Trickle Research

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

F23 Earnings Update and Price Target Decrease

ALVOPETRO

Alvopetro Energy Ltd.

(TSXV:ALV.V; OTC:ALVOF)

http://alvopetro.com/

Report Date: 03/22/24

12- 24 month Price Target: USD *$6.50

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 Allocation Upgrade (Closing Px: 02/01/24): USD $4.33

Closing Stock Price at This Target Decrease (Closing Px: 03/22/24): USD $2.97

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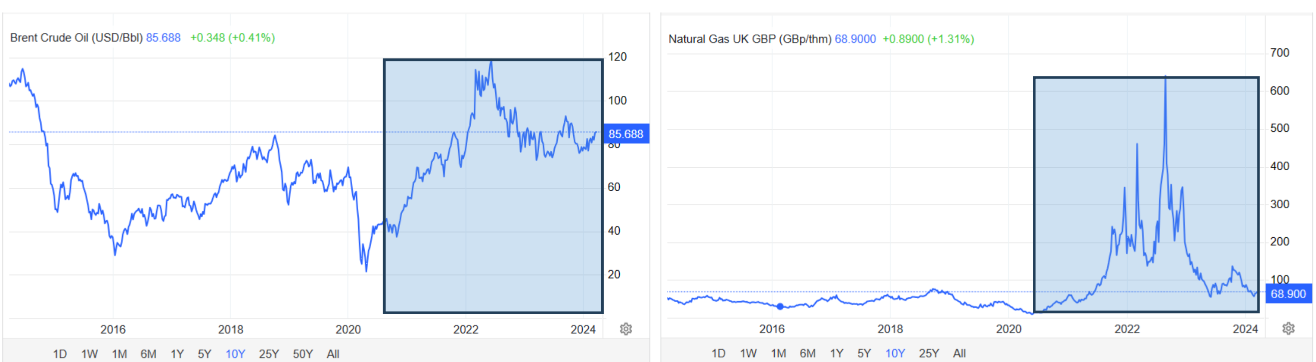
Disclosure: Portions of this report are excerpted from Alvopetro's filings, website(s), presentations or other public collateral. We have attempted to identify those excerpts by *italicizing* them in the text.

Alvopetro shares have experienced some marked compression since marking their all-time highs in mid-summer 2023. Moreover, perhaps the worst of that has occurred over the past 4 months. Here is a bit of the minutia around the compression as we see it, although some of this will be redundant relative to our update of 02/01/24.

First, for fiscal 2023, Alvopetro reported revenues of $59.7 million versus $63.5 million in fiscal 2022. All of the comparative revenue decrease was realized in the second half of fiscal 2023, with Q3 being particularly acute. Predominantly, the revenue shortfall for the second half was related to lower demand from the Company's customer Bahiagas, which the Company has essentially attributed to demand forecasting misses by the customer, or something along those lines. To be honest, we have some questions about that answer (as it relates to Bahiagas not Alvopetro). In short, energy prices have been markedly better since the time Alvopetro started delivering gas in Mid-2020. The two charts below reflect two of the major proxies used in their pricing equation, and the blue boxes reflect the period since the first gas deliveries. Our point here is that for much of that period, prices have been favorable for Alvopetro's pricing arrangement. That is especially true if we compare these prices to those that prevailed prior to the first sales but ostensibly also in and around the time the gas delivery agreement was being negotiated. From another perspective, Alvopetro's most recent pricing reset (February 1, 2024) reflects a realized price of $12.36/Mcf. However, that price in Q3F20 (the first quarter they reported deliveries) was $5.37/Mcf. Moreover, prior to actual deliveries, Bahiagas made some prepayments for gas, which as we recall were *below $5.00/Mcf*. Our point here is that Alvopetro has clearly had the wind at its back in terms of pricing around their agreement.

While we believe Alvopetro's gas prices were likely very attractive relative to Bahiagas's other sources when Alvopetro began delivering gas in mid-2020, we feel confident suggesting that difference has likely narrowed since that time. The Company addressed that on the call, and we have raised the issue prior as well, and their take is a little different than ours. That said, we stand by the notion that as long as their reset pricing remains high relative to prevailing local prices in Brazil (which could be the case for a number of reasons), Alvopetro may sell less gas at times and that may be for one reason or another that may or may not always be clear. That said, we would prefer to see them get higher prices rather than lower prices, especially given some of the take or pay elements of the gas delivery arrangement even if that means they sell less gas at times. Keep in mind, the gas they do not sell today, *will get sold* at some point in the future. They don't sell apples.



Brent crude oil - Price - Chart - Historical Data - News (tradingeconomics.com)

Second, the Company's efforts to find and develop new resources has to this point underperformed apparent expectations. We use the term "apparent" because we are not sure there was ever a defined or anticipated expectation, but for instance, fiscal 2023 reflected some meaningful impairments ($11 million) around unsuccessful exploration endeavors. In addition, while they have managed to get the initial Murucututu wells online, they have *to this point* reflected IPs below our model assumptions and we think below the likely expectations of most, including we suspect the Company. However, as the Company noted on the call, and has alluded to prior, the development of the Murucututu asset is in the very early innings. From that perspective, we would all prefer to lead off the first inning with two home runs, but that just doesn't happen very often. We think it is fair to say that while the Company has accumulated considerable knowledge of Murucututu and its respective formations, they are still developing and learning the optimal approaches to exploiting it, and that is likely to continue to be a process. For instance, they spent some time on the call discussing their adjustments to various sleeves in the formations, and that process will continue to involve some trial and error. Those familiar with O&G development will likely attest, sometimes it seems closer to black art than to science, especially early in the development of a new area.

To be clear, we are not mitigating the fact that the development work to this point has been uninspiring. However, we think the current resource profile clearly supports the notion of continued production well into the future and at rates that could reasonably support the thresholds of the existing plant and associated agreement. By the way, we are not going to reiterate the minutia of the reserves and their deltas here. Readers can access that in detail through the filings on Sedar, but we think they will support our notion. That said, we submit the visibility of that ramp may be lacking, but it is hard for us to derive a scenario around the existing resources that does not support higher valuations than those expressed by the current compression in the share price. To translate we think the stock is clearly oversold on a fundamental basis. That said, we have recast our model to reflect a slower rate of resource exploitation and/or customer demand, and we have made some associated adjustments to our revenue and target assumptions.

Third, we addressed the redetermination process at Caburé in our last update, and the Company referenced it on the call as well. We do not know what that will yield (good or bad) and that seems to be the Company's position as well. However, in our update a few weeks ago we suggested that it seemed to us that the greatest likelihood is that it will not be materially different than currently exists and most of that view is gleaned from our discussions with management that leads us to believe that their assessment of the appropriate redetermination is not significant. Perhaps we misread that because it was admittedly very high level, or in the alternative, maybe they are wrong about that. We submit, the lack of visibility here involves some risk. Again, we are hard pressed to believe that risk is properly reflected in the recent share compression, but it remains a wildcard. However, speaking of Caburé, the Company referenced a new well program and some anticipated capex therein. In short, our expectation is that these efforts at Caburé will likely lead to added future resource reserves and ultimately production beyond our current modeling. That is perhaps *another* Caburé wildcard and one that we think is understated in terms of valuation potential.

Lastly, we tend to think that the greater contribution to the most recent selloff in the shares likely centers on the reduction of the Q1F24 dividend from $.14 to $.09 per share. For those focused on dividends, that is a fair response. It is perhaps short sided in our view, but it is fair. We understand the frustration, but as the Company noted on the call, the reduction in the dividend corresponds to the lower demand/revenue scenarios of the second half of F23 (and into Q1F24) in the context of the established distribution of profits between stakeholders and resources development. In the face of lower demand/revenue/profits, even over (hopefully) limited periods, and in the context of resource development efforts that have not been as robust as anticipated, something has to give. We would submit that maintaining a dividend at the expense of continuing to develop new resources is not a good approach. Further, given the share price, we tend to think that they may be more inclined to buy shares with any future excess shareholder portions if the price weakness persists.

To summarize, less than robust development results coupled with lower gas demand have represented two steps back in what has up until recently been a steady march forward since the time of the first gas sales. In case it is not clear, we remain of the view that these represent bumps in the road rather than data points to a new (lower) trend. We could be wrong, but that is our view. However, as we said, given the visibility challenges, we are modeling new (slower) progress from Murucututu, as well as reducing some forward demand/sales assumptions per the recent results, which will impact projected revenues and profit as well, in turn resulting in lower target assessments. As a result, we are establishing a new (lower 12-24 month price target of *6.5 to reflect these changes. As for allocation, we recently raise our allocation on the stock price compression which turned out to be premature. To be clear, allocations beyond about 6 are atypical for us, so 7 is already a bit out of the ordinary making an increase to 8 extraordinary. We will keep that powder dry for now, but with our finger on the trigger. We will reassess our price targets as well as new data points evolve, as we think we have been aggressive reducing that target for now. To reiterate, in our opinion, the stock is markedly oversold at these levels.

Projected Operating Model

Alvopetro Energy Ltd. **Projected Operating Model (in USD - '000s)** **By Trickle Research LLC**	Estimate 3/31/24	Estimate 6/30/24	Estimate 9/30/24	Estimate 12/31/24	Estimate Fiscal 2024
Oil & Gas Sales	$ 12,890	$ 14,270	$ 15,544	$ 16,512	$ 59,216
Royalties and Production Taxes	$ (451)	$ (499)	$ (544)	$ (578)	$ (2,073)
Net Oil & Gas Revenue	$ 12,439	$ 13,771	$ 15,000	$ 15,934	$ 57,143
Other Income	$ 250	$ 250	$ 250	$ 250	$ 1,000
Total Revenue and Other Income	$ 12,689	$ 14,021	$ 15,250	$ 16,184	$ 58,143
Production	$ 1,034	$ 1,138	$ 1,150	$ 1,150	$ 4,472
General & Administrative	$ 1,222	$ 1,257	$ 1,289	$ 1,413	$ 5,180
Depletion and Depreciation	$ 1,955	$ 1,888	$ 1,974	$ 2,037	$ 7,854
Impairment	$ -	$ -	$ -	$ -	$ -
Exploration and Evaluation	$ -	$ -	$ -	$ -	$ -
Finance Expenses and Interest	$ 350	$ 350	$ 350	$ 350	$ 1,400
Accretion of Decommissioning Liabilities	$ -	$ -	$ -	$ -	$ -
Share Based Compensation	$ 200	$ 200	$ 200	$ 200	$ 800
Foreign Exchange Loss	$ -	$ -	$ -	$ -	$ -
Loss on Disposition of Assets	$ -	$ -	$ -	$ -	$ -
Risk Management Expenses	$ -	$ -	$ -	$ -	$ -
Total Operating Expenses	$ 4,762	$ 4,832	$ 4,962	$ 5,150	$ 19,706
Interest Expenses	$ -	$ -	$ -	$ -	$ -
Other Non-Operating Expenses	$ -	$ -	$ -	$ -	$ -
Total non-operating Expenses	$ -	$ -	$ -	$ -	$ -
Gain (Loss) Before Taxes	$ 7,927	$ 9,189	$ 10,288	$ 11,034	$ 38,438
Income Tax Charge (Recovery)	$ 1,209	$ 1,401	$ 1,569	$ 1,683	$ 5,862
Net Income	$ 6,718	$ 7,787	$ 8,719	$ 9,352	$ 32,576
Exchange (loss) gain on translation of foreign operations	$ -	$ -	$ -	$ -	$ -
Comprehensive (loss) gain	$ 6,718	$ 7,787	$ 8,719	$ 9,352	$ 32,576
Net Gain (Loss) per share					
Basic	$ 0.18	$ 0.21	$ 0.24	$ 0.26	$ 0.88
Diluted	$ 0.18	$ 0.21	$ 0.23	$ 0.25	$ 0.86
Shares O/S - Basic	36,994,640	36,870,650	36,749,091	36,629,916	36,811,074
Shares O/S - Diluted	37,969,121	37,852,634	37,738,430	37,626,466	37,796,663

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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.