Q2F24 Earnings Update

Alvopetro Energy Ltd.

(TSXV:ALV.V; OTC:ALVOF)

http://alvopetro.com/

Report Date: 08/14/24

12- 24 month Price Target: USD $7.25

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 Target Decrease (Closing Px: 03/22/24): USD $2.97

Closing Stock Price at Target Increase (Intraday Px: 04/05/24): USD $3.77

Closing Stock Price at This Update (Closing Px: 08/13/24): USD $3.65

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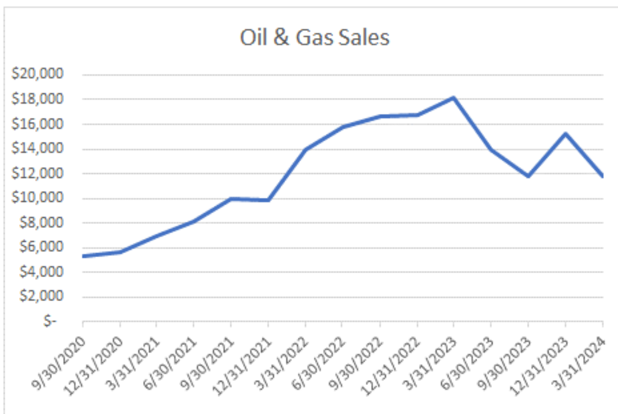
Disclosure: Portions of this report are excerpted from Alvopetro's filings, website(s), presentations or other public collateral. We have attempted to identify those excerpts by *italicizing* them in the text.

For Q2F24, Alvopetro reported revenue of $10.6 million and eps of $.06. Those compared to our estimates of $13.8 million and $.20.

First, as we typically note in our earnings updates of issuers with foreign domiciles and/or operations, we do not attempt to model forex impact on operating results. That applies to Alvopetro, and specifically, for 2QF24 they recognized a $3.2 million operating charge, which negatively impacted eps by $.09 per share. That is, without the forex adjustment they would have earned $.15 rather than $.06. We think that (noncash) distinction is important to recognize, especially in the context of our earnings projection miss. That noted, revenues continued to lag our estimates, and the causes are part of a recurring theme.

Specifically, the Company has noted that much of the recent decline(s) in gas sales (and associated revenue) have been the result of lower demand from their customer Bahiagás. To be clear, we do not dispute that. Over the past few years, Brazil's natural gas demand has experienced some volatility for a variety of reasons. For instance, they rely heavily on hydropower, and a drought a few years back reduced water levels which impacted hydropower capacity, thus increasing gas demand.



Again, there are several moving parts to that demand, which impact it from one period to the next. That said, we still tend to believe that the Company's pricing collar has placed its gas much closer to prevailing market prices (perhaps higher than Bahiagás could get at some points in time) which we think has potentially impacted periodic demand. In short, we have viewed that as temporary or (dare we say) transitory situation, that would ultimately see the Company returning to production levels in the 2,300+ boepd range rather than the 1,600 boepd range they have been selling as of late. Obviously, that situation has lasted longer than we anticipated.

However, as the Company noted in their recent discussion around 2QF24, sales for 3QF24 look to be normalizing:

> *(… July sales volumes increased 49% over Q2 2024, **averaging 2,432 boepd**, including natural gas sales of 13.8 MMcfpd, associated natural gas liquids sales from condensate of 118 bopd and oil sales of 19 bopd, based on field estimates. To address continued impacts resulting from reductions in natural gas demand in the state of Bahia, Alvopetro and Bahiagás have agreed to review natural gas pricing on interruptible sales volumes (those volumes above our 300,000 m3/d (10.6 Mmcfpd) of Firm contracted sales) on a monthly basis. **We expect nominations in August to be consistent with our July sales**…").*

Also notice, the excerpt above, "*To address continued impacts resulting from reductions in natural gas demand in the state of Bahia, Alvopetro and Bahiagás have agreed to review natural gas pricing on interruptible sales volumes (those volumes above our 300,000 m3/d (10.6 Mmcfpd) of Firm contracted sales) on a monthly basis*".

We will not read too much into this, but we think it supports our view that the Company's collar pricing may be impacting demand for its gas. From that perspective, we would reiterate something we have touched on in the past, which is that we do not think scenarios where they sell fewer boe's at higher prices is necessarily worse than selling more boe's at a lower price. We recognize that neither is better than selling as much gas as one can produce at higher prices (a place Alvopetro enjoyed for some time), but as we have seen, gas pricing and associated demand in Brazil may be more fluid than we had anticipated. We suspect we may see lower overall pricing from Alvopetro gas, but at delivery levels closer to 2500 boed than to 1600 boed. We have adjusted our model to reflect that, but our prior model assumed lower future pricing anyway, so it does not materially impact our earnings and target assumptions. (For instance, our model was expecting maximum collar pricing for 1HF25 of $10.56). More specifically, the Company's 2QF24 narrative notes:

> *Effective August 1, 2024, our natural gas price under our long-term gas sales agreement with Bahiagás has been adjusted to BRL1.945/m3 or $10.83/Mcf (based on average heat content to date, the July 31, 2024 BRL/USD exchange rate of 5.66 and sales tax credits applicable). While the BRL contracted price was virtually unchanged from the February 1, 2024 contracted price, the expected USD price of $10.83/Mcf, based on the July 31, 2024 exchange rate of 5.66, is 8% lower than the realized natural gas price of $11.83/Mcf in Q2 2024, which was based on the Q2 2024 average exchange rate of 5.21.*

Again, while the balancing variable to the Company's sales calculus over the past few quarters has ostensibly been delivery volumes, we suspect pricing may play a bigger role going forward. Again, we have worked some of that into our new model.

Lastly, the Company has once again raised the issue of stock repurchases to address shareholder value. Personally, we are not as constructive on stock buybacks as many seem to be, but it looks like the Company is getting more serious about executing that approach. It is unclear to us if that will enhance shareholder value, but we suspect they will buy some shares back in the open market.

To recap, we recognize the fixation on lower sales volumes and by extension, lower revenues that have led to lower dividends. Clearly, *all of that* has culminated in lower share prices. That said, we stand by our argument that Alvopetro *will ultimately sell* all the gas it produces, and the pricing it gets will largely be based on prevailing energy prices (in the context of Brazil). From that vantage point, those who see a future of largely lower macro energy prices should include that in their own assessments of Alvopetro. However, setting that aside, while we do not think the stock includes much credit for it, in our view management continues to operate at a high level as reflected in operating metrics like netbacks and cash flow. While we accept the concerns around declining sales and revenue (which looks to be turning higher in 3QF24), we still think adding resources remains the cogent risk in the story. As usual, they addressed some of their ongoing efforts around that, and we remain constructive on their prospects to replace depleting resources.

We reiterate our allocation of 7 for Alvopetro shares as well as reaffirming our 12-24 month price target of $7.25. We will revisit each as new data points emerge, but for now we remain of the view that the shares, especially in the context of the Company's dividend policy (currently $.09 per quarter or nearly 10% annually), represents a compelling value at current levels.

Projected Operating Model

Alvopetro Energy Ltd.						
Projected Operating Model (in USD - '000s)						
By Trickle Research LLC						
	Actual	Actual	Estimate	Estimate	Estimate	Estimate
	3/31/24	**6/30/24**	**9/30/24**	**12/31/24**	**Fiscal 2024**	**Fiscal 2025**
Oil & Gas Sales	$ 11,752	$ 10,672	$ 14,445	$ 17,652	$ 54,521	$ 75,476
Royalties and Production Taxes	$ (312)	$ (287)	$ (289)	$ (353)	$ (1,241)	$ (1,510)
						$ -
Net Oil & Gas Revenue	$ 11,440	$ 10,385	$ 14,156	$ 17,299	$ 53,280	$ 73,967
Other Income	$ 398	$ 444	$ 250	$ 250	$ 1,342	$ 1,000
Total Revenue and Other Income	$ 11,838	$ 10,829	$ 14,406	$ 17,549	$ 54,622	$ 74,967
						$ -
Production	$ 1,201	$ 850	$ 1,403	$ 1,619	$ 5,073	$ 6,400
General & Administrative	$ 1,423	$ 1,570	$ 1,561	$ 1,741	$ 6,295	$ 6,787
Depletion and Depreciation	$ 1,847	$ 1,701	$ 2,139	$ 2,207	$ 7,894	$ 9,550
Impairment	$ 91	$ -	$ -	$ -	$ 91	$ -
Exploration and Evaluation	$ 96	$ -	$ -	$ -	$ 96	$ -
Finance Expenses and Interest	$ 383	$ 371	$ 350	$ 350	$ 1,454	$ 1,400
Accretion of Decommissioning Liabilities	$ -	$ -	$ -	$ -	$ -	$ -
Share Based Compensation	$ 287	$ 315	$ 200	$ 200	$ 1,002	$ 800
Foreign Exchange Loss	$ 1,170	$ 3,204	$ -	$ -	$ 4,374	$ -
Loss on Disposition of Assets	$ -	$ -	$ -	$ -	$ -	$ -
Risk Management Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Total Operating Expenses	$ 6,498	$ 8,011	$ 5,653	$ 6,117	$ 26,279	$ 24,936
Interest Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Other Non-Operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Total non-operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -
Gain (Loss) Before Taxes	$ 5,340	$ 2,818	$ 8,753	$ 11,432	$ 28,343	$ 50,031
Income Tax Charge (Recovery)	$ 790	$ 468	$ 1,335	$ 1,743	$ 4,336	$ 7,630
Net Income	$ 4,550	$ 2,350	$ 7,418	$ 9,689	$ 24,007	$ 42,401
Exchange (loss) gain on translation of foreign operations	$ (1,462)	$ (5,175)	$ -	$ -	$ (6,637)	$ -
Comprehensive (loss) gain	$ 3,088	$ (2,825)	$ 7,418	$ 9,689	$ 17,370	$ 42,401
Net Gain (Loss) per share						
Basic	$ 0.12	$ 0.06	$ 0.20	$ 0.26	$ 0.65	$ 1.17
Diluted	$ 0.12	$ 0.06	$ 0.20	$ 0.26	$ 0.64	$ 1.17
Shares O/S - Basic	37,281,649	37,066,651	36,855,868	36,649,219	36,963,347	36,152,559
Shares O/S - Diluted	37,975,282	37,773,293	37,575,265	37,381,119	37,676,240	36,152,559

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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.