



INTERIM FINANCIAL STATEMENTS SEPTEMBER 30, 2018

NOTICE TO READER

Management has compiled the unaudited interim consolidated financial information of Alvopetro Energy Ltd. consisting of the Interim Condensed Consolidated Statements of Financial Position at September 30, 2018 and December 31, 2017 and the Interim Condensed Consolidated Statements of Operations and Comprehensive Loss and the Interim Condensed Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2018 and 2017. Please note the interim financial statements have not been reviewed or audited by external auditors.

ALVOPETRO ENERGY LTD.**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

(Unaudited, thousands of United States dollars)

	Note	September 30, 2018	December 31, 2017
ASSETS			
Current			
Cash and cash equivalents		4,527	9,189
Restricted cash		131	106
Trade and other receivables		305	153
Prepaid expenditures		62	208
Assets held for sale	3	195	236
Total current assets		5,220	9,892
Exploration and evaluation assets	4	35,198	54,585
Property, plant and equipment	5	20,448	4,238
Non-current assets		55,646	58,823
Total assets		60,866	68,715
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		816	1,111
Current portion of decommissioning liabilities	6	13	19
Total current liabilities		829	1,130
Long-term liabilities	7	1,690	-
Decommissioning liabilities	6	1,182	1,445
Total liabilities		3,701	2,575
Shareholders' equity			
Share capital	8	151,937	151,937
Contributed surplus	8	1,726	1,662
Deficit		(70,402)	(67,507)
Accumulated other comprehensive loss		(26,096)	(19,952)
Total shareholders' equity		57,165	66,140
Total liabilities and shareholders' equity		60,866	68,715

Commitments and contingencies (Note 14)

See accompanying notes to these interim condensed consolidated financial statements.

ALVOPETRO ENERGY LTD.**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

(Unaudited, thousands of United States dollars, except per share amounts)

		Three months ended September 30,		Nine months ended September 30,	
	Note	2018	2017	2018	2017
Revenue and Other Income					
Oil sales	12	125	120	457	377
Royalties and production taxes		(13)	(12)	(45)	(41)
Oil revenue		112	108	412	336
Other income		29	13	95	113
		141	121	507	449
Expenses					
Production	13	187	186	602	651
Transportation		3	6	12	19
General and administrative	13	625	669	2,097	1,971
Depletion and depreciation	5	33	70	120	183
Impairment	4	-	2,384	196	2,384
Exploration and evaluation expenses		78	120	231	177
Accretion of decommissioning liabilities	6	11	10	31	28
Share-based compensation	8	27	20	54	66
Loss (gain) on disposition of assets		55	(2)	55	16
Foreign exchange (gain) loss		-	(11)	4	(8)
		1,019	3,452	3,402	5,487
Loss before taxes		(878)	(3,331)	(2,895)	(5,038)
Income tax expense		-	-	-	-
Net loss		(878)	(3,331)	(2,895)	(5,038)
Exchange (loss) gain on translation of foreign operations		(1,133)	1,525	(6,144)	903
Comprehensive loss		(2,011)	(1,806)	(9,039)	(4,135)
Net loss per share					
	8				
Basic		(0.01)	(0.04)	(0.03)	(0.06)
Diluted		(0.01)	(0.04)	(0.03)	(0.06)

See accompanying notes to these interim condensed consolidated financial statements.

ALVOPETRO ENERGY LTD.**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

(Unaudited, thousands of United States dollars)

		Nine Months Ended September 30,	
	Note	2018	2017
Common Shares			
Balance, beginning of period		151,937	151,937
Net change		-	-
Balance, end of period		151,937	151,937
Contributed surplus			
Balance, beginning of period		1,662	1,558
Share-based compensation expense	8	54	66
Share-based compensation capitalized		10	16
Balance, end of period		1,726	1,640
Deficit			
Balance, beginning of period		(67,507)	(60,390)
Net loss		(2,895)	(5,038)
Balance, end of period		(70,402)	(65,428)
Accumulated Other Comprehensive Loss			
Balance, beginning of period		(19,952)	(19,330)
Other comprehensive loss		(6,144)	903
Balance, end of period		(26,096)	(18,427)

See accompanying notes to these interim condensed consolidated financial statements.

ALVOPETRO ENERGY LTD.**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited, thousands of United States dollars)

		Three months ended September 30,		Nine months ended September 30,	
	Note	2018	2017	2018	2017
Operating Activities					
Net loss		(878)	(3,331)	(2,895)	(5,038)
Adjustments for non-cash items:					
Depletion and depreciation	5	33	70	120	183
Impairment	4	-	2,384	196	2,384
Accretion of decommissioning liabilities	6	11	10	31	28
Share-based compensation	8	27	20	54	66
Loss on disposition of assets	5	55	(2)	55	16
Unrealized foreign exchange		(3)	3	(1)	21
Settlement of decommissioning liabilities	6	(4)	(113)	(5)	(139)
Funds flow from operations		(759)	(959)	(2,445)	(2,479)
Changes in non-cash working capital	11	(31)	376	(108)	(125)
		(790)	(583)	(2,553)	(2,604)
Investing Activities					
Expenditures on exploration and evaluation assets	4	(176)	(1,599)	(2,048)	(4,508)
Expenditures on property, plant and equipment	5	(1,713)	(11)	(2,047)	(41)
Proceeds on disposition of assets	4	97	78	156	160
Change in restricted cash		(44)	-	(44)	-
Long-term liabilities	7	1,510	-	2,118	-
Changes in non-cash working capital	11	(167)	920	(41)	389
		(493)	(612)	(1,906)	(4,000)
Change in cash and cash equivalents		(1,283)	(1,195)	(4,459)	(6,604)
Effect of foreign exchange on cash balances		(29)	1	(203)	201
Cash and cash equivalents, beginning of period		5,839	12,579	9,189	17,788
Cash and cash equivalents, end of period		4,527	11,385	4,527	11,385
Cash and cash equivalents consist of:					
Cash		1,204	2,693	1,204	2,693
Cash equivalents		3,323	8,692	3,323	8,692
Supplemental information:					
Cash income taxes paid		-	-	-	-
Cash interest income received		25	21	83	112

See accompanying notes to these interim condensed consolidated financial statements.

ALVOPETRO ENERGY LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As at and for the three and nine months ended September 30, 2018

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

NOTE 1 – CORPORATE INFORMATION AND BASIS OF PRESENTATION

Alvopetro Energy Ltd. (“Alvopetro” or “the Company”) is engaged in the exploration, development and production of hydrocarbons in Brazil. Alvopetro is a publicly traded company listed on the TSX Venture Exchange (TSX: ALV.V), was incorporated under the Business Corporations Act (Alberta) on September 25, 2013 as 1774501 Alberta Ltd., and subsequently changed its name to Alvopetro Energy Ltd. on November 19, 2013.

The Company’s head office and records are located at 1700, 525 8th Avenue S.W., Calgary, Alberta, Canada, T2P 1G1.

The interim condensed consolidated financial statements as at September 30, 2018 and December 31, 2017 and for the three and nine months ended September 30, 2018 and September 30, 2017 have been prepared in accordance with International Financial Reporting Standards (“IFRS”) applicable to the presentation of interim financial statements, including International Accounting Standard (“IAS”) 34 *Interim Financial Reporting*. These interim condensed consolidated financial statements are prepared using the same accounting policies and methods of computation as disclosed in the audited consolidated financial statements as at and for the year ended December 31, 2017, except as discussed in Note 2 below with respect to the adoption of revised accounting standards and in Note 4 with respect to the Company’s determination of cash-generating units. These statements do not contain all disclosures required for full annual financial statements and should be read in conjunction with the audited consolidated financial statements as at and for the year ended December 31, 2017.

These interim condensed consolidated financial statements were authorized for issuance by the Company’s Board of Directors on November 14, 2018.

The interim condensed consolidated financial statements are presented in U.S. dollars (“USD”) which is the parent Company’s functional currency.

Segmented Operations

All oil sales revenue is derived entirely from Brazilian operations. All exploration and evaluation assets and all material property, plant and equipment are located in Brazil. The majority of the cash and cash equivalents are held in Canada and all of the restricted cash at September 30, 2018 and December 31, 2017 is in Brazil. The Company does not have any significant income in Canada other than interest earned on cash balances.

NOTE 2 – CHANGES IN ACCOUNTING STANDARDS

New and Revised Accounting Standards

On January 1, 2018, the Company adopted IFRS 15 *Revenue from Contracts with Customers*. This standard requires an entity to recognize revenue reflective of the transfer of goods and services for the amount it expects to receive upon transfer of control to the purchaser. Oil sales revenue, derived from crude oil production in Brazil, is recognized when the performance obligations are satisfied and revenue can be reliably measured. The application of IFRS 15 did not have an impact on the Company’s consolidated financial position, results of operations or cash flows but does require enhanced disclosures about the Company’s revenue transactions (Note 12).

On January 1, 2018, the Company adopted amendments to IFRS 9 *Financial Instruments*. These amendments introduced new models for classification and measurement of financial instruments, hedge accounting and impairment of financial assets. The adoption of these amendments did not have an impact on the Company’s financial statements.

Standards issued but not yet effective

The International Accounting Standards Board issued IFRS 16 *Leases* in January 2016 which is effective for fiscal years beginning on or after January 1, 2019. IFRS 16 replaces the current guidance (IAS 17 *Leases* and IFRIC 4 *Determining Whether an Arrangement Contains a Lease*) with a single lessee accounting model. Under the current guidance lessees classify leases as finance, which are recognized on the statement of financial position, or operating, which are recognized in the statement of operations when the

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expense is incurred. Under IFRS 16 substantially all lease contracts, with the exception of those that qualify for certain exemptions as provided by the guidance, require recognition of a lease liability and a corresponding right-of-use asset. This revised standard results in an increase in assets, liabilities, depletion, depreciation and amortization and finance expenses and a decrease in production and/or transportation costs. The Company is currently implementing this standard and will adopt using a modified retrospective approach.

NOTE 3 – ASSETS HELD FOR SALE

	As at	
	September 30, 2018	December 31, 2017
Balance, beginning of period	236	410
Transferred from E&E (Note 4)	-	322
Disposal – cash proceeds	-	(105)
Disposal – in exchange for drilling services	-	(396)
Foreign currency translation	(41)	5
Balance, end of period	195	236

The balance at December 31, 2017 and September 30, 2018 consists of land owned by the Company in Brazil which management intends to sell within one year.

NOTE 4 – EXPLORATION AND EVALUATION (“E&E”) ASSETS

	As at	
	September 30, 2018	December 31, 2017
Balance, beginning of period	54,585	53,259
Capital expenditures	2,048	5,355
Capitalized share-based compensation	3	18
Change in decommissioning liabilities	170	189
Transfer to PP&E (Note 5)	(15,527)	-
Transfer to assets held for sale (Note 3)	-	(322)
Other transfers	(2)	10
Asset dispositions	(426)	(122)
Impairment	(196)	(3,189)
Foreign currency translation	(5,457)	(613)
Balance, end of period	35,198	54,585

During the three months ended June 30, 2018, the Company finalized the terms of the unitization agreement (“UOA”) with the adjacent resource owner. An independent reserves evaluation, with an effective date of May 31, 2018, assigned proved plus probable reserves to the Company’s Caburé natural gas field, part of a shared gas field which extends across Alvopetro’s Blocks 197 and 198 and two other blocks held by our partner, and the Gomo gas discovered from our 183(1) and 197(1) wells on Blocks 183 and 197 respectively. In the three months ended June 30, 2018, the Company realigned its cash-generating units to combine Blocks 183, 197 and 198 to comprise a single cash-generating unit (“CGU”) based on geographical proximity, shared infrastructure, a common gas sales agreement and management’s intentions with respect to development of this area.

Pursuant to the Company’s E&E accounting policy, E&E assets are transferred to PP&E when the assets are considered technically feasible and commercially viable, which is generally when proved and/or probable reserves have been assigned. Accordingly, the \$15.2 million carrying value of the Caburé natural gas field was transferred to PP&E as at May 31, 2018, as management determined that the technical feasibility and commercial viability criteria had been met. At the time of the transfer to PP&E, the Company tested the asset for impairment and, as the estimated recoverable amount exceeded the carrying value, no impairment was recorded. During the three months ended September 30, 2018 the Company recognized a \$0.7 million transfer of equipment

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classified as E&E assets to the jointly-owned Caburé natural gas facility. Of the total amount, \$0.3 million represented the Company's share and is included in the \$15.5 million transfer to PP&E. Alvopetro's operating partner's share of the equipment transferred (\$0.4 million) was recorded as a disposition. The value assigned to this equipment pursuant to the UOA was equivalent to Alvopetro's net book value of the equipment and no gain or loss was recorded on the transfer.

The reserves assigned to our Gomo gas discovery from our 183(1) and 197(1) wells in the May 31, 2018 independent reserves evaluation were limited to the drainage area around the two existing wells and do not reflect any further potential of the asset beyond this area. The Company continues to evaluate the commercial viability and technical feasibility of this asset and plans to perform a stimulation and long-term testing of the 183(1) well. The carrying value of this portion of the CGU remains in E&E as at September 30, 2018, to be re-evaluated with additional information obtained from the stimulation and production testing results. Given the positive results to date, the Gomo gas discovery from our 183(1) and 197(1) wells and the Company's future plans for this project, there is no indication of impairment of this E&E asset as at September 30, 2018.

During the nine months ended September 30, 2018 the Company disposed of equipment inventory classified as E&E assets in several separate transactions, all to third parties of Alvopetro. Total proceeds were \$0.1 million and there were no gains or losses on the transactions.

The Company relinquished Block 106 in July 2018. As such, an impairment loss of \$0.2 million was recorded during the three months ended June 30, 2018 to reduce the carrying value of this block to \$nil at the end of the reporting period. The Company also recognized E&E expense of \$0.2 million in the three months ended June 30, 2018 with respect to the remaining work commitment fine paid on block relinquishment.

General and administrative costs totaling \$0.6 million (December 31, 2017 - \$1.1 million) that were directly related to exploration and evaluation activities have been capitalized as exploration and evaluation assets.

NOTE 5 – PROPERTY, PLANT AND EQUIPMENT (“PP&E”)

	As at	
	September 30, 2018	December 31, 2017
Cost, beginning of period	9,514	9,599
Capital expenditures	2,047	77
Capitalized share-based compensation	7	1
Transferred from E&E assets (Note 4)	15,527	-
Asset dispositions	(813)	-
Foreign currency translation	(2,501)	(163)
Cost, end of period	23,781	9,514
Accumulated depletion and depreciation and impairment, beginning of period	(5,276)	(4,739)
Depletion and depreciation for the period	(120)	(205)
Asset dispositions	441	-
Impairment	-	(472)
Foreign currency translation	1,622	140
Accumulated depletion and depreciation and impairment, end of period	(3,333)	(5,276)
Net book value, end of period	20,448	4,238

Costs of \$15.2 million transferred from E&E in the three months ended June 30, 2018 represents the May 31, 2018 carrying value of the Caburé natural gas field in which the Company has a 49.1% working interest. Pursuant to the UOA, substantially all the 2018 and 2019 field development will initially be funded by the Company's partner, with Alvopetro's share due upon commencement

ALVOPETRO ENERGY LTD.**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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of production allocations, or March 2020, whichever occurs first. Alvo Petro's share of equipment inventory transferred from E&E assets represents the remaining \$0.3 million transferred during the period.

During the three months ended September 30, 2018 the Company executed an agreement to sell 100% of its Jiribatuba property for gross proceeds of \$0.1 million and a release of all future liabilities associated with the field, including the future abandonment and reclamation obligations, subject to customary approval by the ANP. The property had a net book value of \$0.3 million and associated decommissioning obligations of \$0.2 million resulting in a loss on disposition of \$0.1 million recognized in the period. Dispositions for the period also include \$0.05 million for Alvo Petro's operating partner's share of equipment held in PP&E transferred to the jointly-owned Caburé natural gas facility. As the value assigned to this equipment pursuant to the UOA was equivalent to Alvo Petro's net book value of the equipment there was no resultant gain or loss on the transfer.

General and administrative costs totaling \$0.2 million (December 31, 2017 - \$0.03 million) that were directly related to property, plant, and equipment activities have been capitalized.

NOTE 6 – DECOMMISSIONING LIABILITIES

The decommissioning liabilities were estimated based on the net ownership interest in wells and facilities, management's estimates of costs to abandon and reclaim those wells and facilities, and the potential future timing of the costs to be incurred.

	As at	
	September 30, 2018	December 31, 2017
Balance, beginning of period	1,464	1,399
Liabilities incurred	209	189
Revisions to obligations	(39)	-
Obligations settled	(5)	(139)
Disposition of obligations	(184)	-
Accretion	31	37
Foreign currency translation	(281)	(22)
Balance, end of period	1,195	1,464

Total undiscounted cash flows, escalated at a weighted average rate of 6.0% (December 31, 2017 - 6.5%) for inflation, required to settle the Company's decommissioning liabilities are estimated to be \$1.8 million (December 31, 2017 - \$2.3 million) and have been discounted using an average risk-free rate of 3.1% (December 31, 2017 - 2.5%), which represents an estimated U.S. Treasury bill rate for a period of 15 years, the approximate weighted average remaining years to abandonment.

The Company expects to incur \$0.01 million (December 31, 2017 - \$0.02 million) of decommissioning costs within one year from September 30, 2018 and accordingly this amount is classified as current on the consolidated statements of financial position.

During the three months ended June 30, 2018, the Company recorded a revision to decommissioning liabilities associated with the Caburé and Gomo natural gas assets as the timing of abandonment and reclamation was adjusted to coincide with the independent reserve report.

The disposition of \$0.2 million in the three months ended September 30, 2018 represents the estimated decommission liabilities associated with the Company's Jiribatuba field.

NOTE 7 – LONG-TERM LIABILITIES

The Company's long-term liabilities at September 30, 2018 represent the accrued payable related to Alvo Petro's share of the costs incurred to date with respect to joint development of the Caburé natural gas field (Note 5). Under the terms of the UOA, Alvo Petro will reimburse the operating partner for its share of the development costs on the earlier of March 2020 or commencement of production allocations to Alvo Petro, which is anticipated to be January 1, 2020.

ALVOPETRO ENERGY LTD.**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

As at and for the three and nine months ended September 30, 2018

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

	As at	
	September 30, 2018	December 31, 2017
Balance, beginning of period	-	-
Alvopetro's share of expenditures incurred	2,118	-
Partner share of equipment contributed by Alvopetro	(405)	-
Foreign currency translation	(23)	-
Balance, end of period	1,690	-

NOTE 8 – SHARE CAPITAL**a) Authorized**

Alvopetro has an unlimited number of common shares authorized for issuance. The Company is also authorized to issue preferred shares in one or more series.

b) Issued and Outstanding Common Shares

	Number of Shares	Amount (\$000s)
Balance as at September 30, 2018 and December 31, 2017	85,166,871	\$ 151,937

Subsequent to September 30, 2018, the Company completed a private placement, issuing 11,504,000 common shares at \$0.35 per common share (CAD\$0.45) for total gross proceeds of \$4.0 million (CAD \$5.2 million). In conjunction with the placement 3,676,000 warrants were issued with an exercise price of \$0.50 (CAD\$0.64) for one common share. Of these warrants, 2,876,000 have an expiry date of December 15, 2019 and 800,000 have an expiry date of October 16, 2020. Of the total common shares issued under the private placement, 860,000 common shares were subscribed for by three insiders of Alvopetro for total proceeds of CAD\$387,000. Of the total 3,676,000 warrants issued, 215,000 were issued to these insiders with an expiry date of December 15, 2019 and an exercise price of CAD\$0.64.

c) Options to Purchase Common Shares

The options outstanding at September 30, 2018 are as follows:

	Number of Options	Weighted Average Exercise Price (CAD\$)
Balance as at December 31, 2016	6,874,102	0.53
Granted	64,000	0.19
Expired	(352,166)	0.65
Forfeited	(47,000)	0.28
Balance as at December 31, 2017	6,538,936	0.52
Granted	1,302,250	0.33
Balance as at September 30, 2018	7,841,186	0.49

ALVOPETRO ENERGY LTD.**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

As at and for the three and nine months ended September 30, 2018

All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted

Options Outstanding at September 30, 2018				Options Exercisable at September 30, 2018		
Exercise Price	Number of Options	Weighted Average Exercise Price (CAD\$)	Weighted Average Remaining Contractual Life (years)	Number of Options	Weighted Average Exercise Price (CAD\$)	Weighted Average Remaining Contractual Life (years)
CAD\$0.18 - \$0.39	4,328,750	0.27	3.30	2,000,503	0.25	2.67
CAD\$0.40 - \$0.75	1,540,000	0.42	1.43	1,480,000	0.42	1.29
CAD\$1.01 - \$1.10	1,972,436	1.02	0.23	1,972,436	1.02	0.23
CAD\$0.18 - \$1.10	7,841,186	0.49	2.16	5,452,939	0.58	1.41

Share-Based Compensation

The fair value of the stock options granted under the Alvopetro stock option plan for the three and nine months ended September 30, 2018 and 2017 has been estimated on the grant date using the Black-Scholes option pricing model. Weighted average assumptions and resultant fair values for stock options granted are as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Risk free interest rate (%)	-	-	2.1	0.87
Expected term (years)	-	-	4.0	4.0
Expected volatility (%)	-	-	45.0	45.0
Dividend per share (%)	-	-	-	-
Forfeiture rate (%)	-	-	5.0	5.0
Weighted average fair value (CAD\$)	-	-	0.11	0.06

Total share-based compensation of \$0.06 million was computed for the nine months ended September 30, 2018 (September 30, 2017 - \$0.08 million) related to the Alvopetro stock option plan. Share-based compensation that was directly related to exploration and evaluation assets and property, plant and equipment has been capitalized with the remainder recognized as share-based compensation expense on the consolidated statements of operations and comprehensive loss.

d) Net Loss Per Share Attributable to Common Shareholders

Net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the applicable period. The following table provides the number of shares used in the basic and diluted per share computations:

	Three and nine months ended September 30,	
	2018	2017
Weighted average common shares outstanding, basic and diluted	85,166,871	85,166,871

In determination of the weighted average number of diluted common shares outstanding for the three and nine months ended September 30, 2018 and 2017, all stock options were excluded because the effect would be anti-dilutive.

ALVOPETRO ENERGY LTD.**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

As at and for the three and nine months ended September 30, 2018

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 9 – CAPITAL MANAGEMENT**

The Company's capital consists of the following:

	As at	
	September 30, 2018	December 31, 2017
Working capital	4,391	8,762
Shareholders' equity	57,165	66,140

Alvopetro manages its capital to support the Company's strategic growth objectives and maintain financial capacity and flexibility for the purpose of funding the Company's exploration and development activities.

The Company considers its capital structure to include working capital (including current restricted cash and assets held for sale) and shareholders' equity. At September 30, 2018, the Company's net working capital surplus of \$4.4 million (December 31, 2017 - \$8.8 million) included \$4.5 million (December 31, 2017 - \$9.2 million) of cash, \$0.1 million (December 31, 2017 - \$0.1 million) of current restricted cash, \$0.2 million (December 31, 2017 - \$0.2 million) of assets held for sale, net of a working capital deficit of \$0.4 million (December 31, 2017 - \$0.8 million).

Alvopetro has the ability to adjust its capital structure by issuing new equity or debt and making adjustments to its capital expenditure program, other than with respect to work commitments. The Company considers its capital structure at this time to include shareholders' equity of \$57.2 million (December 31, 2017 - \$66.1 million). In October 2018 Alvopetro completed a private placement for total gross proceeds of \$4.0 million, these funds intended for development of the Caburé natural gas project as well as for ongoing general corporate purposes.

During the three months ended June 30, 2018 Alvopetro concluded the unitization process and entered into a long-term natural gas sales agreement ("GSA") with respect to our share of gas to be produced from the Caburé and Gomo natural gas assets. Key development required for the execution of the Caburé and Gomo natural gas project includes joint upstream development (Alvopetro 49.1%) and wholly-owned midstream infrastructure, including an 11-kilometre transfer pipeline and a natural gas processing facility. During the three months ended September 30, 2018 Alvopetro entered into a 10-year contract (the "Gas Treatment Agreement") with Enerflex Ltd. ("Enerflex") to build, own, operate and maintain a natural gas treatment facility (the "Facility"). Under the terms of the Gas Treatment Agreement, Enerflex will construct and own the Facility, provide ongoing operations and maintenance, and warranty the delivery schedule and on-stream availability. The Facility is scheduled to begin commissioning in November 2019 and be operational by January 1, 2020. Alvopetro does not have any cash outlays under this Gas Treatment Agreement until January 2020, at which time the integrated service fee is \$2.9 million per year, paid monthly.

Alvopetro will require financing to fund its share of the remaining future development costs associated with these assets, including our share of unit development costs, 100% owned pipeline construction costs and Gomo development costs. The Company's work commitments or other projects on its exploration blocks as well as development prospects on our mature fields may also require funding. Financing alternatives include project financing, vendor financing, capital leases for facilities, strategic partnerships, other debt issuances or additional equity issuances. The Company may also explore asset sales or farmouts to assist with funding. Pursuant to the terms of Alvopetro's UOA with respect to the Caburé field, substantially all shared unit development costs are carried by the operating partner with payment by Alvopetro anticipated to occur on or after January 1, 2020, allowing Alvopetro to defer these cash outlays for over one year. The amount owed at September 30, 2018 pursuant to the arrangement was \$1.7 million (December 31, 2017 \$nil) and is recorded as a long-term liability on the consolidated statement of financial position.

The Company has a credit support facility with a Canadian bank which allows for the issuance of letters of credit ("LCs") and letters of guarantee in support of financial guarantees required by the National Agency of Petroleum, Natural Gas and Biofuels (the "ANP") for Alvopetro's work commitments under the terms of its concession contracts as discussed further in Note 14. LCs and letters of guarantee issued must be supported by either cash collateral posted by Alvopetro or through an Account Performance Security Guarantee from Export Development Canada ("EDC"). As at September 30, 2018, the total amount of LCs issued was \$6.1 million (December 31, 2017 - \$12.1 million), the full balance of which was supported by EDC on behalf of Alvopetro. LCs

ALVOPETRO ENERGY LTD.**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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outstanding at September 30, 2018 include \$0.5 million with respect to Block 106, the work commitment for which was been approved by the ANP but the LC not yet released.

The current restricted cash of \$0.1 million (December 31, 2017 - \$0.1 million) relates to cash posted in Brazil in support of abandonment guarantees on the Bom Lugar and Jiribatuba fields. The Company does not have any other restricted cash balances as at September 30, 2018 or December 31, 2017.

The Company has not paid or declared any dividends since the date of incorporation.

NOTE 10 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

The Company's financial instruments consist of cash and cash equivalents, restricted cash, trade and other receivables, accounts payable and accrued liabilities and long-term liabilities. The nature of Alvopetro's operations exposes the Company to credit risk, liquidity risk, and market risk. The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and to monitor market conditions and the Company's activities. The Board of Directors has overall responsibility for establishment and oversight of the Company's risk management.

Fair Value of Financial Instruments

The Company classifies the fair value of financial instruments according to the following hierarchy based on the amount of observable inputs used to value the instrument:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace.

Level 3 – Valuations in this level are those with inputs for the asset or liability that are not based on observable market data.

Assessment of the significance of a particular input to the fair value measurement requires judgment that may affect the placement within the fair value hierarchy level. Due to the short-term nature of accounts receivable and accounts payable and accrued liabilities, their carrying value approximates their fair value. The fair value of the long-term liabilities considers the contractual requirement to adjust the amount owing for inflation, as well as the time value of money. The carrying values and respective fair values of Alvopetro's financial instruments at September 30, 2018 and December 31, 2017 are set forth in the table below. The Company does not currently have any financial instruments classified as Level 2 or Level 3.

	September 30, 2018		December 31, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Carried at fair value through profit or loss				
Cash and cash equivalents ⁽¹⁾	4,527	4,527	9,189	9,189
Restricted cash – current ⁽¹⁾⁽²⁾	131	131	106	106
	4,658	4,658	9,295	9,295
Carried at cost or amortized cost				
Trade and other receivables	305	305	153	153
Accounts payable and accrued liabilities	(816)	(816)	(1,111)	(1,111)
Long-term liabilities	(1,690)	(1,700)	-	-
	(2,201)	(2,211)	(958)	(958)

(1) Level 1

(2) Restricted cash balances include amounts pledged as collateral for abandonment guarantees.

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*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted**Risks Associated with Financial Assets and Liabilities*

A description of the nature and extent of risks arising from the Company's financial instruments can be found in the notes to the audited consolidated financial statements for the year ended December 31, 2017 and there has been no significant change to the Company's exposure to these risks. The following financial instruments were denominated in currencies other than U.S. dollars as at September 30, 2018:

	As at			
	September 30, 2018		December 31, 2017	
	CAD (000's)	BRL (000's)	CAD (000's)	BRL (000's)
Cash and cash equivalents	69	778	128	635
Restricted cash – current	-	525	-	350
Trade and other receivables	23	790	36	407
Accounts payable and accrued liabilities	(258)	(2,383)	(186)	(2,636)
Long term liabilities	-	(6,768)	-	-
Net exposure in foreign currency	(166)	(7,058)	(22)	(1,244)
Net exposure in USD (\$000s)	(128)	(1,762)	(18)	(376)

The Company had no forward exchange rate contracts in place as at or during the periods ended September 30, 2018 or December 31, 2017.

NOTE 11 – CHANGES IN NON-CASH WORKING CAPITAL

Change in:	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Trade and other receivables	(100)	143	(185)	181
Prepaid expenditures	36	94	104	64
Accounts payable and accrued liabilities	(134)	1,059	(68)	19
	(198)	1,296	(149)	264
Changes relating to:				
Operating activities	(31)	376	(108)	(125)
Investing activities	(167)	920	(41)	389
	(198)	1,296	(149)	264

NOTE 12 – REVENUE

The Company's oil sales revenues are derived from two customers, under contracts based on floating prices, specifically the Brent benchmark adjusted for contracted discounts based on both a fixed cost per barrel and a fixed percentage of Brent. In the nine months ended September 30, 2018, discounts averaged 6% of the Brent price (nine months ended September 30, 2017 - 10%).

As at September 30, 2018, accounts receivable included \$0.02 million of accrued sales revenue which related to September 2018 production. There were no collection issues requiring adjustment to revenue recorded in 2017 or in the nine months ended September 30, 2018.

Revenue is measured at the consideration specified in the contracts and represents amounts receivable net of discounts. Performance obligations associated with the sale of crude oil are satisfied when control of the product is transferred to the customer. This occurs when the oil is physically transferred to the delivery point agreed with the customer and the customer obtains legal title. Payment terms are on or before the 25th day of the month following satisfaction of the performance obligation.

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*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 13 – NATURE OF EXPENSES**

Production expenses by nature were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Production expenses:				
Personnel	79	88	241	274
Other fixed	74	58	192	178
Variable	34	40	106	91
Workover	-	-	63	108
Total production expenses	187	186	602	651

General and administrative expenses ("G&A") by nature were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
G&A expenses:				
Personnel	580	670	1,831	1,959
Travel	14	33	64	88
Office and IT	76	96	247	279
Professional fees	85	132	516	397
General corporate	83	66	232	135
Gross G&A expenses	838	997	2,890	2,858
Capitalized to E&E and PP&E	(213)	(328)	(793)	(887)
Net G&A expenses	625	669	2,097	1,971

The majority of the Company's G&A relates to personnel costs. Professional fees for the nine months ended September 30, 2018 included costs related to the independent reserve report completed in the period for the Caburé and Gomo natural gas assets and legal fees associated with the unitization and gas sales agreement. General corporate expenses include public company costs, corporate insurance, directors' fees and other miscellaneous expenses. G&A expenses directly attributable to exploration and development projects, primarily being personnel costs, are capitalized.

NOTE 14 – COMMITMENTS AND CONTINGENCIES

The following is a summary of contractual commitments as at September 30, 2018:

Commitments	< 1 Year	1-3 Years	Thereafter	Total
Minimum work commitments ⁽¹⁾				
<i>Minimum work commitments to be completed</i>				
Block 183 ⁽²⁾	-	833	-	833
Block 169 ⁽³⁾	949	-	-	949
Block 255 ⁽³⁾	1,136	-	-	1,136
Block 57	37	-	-	37
Block 62	37	-	-	37
Block 71	31	-	-	31
Block 145	37	-	-	37
Bom Lugar	-	-	87	87
Total minimum work commitments	2,227	833	87	3,147
Gas Treatment Agreement ⁽⁴⁾	-	5,017	23,652	28,669
Office leases ⁽⁵⁾	109	-	-	109
Total commitments	2,336	5,850	23,739	31,925

ALVOPETRO ENERGY LTD.

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Notes:

- (1) Under the terms of the ANP concession contracts for each of our exploration blocks, the Company has commitments which must be completed prior to the applicable phase expiry date. The Company is required to post a performance guarantee with the ANP for all commitments in the table above.
- (2) The ANP approved a suspension to the portion of Block 183 currently in the second exploration phase to which the above commitment is applicable. The Company will have 517 days from receipt of the environmental permit for the well to be drilled to meet the required work commitment.
- (3) Due to an ongoing injunction against unconventional activities on all 12th Brazil Bid Round Blocks, in December 2017 the Company filed a request with the ANP to cancel the Block 169 and 255 concession contracts, including the commitment noted in the table above, and return the bid round bonuses paid.
- (4) Under the Gas Treatment Agreement the Company has monthly integrated service fees of approximately \$2.9 million per year for a ten year period, anticipated to commence in January 2020. A portion of the payments are in BRL and therefore exposed to foreign exchange fluctuations. Management has assessed that this agreement contains a lease component under IFRS 16 which will affect the presentation of these fees in future consolidated financial statements of the Company.
- (5) The Company is committed to future minimum payments for office space in Canada and Brazil.

During the three months ended June 30, 2018 Alvopetro entered into a long-term GSA with commitments for firm deliveries set to commence on January 1, 2020 (the "Firm Start Date"). The GSA initially provides for the sale of 5.3 million cubic feet per day (150,000 cubic metres per day) on a firm basis and 12.4 million cubic feet per day (350,000 cubic metres per day) on an interruptible basis and provides standard penalties for supply failure in respect of the firm volumes. Supply failure penalties are a function of the shortfall of firm volumes and the prevailing natural gas price under the GSA at the time, which is determined based on a trailing weighted average basket of benchmark reference prices including Henry Hub and National Balancing Point natural gas prices and Brent crude oil prices. Under the terms of the GSA, the Firm Start Date is automatically extended if either Bahiagás or Alvopetro has not received regulatory permits by December 1, 2018. The extension to the Firm Start Date will be for an equivalent number of days from December 1, 2018 to the date both parties are in receipt of the required permits.

In September 2018, Alvopetro entered into a 10-year Gas Treatment Agreement with Enerflex. Under the terms of the Gas Treatment Agreement, Alvopetro is committed to integrated service fees totaling approximately \$2.9 million per year once the Facility is operational. Alvopetro anticipates that the Facility will be operational by January 1, 2020 and has reflected the associated commitment in the table above based on this start date. The Gas Treatment Agreement includes customary penalties and standby charges to the extent Alvopetro is unable to receive the services on the start date. In addition, the Gas Treatment Agreement includes early termination penalty provisions which vary depending on timing of the termination.

As is customary in the oil and gas industry, we may at times have work plans in place to reserve or earn certain acreage positions or wells. If we do not complete such work plans in a timely manner, the acreage positions or wells may be lost, or penalties may be applied.

The Company currently has no contingent liabilities recorded; however, in the normal course of operations, we may have disputes with industry participants for which we currently cannot determine the ultimate results. The Company has a policy to record contingent liabilities as they become determinable and the probability of loss is more likely than not.

Alvopetro's activities in Brazil are subject to minimum local content requirements with respect to materials and supplies utilized. The specific local content requirements for the exploration phase were determined during the bidding process for each particular block and are assessed at the phase expiry date. Management undertakes considerable effort to adhere to these requirements; however, there may be circumstances when it is not advantageous, cost-effective or reasonably practical for the Company to do so. If the Company does not meet the local content requirements for a particular phase, as specified according to the respective concession contract, a penalty, which varies by concession depending on exploration phase and type of cost, will be incurred. In 2018, the ANP introduced revised local content regulations which reduced the local content requirements and, as a result, the Company's estimated local content penalties decreased from \$0.3 million at December 31, 2017 to \$0.1 million at September 30, 2018, the full balance of which is included in accounts payable and accrued liabilities.