

MANAGEMENT'S REPORT

Management is responsible for the integrity and objectivity of the information contained in this report and for the consistency between the consolidated financial statements and other financial and operating data contained elsewhere in this report. The accompanying consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards using estimates and careful judgment, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying consolidated financial statements have been prepared using policies and procedures established by management and fairly reflect the Company's financial position, financial performance and cash flows, in accordance with International Financial Reporting Standards. Management has established and maintains a system of internal controls that is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and the financial information is reliable and accurate.

The Company's external auditors, Deloitte LLP, have audited the consolidated financial statements. Their audit provides an independent view as to the fairness of reported financial results and the financial performance of the Company.

The Audit Committee of the Board of Directors has reviewed in detail the consolidated financial statements with management and the external auditors. The Audit Committee has reported its findings to the Board of Directors who have approved the consolidated financial statements.



Corey C. Ruttan

President & Chief Executive Officer & Director

Calgary, Canada
March 20, 2018



Alison Howard

Chief Financial Officer



Independent auditor's report

To the Shareholders of Alvopetro Energy Ltd.

We have audited the accompanying consolidated financial statements of Alvopetro Energy Ltd., which comprise the consolidated statements of financial position as at December 31, 2017 and 2016, and the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Alvopetro Energy Ltd. as at December 31, 2017 and 2016, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

A handwritten signature in cursive script that reads "Deloitte LLP".

Chartered Professional Accountants
March 20, 2018
Calgary, Alberta

ALVOPETRO ENERGY LTD.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Thousands of United States dollars)

	Note	December 31, 2017	December 31, 2016
ASSETS			
Current			
Cash and cash equivalents		9,189	17,788
Restricted cash		106	108
Trade and other receivables		153	431
Prepaid expenditures		208	196
Assets held for sale	5	236	410
Total current assets		9,892	18,933
Exploration and evaluation assets	6	54,585	53,259
Property, plant and equipment	7	4,238	4,860
Non-current assets		58,823	58,119
Total assets		68,715	77,052
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		1,111	1,878
Current portion of decommissioning liabilities	8	19	78
Total current liabilities		1,130	1,956
Deferred tax liability	10	-	-
Decommissioning liabilities	8	1,445	1,321
Total liabilities		2,575	3,277
Shareholders' equity			
Share capital	9	151,937	151,937
Contributed surplus		1,662	1,558
Deficit		(67,507)	(60,390)
Accumulated other comprehensive loss		(19,952)	(19,330)
Total shareholders' equity		66,140	73,775
Total liabilities and shareholders' equity		68,715	77,052

Commitments and contingencies (Note 16)

The accompanying notes are an integral part of these consolidated financial statements.

Approved by:



John D. Wright
Chairman of the Board of Directors



Firoz Talakshi
Chairman of the Audit Committee

ALVOPETRO ENERGY LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Thousands of United States dollars, except per share amounts)

	Note	Year ended December 31,	
		2017	2016
Revenue			
Oil sales		462	561
Royalties and production taxes		(51)	(59)
Oil revenue		411	502
Other income		144	109
Total revenue and other income		555	611
Expenses			
Production	14	824	1,153
Transportation		23	33
General and administrative	14	2,607	3,523
Depletion and depreciation	7	205	416
Impairment	6,7	3,661	7,823
Accretion of decommissioning liabilities	8	37	28
Exploration and evaluation expense		212	434
Share-based compensation	9	85	80
Foreign exchange		2	(12)
Loss on disposition of assets	5,6,7	16	41
Total expenses		7,672	13,519
Loss before taxes		(7,117)	(12,908)
Income tax recovery	10	-	(330)
Net loss		(7,117)	(12,578)
Exchange (loss) gain on translation of foreign operations		(622)	5,507
Comprehensive loss		(7,739)	(7,071)
Net loss per share			
	9		
Basic		(0.08)	(0.15)
Diluted		(0.08)	(0.15)

The accompanying notes are an integral part of these consolidated financial statements.

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

(Thousands of United States dollars)

		Year Ended December 31,	
	Note	2017	2016
Common shares			
Balance, beginning of year		151,937	151,937
Net change		-	-
Balance, end of year	9	151,937	151,937
Contributed surplus			
Balance, beginning of year		1,558	1,444
Share-based compensation expense	9	85	80
Share-based compensation capitalized	9	19	34
Balance, end of year		1,662	1,558
Deficit			
Balance, beginning of year		(60,390)	(47,812)
Net loss		(7,117)	(12,578)
Balance, end of year		(67,507)	(60,390)
Accumulated other comprehensive loss			
Balance, beginning of year		(19,330)	(24,837)
Other comprehensive (loss) gain		(622)	5,507
Balance, end of year		(19,952)	(19,330)

The accompanying notes are an integral part of these consolidated financial statements.

ALVOPETRO ENERGY LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Thousands of United States dollars)

	Year ended December 31,	
	2017	2016
Operating Activities		
Net loss	(7,117)	(12,578)
Adjustments for non-cash items:		
Depletion and depreciation	7	205
Impairment	6,7	3,661
Accretion of decommissioning liability	8	37
Share-based compensation	9	85
Loss on disposition of assets	5,6,7	16
Deferred tax	10	-
Unrealized foreign exchange loss		8
Non-cash exploration & evaluation		(10)
Settlement of decommissioning liabilities	8	(139)
Funds flow from operations	(3,254)	(4,695)
Changes in non-cash working capital	13	(563)
	(3,817)	(5,859)
Investing Activities		
Expenditures on exploration and evaluation assets	6	(4,906)
Expenditures on property, plant and equipment	7	(77)
Proceeds on dispositions	5,6,7	162
Change in restricted cash		-
Changes in non-cash working capital	13	(71)
	(4,892)	(5,289)
Change in cash and cash equivalents	(8,709)	(11,148)
Effect of foreign exchange on cash balances	110	203
Cash and cash equivalents, beginning of year	17,788	28,733
Cash and cash equivalents, end of year	9,189	17,788
Cash and cash equivalents consist of:		
Cash	1,782	6,568
Cash equivalents	7,407	11,220
Supplemental information:		
Cash income taxes paid	-	-
Cash interest income received	143	96

The accompanying notes are an integral part of these consolidated financial statements.

ALVOPETRO ENERGY LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended December 31, 2017 and 2016

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

NOTE 1 – REPORTING ENTITY

Alvopetro Energy Ltd. (“Alvopetro” or “the Company”) is engaged in the exploration for, and the acquisition, development and production of, hydrocarbons in the Recôncavo and Camamu-Almada basins onshore Brazil. Alvopetro is incorporated under the Business Corporations Act (Alberta) and is a publicly traded company listed on the TSX Venture Exchange (TSX: ALV.V).

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

NOTE 2 – BASIS OF PRESENTATION

Basis of Measurement and Statement of Compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) and were authorized for issuance by the Company’s Board of Directors on March 20, 2018.

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

Use of Judgments, Estimates and Assumptions

The preparation of financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that impact the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, if any, as at the date of the consolidated statements of financial position as well as the reported amounts of revenue, expenses and cash flows during the periods presented. Management makes judgments regarding the application of IFRS for each accounting policy. Estimates and assumptions relate primarily to unsettled transactions and events as of the date of the consolidated financial statements and actual results could differ materially from estimated amounts. Judgments, estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and on a prospective basis. Estimates are subject to measurement uncertainty and changes in such estimates in future years could require a material change in the consolidated financial statements.

Judgments, estimates and assumptions made by management that have the most significant effect on the amounts recognized in the consolidated financial statements are discussed in further detail below.

Exploration and Evaluation (“E&E”) Assets

Costs incurred after the legal right to explore an area has been obtained and prior to establishing technical feasibility and commercial viability are capitalized as exploration and evaluation assets. Exploration and evaluation assets are transferred to property, plant and equipment upon establishment of technical feasibility and commercial viability. The determination of technical feasibility and commercial viability involves significant estimates and assumptions and management’s application of the Company’s accounting policy for exploration and evaluation assets requires judgment.

The carrying amount of exploration and evaluation assets are reviewed at the end of each reporting period to determine whether there is an indication of impairment or impairment reversal. This requires significant judgment, estimates and assumptions with respect to future prospects and drilling success, existing commitments and expiry of rights to explore, available funds, projected production rates, future market conditions and other significant changes (technological, economic, legal, regulatory) that could have an adverse effect on the Company.

Property, Plant and Equipment (“PP&E”)

Oil and natural gas assets classified as property, plant and equipment are aggregated into cash-generating units (“CGUs”). The determination of the Company’s CGUs is subject to judgment. Factors considered in the classification of CGUs include any integration between assets, shared infrastructures, sales points and sales contracts, geography, geologic structure, exposure to market risks and the manner in which management monitors operations and makes decisions regarding future development plans. Each CGU is tested for impairment based on estimates of discounted future cash flows. The estimation of future cash flows,

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including reserves, is an inherently complex process which involves professional judgment and geoscientific interpretation as well as estimates of future production rates, future commodity prices and the timing and amount of future expenditures, all of which are subject to uncertainty.

Decommissioning Liabilities

In estimating future decommissioning liabilities various assumptions are required with respect to the amount and timing of abandonment and reclamation costs, inflation factors, future interest rates and potential changes in the legal, regulatory, environmental and political environments.

Foreign Exchange

The designation of the Company's functional currencies is a judgment made by management based on the currency of the primary economic environment in which the Company operates. The functional currency of the Brazilian subsidiaries is the Brazilian Real ("BRL"). Despite the fact that the benchmark price for oil is set in USD, due to the business environment as well as policies and regulations in Brazil, management is of the opinion that the primary economic environment influencing the Company's labour, material and other costs as well as actual cash receipts from oil sales is Brazil.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES

Consolidation

These consolidated financial statements include the accounts of Alvo Petro and its controlled subsidiaries. Intercompany transactions and balances are eliminated on consolidation. As at December 31, 2017 and 2016, the Company controls 100 percent of its subsidiaries.

Joint Operations

The Company has oil and gas exploration activities that are conducted jointly with others and these consolidated financial statements reflect the Company's proportionate share of the assets, liabilities, expenses and cash flows from such activities.

A joint arrangement is either a joint operation, whereby the parties have rights to the assets and obligations for the liabilities, or a joint venture, whereby the parties have rights to the net assets. Determination of the parties' rights requires management judgment with respect to the structure of the arrangement as well as rights to the assets and obligations of the liabilities.

Cash and Cash Equivalents

Cash and cash equivalents consists of cash on hand and investments and deposits with an initial maturity of three months or less. Cash and cash equivalents are stated at cost, which approximates fair value.

Restricted Cash

Restricted cash consists of cash, cash equivalents, and short-term cash deposits (deposits with an initial maturity of one year or less) held as collateral to ensure the Company's fulfillment of work commitments and other obligations pursuant to concession contracts and credit agreements. Restricted cash is stated at cost, which approximates fair value. Restricted cash held as collateral for letters of credit expiring in less than one year is classified as current, with the remainder classified as non-current.

Assets Held for Sale

Assets are classified as held for sale if the carrying amount will be recovered principally through a highly probable sale transaction rather than through continued use. In accordance with IFRS, a sale is considered highly probable if the assets are available for immediate sale and management has stated their intention to sell the properties within one year. Assets classified as held for sale are measured at the lower of the carrying amount and the fair value less costs to sell, and are not depreciated.

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Exploration and Evaluation Assets

Pre-exploration and pre-licensing costs associated with the investigating, bidding and acquisition of petroleum properties are expensed as exploration and evaluation expense when the targeted petroleum lease or concession is not obtained. Additionally, any costs incurred in advance of obtaining the lease or concession are also expensed.

Costs incurred subsequent to obtaining the rights to explore and prior to establishing commercial viability and technical feasibility, such as land and license acquisition, technical services and studies, exploration drilling and testing, and directly attributable employee compensation are classified as E&E assets. E&E assets include equipment inventory for use on future exploration wells. E&E assets are not depleted and are classified as such until they are considered technically feasible and commercially viable.

E&E assets are considered technically feasible and commercially viable when proved and/or probable reserves have been assigned. Upon determination of reserves, the E&E assets attributable to those reserves are first tested for impairment and then reclassified from E&E assets to PP&E.

When it has been determined that the Company will not be continuing activities in an area classified as an E&E asset or that the accumulated costs are not recoverable, the unrecoverable costs are charged to the consolidated statements of operations and comprehensive loss as impairment expense. Any related costs incurred subsequent to this determination are directly expensed as exploration and evaluation expense.

Property, Plant and Equipment

PP&E consists primarily of oil and natural gas development and production assets and, to a lesser extent, operational equipment for use on future exploration and development projects and corporate assets.

Oil and natural gas assets include all costs directly associated with the development of oil and natural gas reserves. These expenditures include proved property acquisitions, geological and geophysical costs, development drilling and completions on productive and non-productive wells, infrastructure, decommissioning liabilities, directly attributable employee compensation and transfers from exploration and evaluation assets where technical feasibility and commercial viability has been established.

Oil and natural gas assets are accumulated on a CGU basis. Costs accumulated within each CGU are depleted using the unit-of-production method based on proved plus probable reserves before royalties as determined by independent petroleum reservoir engineers. Included in the depletion base are capitalized costs and estimated future costs to be incurred in developing proved and probable reserves.

Costs related to replacing parts of PP&E are capitalized only when they increase the future economic benefits to be derived from the specific asset to which they relate. All other expenditures are recognized as an expense in the consolidated statements of operations and comprehensive loss as incurred. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized as an expense in profit and loss as incurred. Corporate assets included within PP&E consist primarily of computer equipment, leasehold improvements and office furniture and equipment. Depreciation of operational equipment and corporate assets is calculated on a straight-line basis over the estimated useful life of the related assets.

Impairment

E&E assets are comprised of the accumulated expenditures for each block for which technical feasibility and commercial viability has not yet been determined. E&E assets are reviewed quarterly for indicators of impairment and at the time of transfer to PP&E. Indicators of impairment consist of facts and circumstances suggesting that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. Where the carrying amount exceeds the estimated recoverable amount, the unrecoverable costs are charged to the consolidated statements of operations and comprehensive loss.

PP&E assets are grouped for impairment purposes by CGU and reviewed quarterly for indicators of impairment. An impairment test is performed whenever events or changes in circumstances indicate that the carrying value of the asset or CGU may not be

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recoverable. The CGUs recoverable amount is the greater of its fair value less costs of disposal and its value-in-use. Fair value less costs of disposal is determined using discounted future cash flows of proved plus probable reserves using forecasted prices and costs. The value-in-use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the asset or CGU. If the carrying amount exceeds the estimated recoverable amount, the CGU is written down with an impairment loss recorded in the consolidated statement of operations and comprehensive loss.

Impairment losses from previous periods are assessed at each reporting date for indications that the impairment loss no longer exists or has decreased. Impairment losses can be reversed if there is a change in the estimates used to determine the recoverable amount but cannot exceed the carrying value of the asset prior to impairment less any depreciation and depletion that would have been taken if no impairment had been recognized.

Decommissioning Liabilities

The Company recognizes the estimated fair value of future decommissioning liabilities related to statutory, contractual or other legal obligations associated with the retirement of assets, when a reasonable estimate of the provision can be determined and it is probable that an outflow of resources will be required to settle the obligation. A corresponding increase to the carrying amount of the related asset is recorded.

Decommissioning liabilities are based on the estimated costs to abandon and reclaim all wells and facilities as required under the terms of concession contracts and laws and regulations within Brazil. The estimate is evaluated on a quarterly basis and any adjustment to the estimate is applied prospectively. The liability is estimated by discounting expected future cash outflows required to settle the obligation using a risk-free rate. As all abandonment and reclamation activities are expected to be funded in USD, in determining the risk-free rate the Company uses the U.S. treasury bill rate for maturities coinciding with the estimated remaining years to abandonment. The change in net present value of the future decommissioning liabilities due to the passage of time is expensed as accretion expense on the consolidated statements of operations and comprehensive loss. The costs capitalized to the related assets are amortized to earnings in a manner consistent with the depletion and depreciation of the underlying assets. Revisions to the estimated timing of cash flows, inflation rates, discount rates or to the original estimated undiscounted costs also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligations are charged against the obligation to the extent of the liability recorded.

Revenue Recognition

Revenue is recognized when the significant risks and rewards of ownership have transferred to the buyer, when the amounts of revenue and the costs incurred or to be incurred can be measured reliably, and when collection is reasonably assured.

Share-based Compensation

The Company accounts for share-based compensation using the Black-Scholes option-pricing model to determine the fair value of stock options on grant date using various estimates, based on management's judgment and assumptions, including expected share price volatility, risk-free interest rate and expected term of the options.

Share-based compensation is measured at fair value on the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Forfeitures are estimated at the grant date and adjusted as actual forfeitures occur, until the options are fully vested. Consideration paid upon the exercise of stock options, together with corresponding amounts previously recognized in contributed surplus, is recorded as an increase to share capital. The Company capitalizes the portion of share-based compensation directly attributable to its exploration and development activities, with a corresponding decrease to share-based compensation expense.

Income Taxes

Income tax expense is comprised of current and deferred income taxes. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity.

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

Current tax expense is based on estimated taxable income and tax rates which are determined pursuant to tax law enacted or substantively enacted at the reporting date.

The Company follows the liability method of accounting for deferred taxes. Under this method, deferred income tax assets or liabilities are recorded to reflect the difference between the accounting and tax base of assets and liabilities and unused tax losses. Deferred income taxes are measured using tax rates that are expected to apply to the period when the deferred tax asset is realized or the deferred tax liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period.

Deferred income tax assets are recognized for deductible temporary differences to the extent it is probable that future taxable profit will be available. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent it is no longer probable that sufficient taxable profits will be available to allow the assets to be recovered. Deferred income tax assets and liabilities are offset only if there is a legally enforceable right to offset and they relate to income taxes levied by the same tax authority on the same taxable entity or on different tax entities to the extent they could be realized simultaneously.

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. The measurement of income tax expense, related provisions and deferred tax liabilities and assets is based on judgments in applying income tax law and estimates on the applicable tax rates and the timing, likelihood and reversal of temporary differences between the accounting and tax bases of assets and liabilities as well the expected recoverability of deferred tax assets. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. If these judgments and estimates prove to be inaccurate, the actual income tax liability may differ significantly from that estimated and recorded by management and future earnings may be impacted.

Per Share Amounts

The Company computes basic earnings or loss per share using net income or loss divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated using the treasury stock method which assumes that any proceeds received by the Company upon the exercise of in-the-money stock options, plus unamortized stock compensation costs, would be used to buy back common shares at the average market price for the period.

Foreign and Reporting Currency

The Company's functional currencies are the BRL for all Brazil entities and the USD for all Canadian entities. Given that the Company conducts the majority of its business in international markets and its revenues are largely dependent on international commodity prices, Alvo Petro has chosen to present its consolidated financial statements in USD.

Transactions in currencies other than the entity's functional currencies are recognized at the rates of exchange prevailing at the date of the transactions. At the end of each reporting period, monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect at the reporting period date. Non-monetary assets, liabilities, revenues and expenses are translated at transaction date exchange rates. Exchange gains or losses are included in the determination of net loss as foreign exchange gains or losses.

The assets and liabilities of all Brazil entities are translated to USD at exchange rates at the reporting date. The income and expenses of foreign operations are translated to USD at exchange rates at the date of the transactions. Resultant foreign currency differences are recognized in other comprehensive loss.

Financial Instruments

All financial assets and liabilities are initially recognized at fair value on the consolidated statements of financial position. Subsequent measurement of the financial instruments is based on their classification. Each financial instrument is classified into one of the following categories: fair value through profit or loss; held-to-maturity investments; loans and receivables; available for sale financial assets; and other financial liabilities.

ALVOPETRO ENERGY LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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

Financial instruments carried at fair value through profit or loss on the consolidated statements of financial position include cash and cash equivalents and restricted cash. Realized and unrealized gains and losses on financial assets and liabilities carried at fair value through profit or loss are recognized in the consolidated statements of operations and comprehensive loss in the periods such gains and losses arise. Transaction costs related to these financial assets and liabilities are included in the consolidated statements of operations and comprehensive loss when incurred.

Financial instruments classified as other loans, receivable and financial liabilities include trade and other receivables and accounts payable and accrued liabilities. These instruments are carried at amortized cost and transaction costs incurred for these types of financial instruments are amortized into net income/loss over the life of the asset or liability using the effective interest method and are included in finance and other expenses in the consolidated statements of operations and comprehensive loss. Gains and losses on financial assets and liabilities carried at amortized cost are recognized in the consolidated statements of operations and comprehensive loss when these assets or liabilities settle.

Segmented Operations

All oil sales revenue is derived from Brazilian operations. All exploration and evaluation assets and all material property, plant and equipment are located in Brazil. The majority of the Company's cash and cash equivalents are held in Canada. The Company does not have any significant revenue in Canada other than interest earned on cash.

NOTE 4 – CHANGES IN ACCOUNTING STANDARDS

New and Revised Accounting Standards

On January 1, 2017, the Company adopted amendments to IAS 7, *Statement of Cash Flows*. The revisions require additional disclosures relating to changes in liabilities arising from financing activities, including changes arising from cash flow and non-cash changes. The adoption of these amendments had no impact on the amounts recorded in the Company's consolidated financial statements.

Standards Issued but not Yet Effective

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on the Company.

Standard and Description	Date of Adoption	Expected Adoption Impact on Consolidated Financial Statements
IFRS 2 <i>Share-based Payment</i> – In June 2016, the IASB issued amendments to IFRS 2 to clarify the classification and measurement of share-based payment transactions.	January 1, 2018	The Company does not expect the amendments to have a material impact on the financial statements.
IFRS 15 <i>Revenue from Contracts with Customers</i> – The new standard will replace IAS 18 <i>Revenue</i> , IAS 11 <i>Construction Contracts</i> and other revenue related interpretations. The new standard clarifies the principles for recognizing revenue from contracts with customers and provides a model for the recognition and measurement of sales of certain non-financial assets.	January 1, 2018	Based on management's assessment of its oil sales contracts this standard will not have a material impact on the consolidated financial statements, with the exception of expanded note disclosure that will be required to comply with this standard upon adoption.
IFRS 9 <i>Financial Instruments</i> – As of July 2015, the IASB completed the final elements of IFRS 9 which supersedes IAS 39 <i>Financial Instruments</i> :	January 1, 2018	The Company does not expect the amendments to

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

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<i>Recognition and Measurement.</i> IFRS 9 introduces new models for classification and measurement of financial instruments, hedge accounting and impairment of financial assets.		have a material impact on the financial statements.
IFRS 16 <i>Leases</i> – IFRS 16 was issued in January 2016 and replaces IAS 17 <i>Leases</i> . The standard introduces a single lessee accounting model for leases with required recognition of assets and liabilities for most leases.	January 1, 2019	The Company is assessing the effect of this future pronouncement on its financial statements.

NOTE 5 – ASSETS HELD FOR SALE

	As at	
	December 31, 2017	December 31, 2016
Balance, beginning of year	410	-
Transferred from E&E assets (note 6)	322	410
Disposal – cash proceeds	(105)	-
Disposal – in exchange for drilling services	(396)	-
Foreign currency translation	5	-
Balance, end of year	236	410

In several separate transactions during the year ended December 31, 2017, the Company disposed of equipment inventory classified as held for sale. Upon transfer to held for sale, all inventory was written down to the estimated recoverable amount and a nominal gain resulted on these dispositions from total cash and non-cash proceeds of \$0.5 million. All dispositions were to third parties of Alvo Petro and the drilling services received in exchange were measured at fair value. The balance at December 31, 2017, transferred from exploration and evaluation assets during the three months ended September 30, 2017, represents land owned by the Company which management plans to sell in 2018.

NOTE 6 – EXPLORATION AND EVALUATION ASSETS

	Year ended December 31,	
	2017	2016
Balance, beginning of year	53,259	48,409
Capital expenditures	5,355	7,625
Capitalized share-based compensation	18	27
Change in decommissioning liabilities	189	164
Transfer to assets held for sale (note 5)	(322)	(410)
Other transfers	10	(185)
Asset dispositions	(122)	(300)
Impairment	(3,189)	(7,531)
Foreign currency translation	(613)	5,460
Balance, end of year	54,585	53,259

General and administrative costs totaling \$1.1 million (2016 - \$1.0 million) that were directly related to exploration and evaluation activities have been capitalized as exploration and evaluation assets. Capital expenditures in the year ended December 31, 2017 include \$0.4 million of non-cash expenditures, largely in respect of drilling services received in exchange for assets held for sale.

During 2017 the Company disposed of equipment inventory classified as E&E assets in several separate transactions, all to third parties of Alvo Petro. Proceeds, including both cash and non-cash consideration, totaled \$0.1 million, resulting in a loss of \$0.02 million.

In 2016, the Company entered into a farmout agreement with an independent third party (“the Farmee”) to transfer a 95% participating interest in Block 107. Pursuant to the terms of the agreement, Alvo Petro received an upfront cash payment of \$0.3

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million and the Farmee drilled a well in 2017, satisfying all outstanding work commitments on the block. Subsequent to December 31, 2017 Alvo Petro exchanged its 5% participating interest for a 5% gross-overriding royalty on Block 107 and an adjacent block held by the Farmee.

Impairment

The Company recorded impairment losses as follows on its E&E assets:

	Year ended December 31,	
	2017	2016
Block 177	(2,384)	-
Block 169	(269)	-
Block 255	(337)	-
Block 170	-	(2,975)
Block 256	-	(4,392)
Equipment inventory and other E&E assets	(199)	(164)
Net E&E impairment loss	(3,189)	(7,531)

Block 177

During the three months ended September 30, 2017 the 177(A1) well was drilled on Block 177. No commercial quantities of hydrocarbons were discovered and the well was abandoned. Due to limited prospectivity on the block, an impairment loss was recorded to bring the carrying value of this block to \$nil. All costs incurred subsequent to the well abandonment have been recorded as exploration and evaluation expenditures on the consolidated statements of operations and comprehensive loss. Subsequent to December 31, 2017, this block was relinquished to the National Agency of Petroleum, Natural Gas and Biofuels of Brazil ("ANP").

Blocks 169 & 255

Blocks 169 and 255 were awarded to Alvo Petro in the 12th Brazil Bid Round. In 2014, an injunction was issued by a Brazilian Federal Court prohibiting unconventional activities on all 12th Brazil Bid Round Blocks, including Blocks 169 and 255. As a result of this continuing injunction, in December 2017 Alvo Petro filed a request with the ANP to cancel these concession contracts including the associated work commitments and refund the original bid round bonuses paid in 2014. Alvo Petro has recorded impairment losses for Blocks 169 and 255, to reduce the carrying value of each of these blocks to \$0.1 million, which represents the bid round bonuses expected to be returned pursuant to this request. All other costs incurred on these blocks have been written off.

Inventory

The Company holds equipment inventory primarily for use on future exploration wells and, accordingly, the carrying value of the equipment inventory is included in E&E assets. The Company is continually assessing the value of its inventory and provides for impairment on any items which are considered to have a book value in excess of its recoverable amount. In 2017 impairment losses of \$0.2 million were recorded on inventory.

2016 Impairments

The Company recorded total impairment charges of \$7.5 million to E&E assets in the year-ended December 31, 2016. With respect to Block 170, when no commercial quantities of oil or gas were discovered in the 170(B1) well, drilled during the three months ended March 31, 2016, the Company decided to relinquish the block and it was impaired to a carrying value of \$nil. During the three months ended September 30, 2016, the 256(A1) well was drilled on Block 256. As no commercial quantities of hydrocarbons were discovered, the well was abandoned. Based on the drilling results management made the decision to relinquish this block and all costs incurred on the block were impaired to bring the carrying value to \$nil. Any costs incurred on these blocks subsequent to impairment were recorded in exploration and evaluation expense and included in the consolidated statements of operations and comprehensive loss.

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Equipment inventory sales negotiated to take place in 2017 indicated an impairment of the accumulated costs at December 31, 2016 and \$0.5 million of equipment inventory was written down to the estimated recoverable amount of \$0.4 million and transferred to assets held for sale, resulting in an impairment charge of \$0.1 million for the year ended December 31, 2016.

NOTE 7 – PROPERTY, PLANT AND EQUIPMENT

	Year ended December 31,	
	2017	2016
Cost, beginning of year	9,599	8,120
Capital expenditures	77	769
Transferred from E&E assets	-	114
Asset dispositions	-	(68)
Capitalized share-based compensation	1	7
Change in decommissioning liabilities	-	73
Foreign currency translation	(163)	584
Cost, end of year	9,514	9,599
Accumulated depletion, depreciation and impairment, beginning of year	(4,739)	(3,827)
Depletion and depreciation for the year	(205)	(416)
Asset dispositions	-	16
Impairment	(472)	(292)
Foreign currency translation	140	(220)
Accumulated depletion, depreciation and impairment, end of year	(5,276)	(4,739)
Net book value, end of year	4,238	4,860

General and administrative costs totaling \$0.03 million (2016 - \$0.1 million) that were directly related to property, plant and equipment activities have been capitalized.

During 2016, the Company disposed of under-utilized office assets and furniture. The total amount received for these items was \$0.01 million and the carrying value was \$0.05 million for a resultant loss on disposition of \$0.04 million.

Impairment

At the end of each reporting period the Company assesses impairment and impairment reversal indicators related to all of its CGUs. With respect to the Company's Mãe-da-lua field, the continued decline in the current and projected production volumes indicated an impairment as at December 31, 2017. This property was not assigned any probable reserves at December 31, 2017 and an impairment of \$0.5 million was recorded to reduce the carrying value of the property \$nil. An impairment of \$0.3 million was also recognized on this field in 2016 as a result of capital expenditures in the year and a decline in the forecasted commodity prices.

There were no indicators of impairment for the Company's Bom Lugar or Jiribatuba fields.

Future changes to forecasted commodity prices for crude oil could result in future impairment losses or impairment reversals. Increases or decreases to the assumed discount rate could result in additional impairment charges or impairment reversals. The majority of the Company's production expenses and, to a lesser extent, a portion of the Company's future development costs, are denominated in BRL. For purposes of estimating these future costs, any costs denominated in BRL were translated to USD assuming the December 31, 2017 exchange rate. Fluctuations in the BRL relative to the USD may result in additional impairment charges or impairment reversals.

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Based on the assumptions used at December 31, 2017, fluctuations of 5% in forecasted commodity prices and foreign exchange rates and a 2% change to the discount rate would not change the impairment recognized for any of the Company's three PP&E properties in 2017.

NOTE 8 – DECOMMISSIONING LIABILITIES

The decommissioning liabilities were estimated based on the net ownership interest of 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.

	Year ended December 31,	
	2017	2016
Balance, beginning of year	1,399	1,079
Liabilities incurred	189	320
Revisions to obligations	-	(83)
Obligations settled	(139)	(175)
Accretion	37	28
Foreign currency translation	(22)	230
Balance, end of year	1,464	1,399

Total undiscounted cash flows, escalated at 6.5% (2016 - 6.5%) for inflation, required to settle the Company's decommissioning provision are estimated to be \$2.3 million (2016 - \$2.1 million) and have been discounted using an average risk free rate of 2.5% (2016 - 2.5%), which represents an estimated U.S. Treasury bill rate for a period of 15 years (2016 - 15 years), the approximate weighted-average remaining years to abandonment.

The Company recorded a revision to the decommissioning liability during the year ended December 31, 2016 to more accurately reflect the timing of abandonment of a key block, based on management's estimates.

Of the total \$1.5 million in decommissioning liabilities as at December 31, 2017, \$0.02 million (2016 - \$0.08 million) relates to costs expected to be incurred within one year and accordingly, is classified as current on the consolidated statements of financial position.

NOTE 9 – 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
Balance as at December 31, 2017 and 2016	85,166,871	\$ 151,937

c) Options to Purchase Common Shares

Alvopetro has a stock option plan whereby the Company may grant stock options to its directors, officers, employees and consultants. The plan allows for the issuance of up to ten percent of the outstanding common shares of the Company. The exercise price of each option is not less than the five-day volume weighted average price of the Company's common shares on the TSX Venture Exchange prior to the date of grant. Stock option terms are determined by the Company's Board of Directors but typically, options granted vest over a period of three years from the date of grant and expire five years from the date of grant. The options outstanding at December 31, 2017 are as follows:

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	Number of Options	Weighted Average Exercise Price (CAD\$)
Balance as at December 31, 2015	6,843,436	0.66
Granted	2,461,500	0.24
Expired	(1,141,330)	0.84
Forfeited	(1,289,504)	0.42
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

Options Outstanding at December 31, 2017				Options Exercisable at December 31, 2017			
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	3,086,500	0.25	3.50	1,976,503	0.25	3.41	
CAD\$0.40 - \$0.75	1,480,000	0.42	2.04	1,468,000	0.42	2.04	
CAD\$1.01 - \$1.10	1,972,436	1.02	0.98	1,972,436	1.02	0.98	
CAD\$0.18 - \$1.10	6,538,936	0.52	2.41	5,416,939	0.58	2.15	

d) Share-Based Compensation

The fair value of the stock options granted under the Alvo Petro stock option plan for the year-ended December 31, 2017 and 2016 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:

	Year ended December 31,	
	2017	2016
Risk free interest rate (%)	1.03	0.70
Expected term (years)	4.0	2.9
Expected volatility (%)	45.0	46.7
Dividend per share (%)	-	-
Forfeiture rate (%)	5.0	5.0
Weighted average fair value (CAD)	0.07	0.09

Total share-based compensation of \$0.1 million was computed for the year ended December 31, 2017 (2016 - \$0.1 million) related to the Alvo Petro stock option plan. Of this amount, approximately \$0.02 million (2016 - \$0.03 million) was capitalized to exploration and evaluation assets and property, plant and equipment, with the remainder recognized as share-based compensation expense on the consolidated statements of operations and comprehensive loss.

e) Net Loss Per Share

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:

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	Year ended December 31,	
	2017	2016
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 years ended December 31, 2017 and 2016, all stock options were excluded because the effect would be anti-dilutive.

NOTE 10 – TAXES

Income tax expense is comprised of the following amounts relating to current tax expense and deferred tax recovery:

	Year ended December 31,	
	2017	2016
Current income tax expense	-	-
Deferred income tax recovery:		
Origination of temporary differences in the current year	-	(300)
Change in estimated tax pools	-	(30)
Deferred income tax recovery	-	(330)
Income tax recovery	-	(330)

Alvopetro computes Brazil corporate income tax under the actual profit regime. Under this regime, the corporate tax rate on taxable income is 34% and tax losses may be carried forward indefinitely; however, any utilization of losses in a subsequent taxation year is limited to 30% of the taxable income in that period.

Income tax expense differs from the amount that would have been expected by applying the statutory income tax rate to loss before taxes. The principal reasons for this difference are as follows:

	Year ended December 31,	
	2017	2016
Loss before taxes	(7,117)	(12,908)
Statutory income tax rate	34%	34%
Expected income tax recovery	(2,420)	(4,389)
Decrease (increase) resulting from:		
Change in unrecognized deferred tax asset	1,573	5,784
Change in estimated tax pools	199	(30)
Permanent difference on impairment and E&E expense	393	394
Share-based compensation	33	39
Impact of foreign exchange gains and losses	(57)	(1,332)
Other	279	(796)
Income tax recovery	-	(330)

The components of the Company's deferred tax assets and liabilities arising from temporary differences and loss carry-forwards as well as the associated amount of deferred tax recovery or expense recognized in the Company's consolidated statements of operations and comprehensive loss are outlined below.

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Deferred tax liability (asset)	PP&E and E&E assets	Decommissioning liabilities	Tax loss carryforwards	Other Brazil tax pools	Unrealized taxable foreign exchange gains	Unrecognized deferred tax asset	Total
As at December 31, 2015	2,897	(370)	(5,083)	(2,350)	944	4,292	330
Deferred tax (recovery) expense	(591)	(107)	(4,440)	(465)	(511)	5,784	(330)
As at December 31, 2016	2,306	(477)	(9,523)	(2,815)	433	10,076	-
Deferred tax expense (recovery)	536	(21)	(1,852)	42	(278)	1,573	-
As at December 31, 2017	2,842	(498)	(11,375)	(2,773)	155	11,649	-

A deferred tax asset of \$11.6 million exists at December 31, 2017 (December 31, 2016 - \$10.1 million), the full balance of which has not been recognized. Of the full balance of the unrecognized deferred tax asset, \$10.7 million relates to Brazil (December 31, 2016 - \$9.6 million) and \$0.9 million relates to Canada (December 31, 2016 - \$0.5 million). Total tax loss carryforwards include \$30.4 million attributable to Brazil, which carryforward indefinitely but are limited to annual utilization of up to 30% of taxable income in subsequent periods, and \$3.9 million attributable to Canada which expire between 2032 and 2037.

NOTE 11 – CAPITAL MANAGEMENT

The Company's capital consists of the following:

	As at December 31,	
	2017	2016
Working capital	8,762	16,977
Shareholders' equity	66,140	73,775

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 December 31, 2017, the Company's net working capital surplus was \$8.8 million (December 31, 2016 - \$17.0 million), which includes \$9.2 million (December 31, 2016 - \$17.8 million) of cash, \$0.1 million (December 31, 2016 - \$0.1 million) of current restricted cash, and assets held for sale of \$0.2 million (December 31, 2016 - \$0.4 million).

The Company has a credit support facility (the "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 16. LCs and letters of guarantee issued under the Facility must be supported by either cash collateral posted by Alvopetro or through an Account Performance Security Guarantee from Export Development Canada ("EDC"). As at December 31, 2017, the total amount of LCs issued under the Facility was \$12.1 million (December 31, 2016 - \$14.1 million), the full balance of which was supported by EDC on behalf of Alvopetro.

LCs supported by EDC at December 31, 2017 include \$6.0 million of LCs related to commitments which have been met. This includes the \$2.9 million LC on Block 177 which was met in 2017 and approved by the ANP subsequent to December 31, 2017, as well as the \$3.1 million LC for the work commitment associated with Block 107, which was met by the Farmee and approved by the ANP in 2017. The Company is currently awaiting release of both of these LCs from all involved banks.

The current restricted cash of \$0.1 million (December 31, 2016 - \$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 December 31, 2017 or 2016.

Alvopetro may adjust its capital structure by issuing new equity or debt and making adjustments to its capital expenditure program, as allowed pursuant to contracted work commitments. The Company considers its capital structure at this time to include shareholders' equity of \$66.1 million (December 31, 2016 - \$73.8 million). In the event that adjustments to the capital structure are necessary, the Company may consider issuing additional equity, raising debt or revising its capital investment

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programs. Alvo Petro expects that financing will be required to execute the full development of the Caburé field and may also be required to fund future capital expenditures on our existing exploration and evaluation assets and mature fields as well as to support ongoing operations into 2019. Such funding may be facilitated through project financing, vendor financing, other debt issuances or equity issuances, asset sales or farmouts.

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

NOTE 12 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

Overview

The Company's financial instruments consist of cash and cash equivalents, restricted cash, trade and other receivables and accounts payable and accrued liabilities. The nature of Alvo Petro'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.

Credit Risk

Credit risk is the risk of financial loss to the Company if counterparties do not fulfill their contractual obligations. The Company has credit risk on cash and cash equivalents, restricted cash, and trade and other receivables.

At December 31, 2017, accounts receivable consisted of \$0.02 million (December 31, 2016 - \$0.2 million) from crude oil customers with the remainder related to other trade and tax credit receivables. Crude oil production is sold to two counterparties, one of which represented 67 percent of the Company's oil sales revenues in 2017 (2016 – 65%). Alvo Petro routinely assesses the recoverability of the accounts receivable from its crude oil customers and the risk of non-collection from these counterparties is not expected to have a significant impact on the financial statements.

The Company closely monitors other trade receivables, specifically those outstanding for greater than 60 days. When collection does not seem reasonably attainable, an allowance is recorded. The accounts receivable balance at December 31, 2017 includes an allowance of \$0.01 million (December 31, 2016 - \$0.1 million).

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations when due, under both normal and unusual conditions without incurring unacceptable losses or jeopardizing the Company's business objectives. The Company manages this risk by forecasting cash flows for a minimum period of twelve months. This involves preparing annual capital expenditure budgets (for discretionary and non-discretionary activities), operating expense budgets and general and administrative expense budgets, which are monitored and updated as considered necessary. Alvo Petro does not currently derive positive cash flow from its operations. Existing capital expenditures and ongoing production and G&A expenses have been funded from the Company's cash balances. The Company expects that future capital expenditures will require additional funding in excess of current cash and cash equivalent balances and future cash flows from existing operations. In addition, \$12.1 million of the LCs for work commitments are currently supported by EDC. This coverage is reviewed annually and to the extent some or all of the EDC coverage were limited in the future, the Company may be required to provide the required amount from its existing cash balance which would reduce the Company's available funds, limiting its ability to fund future capital projects and further increase the need for additional financing. Future spending may be funded from a combination of asset sales, joint ventures, farmouts, debt financing or equity issuances. This may create a liquidity risk in the future to the extent current economic conditions persist and the Company is not able to secure the necessary funding to proceed with its capital and growth plans.

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Market risk is the risk that changes in the foreign exchange rates, commodity prices and interest rates will affect the Company's cash flows, net income or loss or comprehensive income or loss. The objective of managing market risk is to maintain and control these risks within acceptable limits while maximizing returns.

Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in foreign currency exchange rates. All of the Company's oil sales are denominated in BRL based on a USD oil price and all operational, administrative and capital activities related to the Brazil properties are transacted primarily in BRL. In Canada the Company has expenditures in both CAD and USD. To minimize foreign currency risk, the Company's cash balances are held primarily in USD within Canada. Management transfers funds to Brazil only as needed to fund immediate capital and operational requirements and typically maintains minimal cash balances in BRL. In Canada, USD funds are converted to CAD on an as-needed basis.

As at December 31, 2017 and 2016, the following financial instruments were denominated in currencies other than the USD:

	Year Ended December 31			
	2017		2016	
	CAD (000's)	BRL (000's)	CAD (000's)	BRL (000's)
Cash and cash equivalents	128	635	208	1,064
Restricted cash – current	-	350	-	351
Trade and other receivables	36	407	-	1,403
Accounts payable and accrued liabilities	(186)	(2,636)	(248)	(4,434)
Net exposure in foreign currency	(22)	(1,244)	(40)	(1,616)
Net exposure in USD (\$000s)	(18)	(376)	(30)	(496)

The Company had no forward exchange rate contracts in place as at or during the years ended December 31, 2017 and 2016.

Based on financial instruments held at December 31, 2017 and 2016, fluctuations in the exchange rates as indicated below would have the following estimated effect on net loss and other comprehensive loss:

	Year Ended December 31,	
	2017	2016
Effect of 5% appreciation in CAD and BRL to USD		
Increase to net loss	(2)	(1)
Decrease to accumulated other comprehensive loss	(22)	(28)
Effect of 5% depreciation in CAD and BRL to USD		
Decrease to net loss	2	1
Increase to accumulated other comprehensive loss	20	25

Commodity Price Risk

Although the Company is not dependent on cash flows derived from its oil sales, changes in commodity prices may have a significant impact on the assessment of the carrying value of the Company's properties and any impairment losses recorded as a result of a decline in those values would increase the Company's net loss. Fluctuations in commodity prices can also affect the Company's ability to obtain future financings and the capacity of those future financings. Given its level of sales, the Company did not have any forward contracts in place as at or during the years ended December 31, 2017 and 2016. To the extent sales increase in the future, the Company may consider a hedging program to protect cash flows and manage commodity price risk.

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Interest Rate Risk

The Company is exposed to interest rate cash flow risk on cash and cash equivalents and restricted cash due to fluctuations in market interest rates applied to cash balances. The effect of this risk on the Company is assessed as minimal.

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 carrying values and respective fair values of AlvoPetro's financial instruments at December 31, 2017 and 2016 is set forth in the table below. The Company does not currently have any financial instruments classified as Level 2 or Level 3.

	December 31, 2017		December 31, 2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Carried at fair value through profit or loss				
Cash and cash equivalents ⁽¹⁾	9,189	9,189	17,788	17,788
Restricted cash – current ⁽¹⁾⁽²⁾	106	106	108	108
	9,295	9,295	17,896	17,896
Carried at amortized cost				
Trade and other receivables	153	153	431	431
Accounts payable and accrued liabilities	(1,111)	(1,111)	(1,878)	(1,878)
	(958)	(958)	(1,447)	(1,447)

(1) Level 1

(2) Restricted cash balances include amounts pledged as collateral for work commitments on the Company's Bom Lugar and Jiribatuba fields (Note 16).

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Change in:	Year ended December 31,	
	2017	2016
Trade and other receivables	390	(125)
Prepaid expenditures	(12)	149
Accounts payable and accrued liabilities	(1,012)	(574)
	(634)	(550)
Changes relating to:		
Operating activities	(563)	(1,164)
Investing activities	(71)	614
	(634)	(550)

NOTE 14 – NATURE OF EXPENSES

Production expenses by nature were as follows:

Production expenses:	Year Ended December 31,	
	2017	2016
Personnel	359	347
Production facilities rental	-	277
Other fixed	230	238
Variable	111	165
Workover	124	126
Production expenses	824	1,153

The majority of the Company's production expenses in 2017 relate to personnel costs. Costs in 2016 also included rental costs for production facilities on the Mãe-da-lua field. This rental contract was cancelled during the three months ended June 30, 2016.

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

G&A expenses:	Year Ended December 31,	
	2017	2016
Personnel	2,493	2,937
Travel	104	169
Office and IT costs	368	457
Professional fees	522	633
General corporate	214	451
Gross G&A expenses	3,701	4,647
Capitalized to E&E and PP&E	(1,094)	(1,124)
Net G&A expenses	2,607	3,523

The majority of the Company's G&A relates to personnel costs. General corporate expenses include public company costs, corporate insurance, directors' fees, rental vehicle costs, cell phones and other miscellaneous expenses. G&A expenses that are directly attributable to exploration and development projects are capitalized. The majority of capitalized costs relate to personnel.

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Alvopetro was previously party to non-material office-related administrative transactions with a related party of the Company due to common directors, summarized as follows:

	Year Ended December 31,	
	2017	2016
Office rent and related costs	-	60

This contract was terminated during the three months ended September 30, 2016. As at December 31, 2017 and December 31, 2016, the Company owed the related party \$nil.

Key management personnel are comprised of Alvopetro's directors and officers. Compensation for these individuals is set forth as follows:

	Year ended December 31,	
	2017	2016
Short-term benefits ⁽¹⁾	425	490
Share-based compensation ⁽¹⁾	74	100
Total	499	590

Notes:

(1) Before capitalization of any directly attributable compensation to E&E or PP&E.

NOTE 16 – COMMITMENTS AND CONTINGENCIES

The following is a summary of contractual commitments as at December 31, 2017:

Commitments	< 1 Year	1-3 Years	Thereafter	Total
Minimum work commitments ⁽¹⁾				
<i>Minimum work commitments to be completed</i>				
Block 183 ⁽²⁾	-	1,008	-	1,008
Block 106	345	-	-	345
Block 169 ⁽³⁾	1,149	-	-	1,149
Block 255 ⁽³⁾	1,375	-	-	1,375
Block 57 ⁽⁴⁾	-	45	-	45
Block 62 ⁽⁴⁾	-	45	-	45
Block 71 ⁽⁴⁾	-	38	-	38
Block 145 ⁽⁴⁾	-	45	-	45
Bom Lugar	-	-	106	106
Jiribatuba	-	-	106	106
Minimum work commitments to be completed	2,869	1,181	212	4,262
<i>Minimum work commitments incurred</i>				
Block 177 ⁽⁵⁾	1,263	-	-	1,263
Minimum work commitments incurred	1,263	-	-	1,263
Total minimum work commitments	4,132	1,181	212	5,525
Office leases⁽⁶⁾	184	26	-	210
Total commitments	4,316	1,207	212	5,735

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.

ALVOPETRO ENERGY LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the years ended December 31, 2017 and 2016

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

- (2) In February 2018, 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) Alvo Petro holds a 65% interest in each of these blocks and the amounts provided in the table above represent Alvo Petro's share of the related commitments. During 2017, the Company re-evaluated its cost estimates with respect to these commitments given changes in cost structures. As a result of these reviews, the estimates were reduced from a total of \$1.0 million on these four blocks to \$0.2 million.
- (5) In 2017, the Company drilled the 177(A1) well and performed other work in satisfaction of the work commitment on Block 177 which was approved by the ANP subsequent to December 31, 2017.
- (6) The Company is committed to future minimum payments for office space in Canada and Brazil.

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.

Alvo Petro'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 possible 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. The Company is continually monitoring its local content compliance and actual or potential penalties and, as of December 31, 2017, the potential estimated penalty was \$0.3 million (December 31, 2016 - \$0.2 million), which is included in accounts payable and accrued liabilities in the respective consolidated statements of financial position.