Trickle Research

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

Production and Model Updates

Alvopetro Energy Ltd.

(TSXV:ALV.V; OTC:ALVOF)

http://alvopetro.com/

Report Date: 12/30/24

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: 12/27/24): USD $3.58

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

As we noted in our last update, we do not typically comment on Alvopetro's monthly production announcements, but after looking this particular announcement over, we thought there were some particular important aspects worth addressing. Here is the announcement and some of our associated color around it.

CALGARY, AB, Dec. 17, 2024 /CNW/ - Alvopetro Energy Ltd. (TSXV: ALV) (OTCQX: ALVOF) announces November 2024 sales volumes, an update to our long-term natural gas sales agreement, and our Q4 2024 dividend.

President & CEO, Corey C. Ruttan commented:

"In 2024 we increased our productive capacity at Caburé and, with our recent success at Murucututu, this has allowed us to commit to a higher level of base committed firm sales volumes starting in 2025 further strengthening our disciplined capital allocation model, balancing returns to stakeholders and organic growth."

-November Sales Volumes

November sales volumes averaged 1,465 boepd including natural gas sales of 8.1 MMcfpd, associated natural gas liquids sales from condensate of 110 bopd and oil sales of 9 bopd, based on field estimates. Our November sales were impacted by reduced demand in the state of Bahia resulting mainly from facility turnarounds. During this period Alvopetro also shut in all production for a 2-day period to complete mandatory turnaround and inspection works at all facilities. Based on field estimates, natural gas sales volumes to-date in December have averaged 11.6 MMcfpd.

	November	October
Natural gas, NGLs and crude oil sales:	**2024**	2024
Natural gas (Mcfpd), by field:		
Caburé	**5,827**	8,980
Murucututu	**2,245**	1,764
Total Company natural gas (Mcfpd)	**8,073**	10,744
NGLs (bopd)	**110**	108
Oil (bopd)	**9**	14
Total Company (boepd)	**1,465**	1,912

Our Murucututu sales volumes accounted for 28% of November natural gas sales. Murucututu production in November was entirely from our 183-A3 well which was being prioritized and continues to perform well above expectations.

Bahiagas Sales Agreement Update

Alvopetro and Bahiagás have agreed to update our long-term gas sales agreement to increase Alvopetro's share of Bahiagas' supply and better align the contract with prevailing market conditions, highlighted as follows:

Increasing Alvopetro's contracted firm volumes starting January 1, 2025 by 33% up to 400 e3m3/d(1).

- *Adjusted the natural gas pricing model to be recalculated quarterly and to be a function of Brent oil equivalent prices and Henry Hub natural gas prices resulting in quicker adjustments for commodity price and foreign exchange rate fluctuations.*
- *Removed the contractual floor and ceiling provisions.*
- *Enhanced supply failure penalty mechanisms to reduce Alvopetro's exposure in the event of any supply failures.*
- *Retained existing take or pay provisions requiring Bahiagas to pay for any gas not taken to the extent deliveries are less than 80% of firm volumes monthly, or less than 90% annually. For reference in 2024, while Bahiagas was managing demand disruptions, Alvopetro delivered 104% of the firm contracted amount on average to-date.*

The updated contract extends to December 31, 2034.

The contracted firm volumes would be satisfied with delivered natural gas sales of 371 e3m3/d (13.1 MMcfpd)(1). At this sales level and including expected natural gas liquids (condensate) yields our 2025 sales volumes would average approximately 2,310 boepd, a 28% increase from forecast 2024 sales. Using currently forecast commodity prices in the futures markets, a constant foreign exchange rate of 6.05BRL:1USD, 2.2% US inflation, 4.1% Brazilian inflation and our average heat content, our natural gas price is forecast to average $10.37/Mcf in 2025. This is approximately 2.5% lower than what would be forecast under our previous natural gas pricing model.

*The 2025 firm volume of 400 e3m3/d (before any provisions for take or pay allowances) represents contracted volumes based on contract referenced natural gas heating value. Note that Alvopetro's reported natural gas sales volumes are prior to any adjustments for heating value of Alvopetro natural gas. Alvopetro's natural gas is approximately 7.8% hotter than the contract reference heating value. Therefore, to satisfy the contractual firm deliveries Alvopetro would be required to deliver approximately 371e3m3/d (**13.1MMcfpd**).*

Q4 2024 Dividend

Our Board of Directors has declared a quarterly dividend of US$0.09 per common share, payable in cash on January 15, 2025, to shareholders of record at the close of business on December 31, 2024. This dividend is designated as an "eligible dividend" for Canadian income tax purposes.

First, on the downside, production for the month of November was negatively impacted by "..*facility turnarounds in the State of Bahia…"* in addition*, "During this period Alvopetro also shut in all production for a 2-day period to complete mandatory turnaround and inspection works at all facilities".* We did not anticipate that, so we have adjusted our projections for Q4F24 (down) accordingly. On the flipside, the release above also notes that through the time of the releases (roughly halfway through the month of December) daily production numbers "*averaged 11.6 MMcfpd",* which is close to the average daily production in Q3F24. That noted, the more important news from the release dealt with changes to the Company's sales agreement with their sole customer Bahia Gas.

In short, Alvopetro has renegotiated their sales agreement with Bahia, and the major points therein are listed in the bullet points above. In short and as we see it, Bahia is conceding to guarantee a higher level of minimum purchases, while Alvopetro is conceding to calibrate their sale price based on a new mix of commodity proxies, and they are both agreeing to abandon the minimum and maximum collar prices. In our view, this new arrangement will likely address actual market dynamics better than the old arrangement. That is, we think it will result in pricing that is more reflective of prevailing market prices, which should "smooth" the results for both parties. Recall, we have argued for some time now that we believed at least some portion of Bahia Gas' reduced demand for Alvopetro's gas likely stemmed from the higher relative pricing that the prior arrangement may have afforded Alvopetro. That is, we think Bahia *may have been* able to source gas at a lower price, so they bought less from Alvopetro. Recall, the Company's explanation from Bahia has been that they overestimated demand and therefore purchased less to balance that miss. Again, we will not argue the point, but we think the new sales arrangement speaks to our notion. Regardless, the results going forward will likely be higher consistent sales volumes for Alvopetro, and lower overall pricing depending on the trajectory of Brent Crude and Henry Hub gas prices. To be clear, our model has consistently forecast decreasing prices for Alvopetro gas, as we have generally assumed declining proxy prices around the basket of commodities used to determine the bi-annual pricing mechanism. As an aside, on a net basis the new pricing arrangement may yield slightly better longer-term pricing assumptions than *our model* had previously forecast. All things considered, we believe the new sales agreement is a positive development, which we think may smooth results and likely provide better visibility, and **we have recast our model around the changes and more specifically demand assumptions around those around levels implied by the new agreement as well as those of the Company's current capacity ("*18+ MMcfpd capacity*").**

To conclude, the production figures for November included another unforeseen item that will negatively impact our initial estimates for Q4F24. That said, the results for the month of December appear to be more in line. We have adjusted our number accordingly. More importantly, we believe the new pricing arrangement with Bahia should provide better demand visibility going forward and perhaps eliminate some of the negative surprises we have seen more recently in the numbers. That fact should allow us to turn the attention back to the more topical longer-term unknown, which is Alvopetro's ability to develop/replace reserves that will allow them to generate predictable robust gas production well into the foreseeable future. As we noted in our last update, we continue to believe that favorable results out of Murucututu, the recent favorable Caburé redetermination and likely added production from new development at Caburé speak to that end.

Lastly, as we have also addressed in prior updates, the Company's decision to adjust the dividend (lower) as a result of lower operating cash flow, has likely played an outsized role in the decline of the shares. To be clear, that decision includes objective elements, as the Company has stated on many occasions that shareholder returns in terms of dividends or share repurchases would be driven by percentages of available operating cash flow. To that end, *if our model proves reasonably accurate*, our math suggests the Company could be in a position to raise the dividend in the second half of 2025, or perhaps increase share buybacks if they deem that more opportunistic.

We reiterate our Allocation of 7 as well as our 12-24 month Price Target of $7.25. We will review each as we move forward.

Projected Operating Model

Alvopetro Energy Ltd.							
Projected Operating Model (in USD - '000s)							
By Trickle Research LLC							
	Actual	Actual	Actual	Estimate	Estimate	Estimate	Estimate
	3/31/24	**6/30/24**	**9/30/24**	**12/31/24**	**Fiscal 2024**	**Fiscal 2025**	**Fiscal 2026**
Oil & Gas Sales	$ 11,752	$ 10,672	$ 12,879	$ 10,651	$ 45,954	$ 60,665	$ 74,117
Royalties and Production Taxes	$ (312)	$ (287)	$ (367)	$ (288)	$ (1,254)	$ (1,638)	$ (2,001)
						$ -	$ -
Net Oil & Gas Revenue	$ 11,440	$ 10,385	$ 12,512	$ 10,364	$ 44,700	$ 59,027	$ 72,116
Other Income	$ 398	$ 444	$ 455	$ 400	$ 1,697	$ 1,600	$ 1,600
Total Revenue and Other Income	$ 11,838	$ 10,829	$ 12,967	$ 10,764	$ 46,397	$ 60,627	$ 73,716
						$ -	$ -
Production	$ 1,201	$ 850	$ 1,043	$ 816	$ 3,910	$ 3,734	$ 3,119
General & Administrative	$ 1,423	$ 1,570	$ 1,572	$ 1,642	$ 6,207	$ 6,592	$ 6,834
Depletion and Depreciation	$ 1,847	$ 1,701	$ 2,020	$ 1,798	$ 7,366	$ 8,542	$ 9,515
Impairment	$ 91	$ -	$ -	$ -	$ 91	$ -	$ -
Exploration and Evaluation	$ 96	$ -	$ -	$ -	$ 96	$ -	$ -
Finance Expenses and Interest	$ 383	$ 371	$ 361	$ 375	$ 1,490	$ 1,500	$ 1,500
Accretion of Decommissioning Liabilities	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Share Based Compensation	$ 287	$ 315	$ 283	$ 250	$ 1,135	$ 1,000	$ 1,000
Foreign Exchange Loss	$ 1,170	$ 3,204	$ (616)	$ -	$ 3,758	$ -	$ -
Loss on Disposition of Assets	$ -	$ -	$ (50)	$ -	$ (50)	$ -	$ -
Risk Management Expenses	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total Operating Expenses	$ 6,498	$ 8,011	$ 4,613	$ 4,881	$ 24,002	$ 21,368	$ 21,968
Interest Expenses	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Other Non-Operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Total non-operating Expenses	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Gain (Loss) Before Taxes	$ 5,340	$ 2,818	$ 8,354	$ 5,883	$ 22,395	$ 39,259	$ 51,748
Income Tax Charge (Recovery)	$ 790	$ 468	$ 1,202	$ 897	$ 3,357	$ 5,987	$ 7,892
Net Income	$ 4,550	$ 2,350	$ 7,152	$ 4,986	$ 19,038	$ 33,272	$ 43,856
Exchange (loss) gain on translation of foreign operations	$ (1,462)	$ (5,175)	$ 1,124	$ -	$ (5,513)	$ -	$ -
Comprehensive (loss) gain	$ 3,088	$ (2,825)	$ 8,276	$ 4,986	$ 13,525	$ 33,272	$ 43,856
Net Gain (Loss) per share							
Basic	$ 0.12	$ 0.06	$ 0.19	$ 0.14	$ 0.52	$ 0.94	$ 1.31
Diluted	$ 0.12	$ 0.06	$ 0.19	$ 0.13	$ 0.51	$ 0.94	$ 1.31
Shares O/S - Basic	37,281,649	37,066,651	37,000,231	36,349,708	36,924,560	35,292,290	33,415,323
Shares O/S - Diluted	37,975,282	37,773,293	37,622,413	37,024,384	37,598,843	35,292,290	33,415,323

General Disclaimer:

Trickle Research LLC produces and publishes independent research, due diligence and analysis for the benefit of it investor base. Our publications are for information purposes only. Readers should review all available information on any company mentioned in our reports or updates, including, but not limited to, the company's annual report, quarterly report, press releases, as well as other regulatory filings. Trickle Research is not registered as a securities broker-dealer or an investment advisor either with the U.S. Securities and Exchange Commission or with any state securities regulatory authority. Readers should consult with their own independent tax, business and financial advisors with respect to any reported company. Trickle Research and/or its officers, investors and employees, and/or members of their families may have long/short positions in the securities mentioned in our research and analysis and may make purchases and/or sales for their own account of those securities. David Lavigne does not hold a position in Alvopetro.

Trickle Research co-sponsors two microcap conferences each year. Trickle Research encourages its coverage companies to present at those conferences and Trickle charges them a fee to do so. Companies are under no obligation to present at these conferences.

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.