

Trickle Research

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



Allocation Upgrade



Alvopetro Energy Ltd.

(TSXV:ALV.V; OTC:ALVOF)

<http://alvopetro.com/>

Report Date: 02/02/24

12- 24 month Price Target: USD \$10.00

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

Closing Stock Price at Target Increase & Allocation Decrease (Closing Px: 08/15/23): USD \$7.90

Closing Stock Price at This Allocation Upgrade (Closing Px: 02/01/24): USD \$4.33

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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.

Since our Allocation Downgrade and Price Target upgrade on ★ 08/15/23, Alvopetro has been selling off, which has prompted some calls from some of our subscribers:



As we covered in our more recent update (11/09/23), Company gas sales for Q3F23 were light, missing expectations, which was related in part to a temporary softness in gas demand in Bahia. The stock recovered a bit following the earnings release and associated company call but continued the slide thereafter. Further, over the past 45 days, Alvopetro has made some additional announcements that may have contributed to the decline in the shares, which we will address below, however, we think it is reasonable to assume that some of the compression in the shares since the summer 2023 highs, are likely related to similar declines in oil prices over much of the same period:



Macro items aside, in mid-December (2023), the Company noted that a “redetermination” of the Caburé project was underway. To clarify, redetermination is an extension of a production sharing process used in Brazil to avoid/mitigate resource disputes between contiguous owners, which they refer to as “unitization”. The process

involves an original determination, which is periodically “redetermined”. In Alvo Petro’s case, the first redetermination of Caburé was to occur “18 months after Alvo Petro commenced production allocations or on January 5, 2022”. However, the first redetermination was “deferred to include data up to October 31, 2023, and has now commenced”. We could be wrong about this, but our sense is that this particular announcement has created some consternation in the street and among shareholders. Part of our view in that regard stems from our own reaction when we first read it. That noted, we have discussed this with management, and we have a few observations in that regard.

First, we understand concerns around what effectively represents a large majority of the Company’s current production and source of revenue. To edify, as part of the redetermination process, both Alvo Petro and its utilization counterpart submit an analysis, which essentially tries to establish what portion of the production has likely emanated from each’s respective property(s). Those respective analyses are submitted to a third party that effectively arbitrates or otherwise decides which position they believe is the most likely/accurate. From there, adjustments are made to reflect any differences from the original determination. We submit that sounds potentially ominous, because it provides the potential for Alvo Petro to get less (or more) of the Caburé production than we are accustomed to. Further, it is perhaps more concerning because it is not an issue the Company is able to discuss or otherwise comment on prior to the completion and announcement of the redetermination, which effectively adds to the uncertainty. We understand that too.

In short, we have no idea what the redetermination will yield, however, each of these entities developed initial estimates of their potential reserves. It is difficult for us to imagine that the redetermination is going to yield markedly different results from the original determination. There may be some differences, we just do not think it is likely that they will be impactful one way or the other. While we are not able to glean anything from our discussion with management about the outcome, we are very confident that the Company is quite capable of identifying resources and in that regard, has put “its best foot forward”, in terms of determining and arguing what portion the whole is theirs. Again, we could be overstating this, and if we are wrong about the results of the redetermination, then perhaps the compression in the stock is justified. On the other hand, if we are not, then the compression in the stock may represent an opportunity.

The second release that may be creating some concern was the January 4, 2024, announcement regarding the initial results from the Murucututu183-A3 well. That release noted that “during the final 7.25 hour flow period the well produced an average rate of 8.5 e3m3/d (300 Mcfpd) with a final stabilized rate of 4.9 e3m3/d (175 Mcfpd)”. To put that into perspective, in the Month of December (2023) Caburé produced **12,778 Mcfpd**. It will take *several dozen* wells at that rate to replace Caburé. Further, the two Murucututu wells produced 535 mcfpd in December 2023. To translate, the initial results from 183-A3 are at first glance, underwhelming. However, recognize, the Company is still studying/applying iterations to the well to better understand the structure. We do not believe the rate noted above is indicative of its ultimate flow rates once the Company has completed their work or for additional wells they will add in the future. We think more definitive results are forthcoming.

Lastly, we would add, the January 4, 2024, announcement also reflected December (2023) monthly sales volume of 2,331 Mcfpd, which is in the ballpark of the volumes we were seeing prior to the 2QF23 miss. Obviously, that is encouraging.

To reiterate, we understand concerns around Alvo Petro’s ability to ultimately replace the reserves/production from Caburé. Frankly, that has been an increasingly topical issue since the day the Company delivered its first Mcf to the City Gate. However, we continue to view management’s ability to identify, develop and deliver resources as a demonstrative strength and we believe their efforts in that regard remain in the early innings. We recognize that there remain risks around that assessment and the street is clearly discounting our view. In our opinion, that discounting has provided a compelling opening for the shares, which now includes a dividend yield approaching 13%. As a result of the compression in the stock around concerns that we think may be overstated, we are raising our allocation back up to *7 and reiterating our 12-24 month price target of \$10.00.

Projected Operating Model

Alvopetro Energy Ltd.						
Projected Operating Model (in USD - '000s)						
By Trickle Research LLC						
	Actual	Actual	Actual	Estimate	Estimate	Estimate
	3/31/23	6/30/23	9/30/23	12/31/23	Fiscal 2023	Fiscal 2024
Oil & Gas Sales	\$ 18,160	\$ 13,914	\$ 11,812	\$ 15,560	\$ 59,447	\$ 76,150
Royalties and Production Taxes	\$ (582)	\$ (354)	\$ (318)	\$ (545)	\$ (1,799)	\$ (2,665)
					\$ -	\$ -
Net Oil & Gas Revenue	\$ 17,578	\$ 13,560	\$ 11,494	\$ 15,015	\$ 57,648	\$ 73,485
Other Income	\$ 427	\$ 477	\$ 471	\$ 250	\$ 1,625	\$ 1,000
Total Revenue and Other Income	\$ 18,005	\$ 14,037	\$ 11,965	\$ 15,265	\$ 59,273	\$ 74,485
					\$ -	\$ -
Production	\$ 988	\$ 1,048	\$ 1,017	\$ 1,288	\$ 4,341	\$ 4,924
General & Administrative	\$ 1,222	\$ 1,286	\$ 1,298	\$ 1,389	\$ 5,195	\$ 5,604
Depletion and Depreciation	\$ 2,144	\$ 1,711	\$ 1,621	\$ 1,729	\$ 7,205	\$ 9,240
Impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Exploration and Evaluation	\$ 82	\$ -	\$ -	\$ -	\$ 82	\$ -
Finance Expenses and Interest	\$ 403	\$ 389	\$ 386	\$ 350	\$ 1,528	\$ 1,400
Accretion of Decommissioning Liabilities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Share Based Compensation	\$ 283	\$ 281	\$ 249	\$ 200	\$ 1,013	\$ 800
Foreign Exchange Loss	\$ (1,374)	\$ (2,331)	\$ 1,471	\$ -	\$ (2,234)	\$ -
Loss on Disposition of Assets	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Risk Management Expenses	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total Operating Expenses	\$ 3,748	\$ 2,384	\$ 6,042	\$ 4,957	\$ 17,131	\$ 21,967
Interest Expenses	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Other Non-Operating Expenses	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Total non-operating Expenses	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Gain (Loss) Before Taxes	\$ 14,257	\$ 11,653	\$ 5,923	\$ 10,309	\$ 42,142	\$ 52,518
Income Tax Charge (Recovery)	\$ 2,055	\$ 1,801	\$ 605	\$ 1,572	\$ 6,033	\$ 8,009
Net Income	\$ 12,202	\$ 9,852	\$ 5,318	\$ 8,737	\$ 36,109	\$ 44,509
Exchange (loss) gain on translation of foreign operations	\$ 616	\$ 1,609	\$ (1,575)	\$ -	\$ 650	\$ -
Comprehensive (loss) gain	\$ 12,818	\$ 11,461	\$ 3,743	\$ 8,737	\$ 36,759	\$ 44,509
Net Gain (Loss) per share						
Basic	\$ 0.34	\$ 0.27	\$ 0.15	\$ 0.24	\$ 0.99	\$ 1.23
Diluted	\$ 0.33	\$ 0.26	\$ 0.14	\$ 0.23	\$ 0.96	\$ 1.20
Shares O/S - Basic	36,322,948	36,491,775	36,587,442	36,458,443	36,465,152	36,148,408
Shares O/S - Diluted	37,469,951	37,389,731	37,546,465	37,425,272	37,457,855	37,133,997

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

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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.