23**	**12/31/23**	**Fiscal 2023**	**Fiscal 2024**
Oil & Gas Sales	$ 19,437	$ 18,844	$ 20,387	$ 21,337	$ 80,006	$ 74,449
Royalties and Production Taxes	$ (1,749)	$ (1,696)	$ (1,835)	$ (1,920)	$ (7,201)	$ (6,700)
					$ -	$ -
Oil & Gas Revenue	$ 17,688	$ 17,148	$ 18,553	$ 19,417	$ 72,805	$ 67,748
Other Income	$ -	$ -	$ -	$ -	$ -	$ -
Total Revenue and Other Income	$ 17,688	$ 17,148	$ 18,553	$ 19,417	$ 72,805	$ 67,748
					$ -	$ -
Production	$ 982	$ 912	$ 828	$ 799	$ 3,522	$ 2,151
General & Administrative	$ 1,486	$ 1,471	$ 1,510	$ 1,633	$ 6,100	$ 5,961
Depletion and Depreciation	$ 1,882	$ 1,856	$ 1,893	$ 1,919	$ 7,549	$ 6,673
Impairment	$ -	$ -	$ -	$ -	$ -	$ -
Exploration and Evaluation	$ -	$ -	$ -	$ -	$ -	$ -
Finance Expenses and Interest	$ -	$ -	$ -	$ -	$ -	$ -
Accretion of Decommissioning Liabilities	$ -	$ -	$ -	$ -	$ -	$ -
Share Based Compensation	$ 200	$ 200	$ 200	$ 200	$ 800	$ 800
Foreign Exchange Loss	$ -	$ -	$ -	$ -	$ -	$ -
Loss on Disposition of Assets	$ -	$ -	$ -	$ -	$ -	$ -
Risk Management Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Total Operating Expenses	$ 4,550	$ 4,439	$ 4,431	$ 4,551	$ 17,972	$ 15,586
Interest Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Other Non-Operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Total non-operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Gain (Loss) Before Taxes	$ 13,138	$ 12,709	$ 14,121	$ 14,865	$ 54,833	$ 52,163
Income Tax Charge (Recovery)	$ 2,004	$ 1,938	$ 2,154	$ 2,267	$ 8,362	$ 7,955
Net Income	$ 11,134	$ 10,771	$ 11,968	$ 12,598	$ 46,471	$ 44,208
Exchange (loss) gain on translation of foreign operations	$ -	$ -	$ -	$ -	$ -	$ -
Comprehensive (loss) gain	$ 11,134	$ 10,771	$ 11,968	$ 12,598	$ 46,471	$ 44,208
Net Gain (Loss) per share						
Basic	$ 0.31	$ 0.30	$ 0.33	$ 0.35	$ 1.29	$ 1.24
Diluted	$ 0.30	$ 0.29	$ 0.32	$ 0.34	$ 1.26	$ 1.21
Shares O/S - Basic	36,325,744	36,186,796	36,038,008	35,892,138	36,110,672	35,541,555
Shares O/S - Diluted	37,214,517	37,084,752	36,944,967	36,807,923	37,013,040	36,478,553

General Disclaimer:

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.