



INTERIM FINANCIAL STATEMENTS
SEPTEMBER 30, 2021

NOTICE TO READER

Please note the interim financial statements as at and for the three and nine months ended September 30, 2020 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, 2021	December 31, 2020
ASSETS			
Current			
Cash and cash equivalents		8,084	5,159
Restricted cash		155	125
Trade and other receivables		4,555	2,802
Prepaid expenditures		344	273
Assets held for sale	3	63	128
Total current assets		13,201	8,487
Non-current assets			
Exploration and evaluation assets	4	3,479	32,262
Property, plant and equipment	5	50,534	25,843
Right-of-use assets	6	7,562	8,092
Deferred tax asset		3,676	4,576
Other assets	7	652	1,128
Total non-current assets		65,903	71,901
Total assets		79,104	80,388
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		3,786	2,390
Dividend payable	10	2,023	-
Lease liabilities	6	496	483
Decommissioning liabilities	8	57	63
Other liabilities		-	12
Total current liabilities		6,362	2,948
Non-current liabilities			
Lease liabilities	6	7,595	7,827
Credit facility	9	6,545	15,423
Decommissioning liabilities	8	835	1,080
Total non-current liabilities		21,337	27,278
Shareholders' equity			
Share capital	10	39,269	156,755
Contributed surplus	10	51,603	2,821
Deficit	10	(532)	(71,172)
Accumulated other comprehensive loss		(32,573)	(35,294)
Total shareholders' equity		57,767	53,110
Total liabilities and shareholders' equity		79,104	80,388

Commitments and contingencies (Note 16)

See accompanying notes to these interim condensed consolidated financial statements.

ALVOPETRO ENERGY LTD.
INTERIM CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

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

		Three Months Ended September 30,		Nine Months Ended September 30,	
	Note	2021	2020	2021	2020
Revenue					
Natural gas, oil and condensate sales	11	9,963	5,320	25,084	5,421
Royalties		(910)	(456)	(2,162)	(469)
Net oil and condensate revenue		9,053	4,864	22,922	4,952
Other income	12	915	14	930	58
Total revenue and other income		9,968	4,878	23,852	5,010
Expenses					
Production	12	824	648	2,325	728
General and administrative	12	1,139	654	3,026	2,326
Depletion and depreciation	5,6	2,667	931	6,433	1,043
Impairment	5	-	-	-	1,381
Finance expenses	12	686	996	2,513	1,341
Share-based compensation	10	120	74	301	141
Risk management gains	14	(115)	-	(7)	-
Foreign exchange losses (gains)		1,813	(15)	1,067	(9)
Gain on disposition of assets	4,5	(23)	-	(39)	-
Total expenses		7,111	3,288	15,619	6,951
Income (loss) before taxes		2,857	1,590	8,233	(1,941)
Income tax expense (recovery)					
Current		79	-	374	-
Deferred		1,288	(4,893)	3,820	(4,893)
Total		1,367	(4,893)	4,194	(4,893)
Net income		1,490	6,483	4,039	2,952
Exchange (loss) gain on translation of foreign operations		(633)	(1,056)	2,721	(10,820)
Comprehensive income (loss)		857	5,427	6,760	(7,868)
Net income per share					
	10				
Basic		0.05	0.20	0.12	0.09
Diluted		0.04	0.19	0.12	0.08

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)

		Common Shares	Contributed Surplus	Deficit	Accumulated Other Comprehensive Loss	Total
	Note					
Balance, December 31, 2020		156,755	2,821	(71,172)	(35,294)	53,110
Issue of common shares	10	874	(116)	-	-	758
Share issuance and restructuring costs		(61)	-	-	-	(61)
Share-based compensation	4,5,10	-	342	-	-	342
Net income		-	-	4,039	-	4,039
Other comprehensive income		-	-	-	2,721	2,721
Dividends declared	10	-	-	(2,023)	-	(2,023)
Share restructuring	10	(1,119)	-	-	-	(1,119)
Stated capital reduction	10	(117,180)	48,556	68,624	-	-
Balance, September 30, 2021		39,269	51,603	(532)	(32,573)	57,767
Balance, December 31, 2019		156,355	2,790	(76,878)	(26,393)	55,874
Issue of common shares	10	334	(201)	-	-	133
Share issuance costs		(3)	-	-	-	(3)
Share-based compensation	10	-	161	-	-	161
Net income		-	-	2,952	-	2,952
Other comprehensive income		-	-	-	(10,820)	(10,820)
Balance, September 30, 2020		156,686	2,750	(73,926)	(37,213)	48,297

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	2021	2020	2021	2020
Operating Activities					
Net income		1,490	6,483	4,039	2,952
Adjustments:					
Depletion and depreciation	5,6	2,667	931	6,433	1,043
Impairment	5	-	-	-	1,381
Finance expenses	12	686	996	2,513	1,341
Share-based compensation	10	120	74	301	141
Gain on disposition of assets	4,5	(23)	-	(39)	-
Foreign exchange		1,842	20	1,136	3
Unrealized risk management gains		(139)	-	(42)	-
Deferred tax		1,288	(4,893)	3,820	(4,893)
Settlement of decommissioning liabilities	8	(1)	(1)	(4)	(4)
Funds flow from operations		7,930	3,610	18,157	1,964
Changes in non-cash working capital	15	(696)	(1,639)	(954)	(2,027)
		7,234	1,971	17,203	(63)
Financing Activities					
Credit Facility (repayments) advances	9	(1,000)	-	(9,000)	10,000
Interest on Credit Facility	9	(153)	(321)	(793)	(478)
Unearned revenue		-	(880)	-	300
Issue of common shares, net of share issuance costs		720	141	757	192
Lease liabilities payments	6	(451)	(455)	(1,382)	(544)
Shares repurchased	10	(1,119)	-	(1,119)	-
Share issuance and restructuring costs		(61)	-	(61)	(3)
Repayment of other liabilities		-	-	-	(4,231)
Changes in non-cash working capital	15	151	43	278	63
		(1,913)	(1,472)	(11,320)	5,299
Investing Activities					
Expenditures on exploration and evaluation assets	4	(197)	(106)	(1,236)	(608)
Expenditures on property, plant and equipment	5	(1,064)	(1)	(1,807)	(2,357)
Proceeds on dispositions	3,4,5	44	-	185	158
Change in restricted cash		(17)	3	(36)	120
Changes in non-cash working capital	15	112	(181)	124	(68)
		(1,122)	(285)	(2,770)	(2,755)
Change in cash and cash equivalents		4,199	214	3,113	2,481
Effect of foreign exchange on cash balances		(364)	(197)	(188)	(529)
Cash and cash equivalents, beginning of period		4,249	3,150	5,159	1,215
Cash and cash equivalents, end of period		8,084	3,167	8,084	3,167
Cash and cash equivalents consist of:					
Cash		3,019	3,167	3,019	3,167
Cash equivalents		5,065	-	5,065	-
Cash income taxes paid		446	-	446	-
Cash interest income received		9	2	14	17

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, 2021

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 for, and the acquisition, development and production of, hydrocarbons in the Recôncavo basin 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) and is also traded on the OTCQX® Best Market in the United States (OTCQX: ALVOF).

The Company’s head office and records are located at 1920, 215 9th Avenue S.W., Calgary, Alberta, Canada, T2P 1K3.

The interim condensed consolidated financial statements as at September 30, 2021 and December 31, 2020 and for the three and nine months ended September 30, 2021 and September 30, 2020 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, 2020 other than as discussed in Note 2. 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, 2020.

These interim condensed consolidated financial statements were authorized for issuance by the Company’s Board of Directors on November 9, 2021.

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

Use of Estimates, Judgments and Assumptions and Estimation Uncertainty

The timely preparation of the condensed consolidated interim financial statements requires management to make estimates, judgments and assumptions that may affect the reported amounts of assets and liabilities, disclosures of contingencies and the reported amounts of expenses during the period. Details on these estimates, judgments and assumptions are included in the audited consolidated financial statements as at and for the year ended December 31, 2020.

Impact of the COVID-19 Pandemic

Alvopetro continues to respond to the evolving situation of the novel coronavirus (“COVID-19”) and to date there have been no restrictions or outbreaks that have caused any operational interruptions. As the global community progresses with the vaccination roll outs and overall mobility increases management is not anticipating any significant impact on operations resulting from COVID-19.

However, given the unprecedented nature of this pandemic, the estimates and judgments used to prepare these financial statements are subject to a higher degree of management uncertainty. For Alvopetro, the most significant estimates, judgments and assumptions potentially affected by COVID-19 relate to the valuation of property, plant and equipment. Amounts recorded for depletion and depreciation, the decommissioning provision and deferred taxes are also based on several assumptions and estimates with respect to oil and natural gas reserves, which are impacted by the worldwide economic climate. Any potential direct and indirect impact to the Company has been considered in management’s estimates at the period end; however, there could be material impacts in future periods, the extent of which is unknown.

Property, Plant & Equipment

During the three months ended March 31, 2021, management determined that the Gomo asset had satisfied the conditions for technical feasibility and commercial viability in accordance with the Company’s accounting policies and as such, the \$30.0 million carrying value was transferred from E&E assets to the Caburé cash-generating unit (“CGU”) within PP&E assets. This determination involves significant estimates and assumptions and requires management’s interpretation of accounting standards for exploration and evaluation assets. This transfer has resulted in higher depletion expense with the incremental depletable base for the Caburé CGU.

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

As at and for the three and nine months ended September 30, 2021

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NOTE 2 – CHANGES IN ACCOUNTING STANDARDS**Income Taxes – SUDENE Benefit**

In the three months ended September 30, 2021, the Company received approval from tax authorities in Brazil for Supertintendência de Desenvolvimento do Nordeste (“SUDENE”), a regional tax incentive offered for Bahia State. Pursuant to the incentive, special deductions reduce the inherent current tax payable on qualifying projects to an effective rate of 15.25%. The SUDENE incentive applies to natural gas profits Alvo Petro earns for a period of ten taxation years, commencing January 1, 2021 and ending December 31, 2030. The SUDENE incentive is recognized in consolidated statements of operations and comprehensive income (loss) through a reduction in tax expense.

New and Revised Accounting Standards

The interim condensed consolidated financial statements have been prepared following the same accounting policies and methods of computation as the 2020 annual consolidated financial statements.

The Company has not early adopted any standard, interpretation, or amendment that has been issued but is not yet effective.

NOTE 3 – ASSETS HELD FOR SALE

	As at	
	September 30, 2021	December 31, 2020
Balance, beginning of period	128	332
Transferred from PP&E (Note 5)	63	-
Impairment	-	(4)
Disposition	(119)	(158)
Foreign currency translation	(9)	(42)
Balance, end of period	63	128

During the three months ended March 31, 2021, the Company disposed of land for proceeds equal to the carrying value, resulting in no gain or loss on the transaction.

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

	As at	
	September 30, 2021	December 31, 2020
Balance, beginning of period	32,262	35,971
Capital expenditures	1,236	992
Capital expenditures – non-cash	-	3
Capitalized share-based compensation	15	10
Change in decommissioning liabilities (Note 8)	7	-
Transfer (to) from PP&E (Note 5)	(29,924)	99
Asset dispositions & other transfers	(13)	(1)
Impairment	-	21
Foreign currency translation	(104)	(4,833)
Balance, end of period	3,479	32,262

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

As at and for the three and nine months ended September 30, 2021

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

During the three months ended March 31, 2021 the Company's \$30.0 million carrying value of its Gomo natural gas asset (subsequently renamed to the Murucututu field), which includes the 183(1) and 197(1) wells, was transferred from E&E assets to PP&E (note 5). Proved plus probable reserves have been assigned to the project since December 31, 2018 and the Company continued to evaluate the technical feasibility and commercial viability of the property since that time. In early 2020 Alvopetro completed a stimulation and initial production test on the 183(1) well and another production test was completed in early 2021. Following this test, the Company made the decision to declare commerciality on Block 183, which was ultimately filed in April 2021. Given the results of the stimulation and production testing, reserves assigned to date and additional prospects on this project, to which the Company has been assigned contingent and prospective resources, there was no impairment on this E&E asset at the time of the transfer to PP&E.

The Company holds equipment inventory which has been predominantly used for exploration wells with a carrying value of \$1.6 million (December 31, 2020 - \$1.1 million) which is included in E&E assets.

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

	As at	
	September 30, 2021	December 31, 2020
Cost, beginning of period	31,189	34,354
Capital expenditures – cash	1,807	2,425
Capital expenditures – non-cash	-	394
Capitalized share-based compensation	26	12
Transfer from (to) E&E assets (Note 4)	29,924	(99)
Transfer to assets held for sale (Note 3)	(63)	-
Change in decommissioning liabilities	(287)	-
Asset disposition	(50)	-
Foreign currency translation	(1,730)	(5,897)
Cost, end of period	60,816	31,189
Accumulated depletion, depreciation and impairment, beginning of period	(5,346)	(3,370)
Depletion and depreciation for the period	(5,697)	(1,496)
Impairment	-	(1,381)
Asset disposition	36	-
Foreign currency translation	725	901
Accumulated depletion, depreciation and impairment, end of period	(10,282)	(5,346)
Net book value, end of period	50,534	25,843

General and administrative costs totaling \$0.2 million (December 31, 2020 - \$0.5 million) and finance expenses of \$nil (December 31, 2020 - \$0.6 million) that were directly related to property, plant, and equipment activities have been capitalized.

At the onset of the COVID-19 pandemic the Company determined that indications of impairment existed as at March 31, 2020 and an impairment test resulted in a \$1.4 million impairment charge on the Company's Bom Lugar field. To date in 2021, there have been no indications of impairment or impairment reversal.

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

As at and for the three and nine months ended September 30, 2021

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 6 – RIGHT-OF-USE (“ROU”) ASSETS AND LEASE LIABILITIES**

The Company’s contracts that contain leases or lease components include equipment for processing natural gas and access to land for midstream development in Brazil as well as office space in both Canada and Brazil. The net book value of the Company’s ROU assets is as follows.

	As at	
	September 30, 2021	December 31, 2020
Net book value, beginning of period	8,092	219
Additions	177	8,494
Depreciation of ROU assets	(736)	(574)
Foreign currency translation	29	(47)
Net book value, end of period	7,562	8,092

The Company’s lease liabilities are as follows:

	As at	
	September 30, 2021	December 31, 2020
Lease liabilities, beginning of period	8,310	163
Additions	177	8,494
Finance expense	1,050	706
Lease payments	(1,382)	(1,014)
Foreign currency translation	(64)	(39)
Lease liabilities, end of period	8,091	8,310
Current	496	483
Non-current	7,595	7,827
Total	8,091	8,310

The majority of the right-of-use assets and the lease liabilities are related to the lease component contained in Alvo Petro’s 10-year contract (the “Gas Treatment Agreement”) with Enerflex Ltd. (“Enerflex”).

NOTE 7 – OTHER ASSETS

Other assets represents the unamortized portion of the Company’s deferred financing costs associated with the Company’s Credit Facility.

	As at	
	September 30, 2021	December 31, 2020
Balance, beginning of period	1,128	1,790
Amortization of deferred financing costs	(479)	(650)
Foreign currency translation	3	(12)
Balance, end of period	652	1,128

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

As at and for the three and nine months ended September 30, 2021

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 8 – DECOMMISSIONING LIABILITIES**

Decommissioning liabilities are estimated based on the net ownership interest of wells, facilities and pipelines, management's estimates of costs to abandon and reclaim those wells and infrastructure, and the potential future timing of the costs to be incurred.

	As at	
	September 30, 2021	December 31, 2020
Balance, beginning of period	1,143	1,380
Liabilities incurred	16	-
Obligations settled	(4)	(5)
Revisions to obligations	(296)	-
Accretion	59	80
Foreign currency translation	(26)	(312)
Balance, end of period	892	1,143
Current	57	63
Non-current	835	1,080
Total	892	1,143

Total undiscounted cash flows, escalated at 3.0% (December 31, 2020 - 5.5%) for inflation, required to settle the Company's decommissioning liabilities are estimated to be \$3.3 million (December 31, 2020 - \$5.8 million). These estimated cash flows are discounted using an average risk-free rate of 7.1% (December 31, 2020 - 6.9%).

NOTE 9 – CREDIT FACILITY

	As at	
	September 30, 2021	December 31, 2020
Balance at beginning of period	15,423	5,027
(Repayments) advances	(9,000)	10,000
Accrued interest due upon repayment	122	396
Balance at end of period	6,545	15,423

During the three months ended June 30, 2021, the Company negotiated an amendment to the Credit Facility including a one-year extension of the maturity date to October 8, 2023, elimination of the 3% per annum interest payable upon repayments (effective April 15, 2021), and relaxation of covenants with respect to dividend payments.

Covenants

The Credit Facility contains certain customary financial and non-financial covenants, standard representations and warranties, and events of default. Financial covenants include a minimum debt service ratio of 1.30:1 and a maximum leverage ratio of 2.25:1.

Debt Service Ratio is computed based on the "Adjusted Consolidated EBITDA" to "Consolidated Debt Service". Both Adjusted Consolidated EBITDA and Consolidated Debt Service are defined terms in the Credit Facility agreement. Adjusted Consolidated EBITDA is "Consolidated EBITDA" decreased by income taxes, capital expenditures, dividends and share repurchases in the period and increased or decreased by the net change in non-cash working capital in the period. Consolidated EBITDA is defined in the Credit Facility and is reconciled to net income by adding back depletion, depreciation, impairment, finance expenses, taxes, share based compensation, unrealized gains and losses and other non-cash items. In addition, for all periods commencing on July 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, 2021

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

(being those covenant calculations ending on December 31, 2020, March 31, 2021 and June 30, 2021), Adjusted Consolidated EBITDA was increased by the Company's cash and cash equivalents as of June 30, 2020. Consolidated Debt Service is defined to include all interest and principal payments on the Company's outstanding debt and capital lease obligations for the period.

	As at	
	September 30, 2021	December 31, 2020
Adjusted Consolidated EBITDA	16,026	6,639
Consolidated Debt Service	3,244	1,858
Debt Service Ratio (Minimum of 1.30:1)	4.94:1	3.57:1

The Leverage Ratio is computed as the ratio of "Adjusted Consolidated Indebtedness" to "Consolidated EBITDA". Adjusted Consolidated Indebtedness includes all debt of the Company reduced by the portion of debt attributable to the capital lease obligation outstanding to Enerflex and the unrestricted cash balance.

	As at	
	September 30, 2021	December 31, 2020
Adjusted Consolidated Indebtedness	(1,345)	10,435
Consolidated EBITDA	22,784	7,865
Leverage Ratio (Maximum of 2:25:1)	(0.06):1	1.33:1

The Company is in compliance with all financial and non-financial covenants as of September 30, 2021.

NOTE 10 – 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.

During the three months ended September 30, 2021, Alvopetro completed a share consolidation and split (the "Share Restructuring"). Prior to the Share Restructuring, there were a total of 99,828,295 common shares of Alvopetro outstanding and as part of the Share Restructuring, 1,265,306 common shares were repurchased at a price of CAD\$1.12 per common share, representing 1.3% of the total common shares outstanding prior to the Share Restructuring. The remaining common shares participated in the 2,100 to 1 share consolidation followed immediately by a 1 to 700 share split, for an effective 3:1 share consolidation. For the current and comparative periods, all common share, stock option, warrant, restricted share units and deferred share unit quantities, as well as stock option and warrant exercise prices and diluted weighted average shares outstanding have been retrospectively adjusted to reflect the Share Restructuring.

A special resolution was approved by the Company's shareholders during the three months ended September 30, 2021 approving the reduction of the stated capital of the Company's common shares by an aggregate amount of up to CAD\$150 million without any payments on the reduction. This stated capital reduction was subsequently approved by the Board of Directors on September 21, 2021. For accounting purposes, the stated capital reduction resulted in a reduction of \$117.2 million and \$68.6 million to the Company's share capital and deficit, respectively, and a corresponding increase of \$48.6 million to contributed surplus.

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

As at and for the three and nine months ended September 30, 2021

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***Issued and Outstanding Common Shares**

	Number of Shares	Amount (\$000s)
Balance as at December 31, 2019	32,616,596	156,355
Exercise of stock options	537,204	403
Share issue costs	-	(3)
Balance as at December 31, 2020	33,153,800	156,755
Share buy-back and associated adjustments	(421,699)	(1,119)
Exercise of stock options	853,129	649
Exercise of warrants	125,000	225
Stated capital reduction	-	(117,180)
Share issue and restructuring costs	-	(61)
Balance as at September 30, 2021	33,710,230	39,269

b) Warrants

Warrants outstanding as follows are exercisable into an equal number of common shares:

	Number of Options	Weighted Average Exercise Price (\$)
Balance as at December 31, 2019	3,077,623	1.77
Expired	(266,667)	1.50
Balance as at December 31, 2020	2,810,956	1.80
Exercised	(125,000)	1.80
Balance as at September 30, 2021	2,685,956	1.80
Percentage of common shares outstanding	8.0%	

All warrants outstanding as of September 30, 2021 expire on September 20, 2022.

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 as part of the Company's long-term incentive plan to align compensation with shareholders' interests. The options outstanding at September 30, 2021 are as follows:

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

As at and for the three and nine months ended September 30, 2021

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

	Number of Options	Weighted Average Exercise Price (CAD\$)
Balance as at December 31, 2019	2,679,583	1.14
Granted	436,000	2.43
Exercise of options for common shares	(537,204)	0.87
Adjustment for net settlement of options	(286,570)	1.20
Adjustment for cash settlement of options	(41,226)	1.20
Balance as at December 31, 2020	2,250,583	1.41
Granted	20,000	2.97
Exercise of options for common shares	(853,129)	0.96
Adjustment for net settlement of options	(60,346)	0.96
Balance as at September 30, 2021	1,357,108	1.76
Percentage of common shares outstanding	4.0%	

Options Outstanding at September 30, 2021				Options Exercisable at September 30, 2021		
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\$0.60 - \$0.99	350,000	0.83	1.1	350,000	0.83	1.1
CAD\$1.00 - \$1.49	278,885	1.29	2.2	141,116	1.29	2.2
CAD\$2.00 - \$2.49	708,223	2.36	4.0	68,668	2.23	3.1
CAD\$2.50 - \$2.99	20,000	2.97	4.7	-	-	-
CAD\$0.60 - \$2.99	1,357,108	1.76	2.9	559,784	1.12	1.6

c) Restricted Share Units and Deferred Share Units

Alvopetro has an incentive share plan whereby the Company may grant restricted share units ("RSUs"), deferred share units ("DSUs") and performance share units ("PSUs") to purchase common shares of the Company.

	Number of RSUs & DSUs	Weighted Average Remaining Contractual Life (Years)
Balance as at December 31, 2020	300,000	3.9
Granted	166,665	4.8
Balance as at September 30, 2021	466,665	4.2
Percentage of common shares outstanding	1.4%	

d) Share-Based Compensation

The fair value of the stock options is estimated on the grant date using the Black-Scholes option pricing model. The fair value of the DSUs and RSUs is estimated based on the share price on the grant date. Weighted average assumptions and resultant fair values for stock options granted are as follows:

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	Three months ended September 30,		Nine months ended September 30,	
	2021	2020	2021	2020
Risk free interest rate (%)	-	-	0.71	0.45
Expected term (years)	-	-	4.0	5.4
Expected volatility (%)	-	-	45.0	45.0
Dividend per share (%)	-	-	-	-
Forfeiture rate (%)	-	-	5.0	5.0
Weighted average fair value (CAD\$)	-	-	1.06	0.96

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 income.

e) Net Income Per Share

Net income per share is calculated by dividing net income by the weighted average number of common shares outstanding during the applicable period.

	Three months ended September 30,		Nine months ended September 30,	
	2021	2020	2021	2020
Weighted average basic	32,923,238	32,817,688	32,860,300	32,799,770
Dilutive securities				
Stock options	1,019,414	386,142	915,717	2,350,166
Warrants ⁽¹⁾	900,239	11,273	583,194	5,534
RSUs & DSUs	466,667	143,478	357,387	48,175
Weighted average diluted	35,309,558	33,358,581	34,716,598	35,203,645

(1) Exercise price of warrants with USD-denominated exercise price translated to CAD at the period-end rate.

f) Dividends Declared

During the three months ended September 30, 2021, the Company declared a dividend payment of \$0.06 per common share, totaling \$2.0 million, to shareholders of record on September 29, 2021. The dividend was paid subsequent to September 30, 2021, on October 15, 2021. The declaration, timing, amount and payment of future dividends remain at the discretion of the Board of Directors.

NOTE 11 – REVENUE FROM CONTRACTS WITH CUSTOMERS

	Three months ended September 30,		Nine months ended September 30,	
	2021	2020	2021	2020
Natural gas	9,173	4,993	22,993	4,993
Condensate	779	327	2,054	367
Oil	11	-	37	61
Total	9,963	5,320	25,084	5,421

The Company's natural gas price is set semi-annually (in February and August) using a trailing weighted average basket of USD benchmark prices, with a floor and a ceiling price adjusted based on United States inflation. The natural gas price is then translated

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to Brazilian Real ("BRL") based on the average BRL relative to USD and fixed in BRL until the next price re-set date. As all invoices are issued in BRL, actual receipts and revenue recognized in equivalent USD will be subject to exchange rate variations.

The Company's oil and condensate sales revenues are derived under contracts with customers based on floating prices, specifically the Brent benchmark oil price adjusted for contracted discounts at a fixed percentage of Brent in the case of oil sales and at fixed premiums to Brent in the case of condensate sales.

Payment terms are on or before the 25th day of the month following satisfaction of the performance obligation and payments for condensate are often made in advance of shipment. For the period ended September 30, 2021 the natural gas sales revenue has been collected within the timing expected. There is no indication of potential collection issues with Bahiagás, the local distribution company in the state of Bahia in Brazil and sole customer of the Company's natural gas production.

NOTE 12 – NATURE OF OTHER INCOME AND EXPENSES**a) Other Income**

	Three months ended September 30,		Nine months ended September 30,	
	2021	2020	2021	2020
Tax recoveries from operations	508	-	508	-
Retroactive tax recoveries	390	-	390	-
Interest income	9	16	14	19
Water disposal income & other	8	(2)	18	39
Total Other Income	915	14	930	58

Upon the transition to a producing company, Alvo Petro is entitled to certain tax credits which starting in 2021 are recorded as other income. In the nine months ended September 30, 2021 the Company recorded a \$0.4 million retroactive tax recovery resulting from a change in Brazilian tax legislation.

b) Production Expenses

	Three months ended September 30,		Nine months ended September 30,	
	2021	2020	2021	2020
Personnel	69	105	198	130
Facility and pipeline	433	262	1,229	262
Other fixed	238	264	696	305
Variable	81	17	164	31
Workover	3	-	38	-
Total Production Expenses	824	648	2,325	728

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	Three months ended September 30,		Nine months ended September 30,	
	2021	2020	2021	2020
Personnel	745	365	2,015	2,173
Travel	8	1	15	14
Office and IT	39	35	110	88
Professional fees	203	104	579	262
General corporate	321	170	813	458
Total Gross G&A Expenses	1,316	675	3,532	2,995
Capitalized to E&E	(61)	(21)	(214)	(178)
Capitalized to PP&E	(116)	-	(292)	(491)
Total Net G&A Expenses	1,139	654	3,026	2,326

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.

d) Finance Expenses

	Three months ended September 30,		Nine months ended September 30,	
	2021	2020	2021	2020
Lease interest (Note 6)	364	353	1,050	356
Accretion of decommissioning liabilities (Note 8)	17	14	59	56
Amortization of deferred financing costs (Note 7)	161	147	479	474
Interest on Credit Facility (Note 9)	144	482	925	1,192
Gross Finance Expenses	686	996	2,513	2,078
Capitalized to E&E	-	-	-	(114)
Capitalized to PP&E	-	-	-	(623)
Total Net Finance Expenses	686	996	2,513	1,341

The portion of interest on the Credit Facility and the amortization of deferred financing costs that were directly attributable to eligible PP&E and E&E projects in 2020 were capitalized to those assets.

NOTE 13 – CAPITAL MANAGEMENT

The Company’s capital consists of the following:

	As at	
	September 30, 2021	December 31, 2020
Cash and cash equivalents	8,084	5,159
Non-cash working capital (deficit) surplus	(1,245)	380
Credit Facility	(6,545)	(15,423)
Working capital net of debt (net debt)	294	(9,884)
Lease liabilities – non-current	(7,595)	(7,827)
Shareholders’ equity	57,767	53,110

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Alvopetro may adjust its capital structure by issuing new equity or debt and adjusting its capital expenditure program, as allowed pursuant to contracted work commitments.

NOTE 14 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT**Overview**

The Company's financial instruments, classified as financial assets and liabilities, consist of cash and cash equivalents, restricted cash, trade and other receivables, accounts payable and accrued liabilities, other liabilities, risk management contracts and the Credit Facility.

Financial Risk

The Company is exposed to risks arising from the volatility of commodity prices, foreign exchange rates and interest rates, resulting in market risks, credit risk and liquidity risk. A description of the nature and significance of risks arising from the Company's financial instruments can be found in the notes to the audited consolidated financial statements as at and for the year ended December 31, 2020 with updated information for the current period as follows:

Market Risk

Market uncertainty associated with the COVID-19 pandemic is incorporated into management's risk assessments but given the lack of precedence continues to be difficult to predict with confidence.

Foreign Currency Risk

Alvopetro's long-term gas sales agreement ("GSA") is exposed to fluctuations in the USD to the BRL as the natural gas price, although benchmarked to USD, is set semi-annually in BRL (based on historical foreign exchange rates) and billed monthly in the set BRL price until the next price redetermination. The following table denotes the overall impact on natural gas revenues of a 5% and 10% appreciation and depreciation of the BRL relative to the USD:

	Three Months Ended		Nine Months Ended	
	September 30, 2021	2020	September 30, 2021	2020
Increase (decrease) to natural gas revenues from:				
5% Appreciation of BRL to USD	483	263	1,210	263
10% Appreciation of BRL to USD	1,019	555	2,555	555
5% Depreciation of BRL to USD	(437)	(238)	(1,095)	(238)
10% Depreciation of BRL to USD	(834)	(454)	(2,090)	(454)

To manage exposure to foreign exchange volatility with respect to the BRL, the Company has entered into BRL/USD forward exchange rate contracts. As of September 30, 2021, the Company has a total of BRL3.9 million forward exchange contracts with settlements based on fixed rates between 5.07 and 5.59 and settlement dates occurring until December 2021. The Company recognizes the fair value of these contracts in the statement of financial position, included with trade and other receivables or other liabilities, with changes in fair value recognized as an unrealized gain or loss included in earnings. Realized gains or losses are recognized in the period the contracts are settled.

The fair value of the risk management contracts as at September 30, 2021 was an asset of \$0.02 million (December 31, 2020 – liability of \$0.01 million).

The realized and unrealized losses recognized are as follows:

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Realized losses	(24)	-	(35)	-
Unrealized gains	139	-	42	-
Total gains	115	-	7	-

The following financial instruments are denominated in currencies other than the USD:

	As at			
	September 30, 2021		December 31, 2020	
	CAD (000's)	BRL (000's)	CAD (000's)	BRL (000's)
Cash and cash equivalents	609	27,586	64	4,282
Restricted cash – current	-	845	-	651
Trade and other receivables	238	23,301	40	14,156
Risk management contracts	-	120	-	(65)
Accounts payable and accrued liabilities	(850)	(17,066)	(415)	(10,371)
Net exposure in foreign currency	(3)	34,786	(311)	8,653
Net exposure in USD (\$000s)	(2)	6,395	(244)	1,665

In addition, a portion of the Company's receivable from its Brazilian subsidiary is considered to be an investment that is not permanent in nature. As a result, the Company recorded a foreign exchange loss of \$1.5 million and \$1.2 million for the three and nine months ended September 30, 2021 respectively (September 30, 2020 – nil) related to the change in the BRL to USD exchange rate on this intercompany balance.

Credit Risk

The Company is subject to increased credit risk as the Company has one customer for its natural gas production contributing to economic dependence on this one counterparty. There were no expected credit losses recognized in the nine months ended September 30, 2021 and the majority of the accounts receivable balance was collected subsequent to the end of the quarter.

Fair Value of Financial Instruments

There were no transfers of any financial instruments between levels within the fair value hierarchy during the period ended September 30, 2021.

Given the short term to maturity of the Company's current financial assets and liabilities the carrying values approximate their fair values. The Credit Facility is a level two fair value instrument and considering the recent renegotiation on terms approximating current market rates, the carrying value approximates its fair value.

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	Three months ended September 30,		Nine months ended September 30,	
	2021	2020	2021	2020
Change in:				
Trade and other receivables	(1,211)	(1,637)	(1,512)	(2,072)
Prepaid expenditures	(16)	43	(125)	340
Accounts payable and accrued liabilities	(1,229)	(183)	(938)	(300)
Dividend payable	2,023	-	2,023	-
	(433)	(1,777)	(552)	(2,032)
Changes relating to:				
Operating activities	(696)	(1,639)	(954)	(2,027)
Financing activities	151	43	278	63
Investing activities	112	(181)	124	(68)
	(433)	(1,777)	(552)	(2,032)

NOTE 16 – COMMITMENTS AND CONTINGENCIES

The following is a summary of contractual commitments as at September 30, 2021:

Commitments	< 1 Year	1-3 Years	Thereafter	Total
Minimum work commitments ⁽¹⁾				
Block 183	613	-	-	613
Bom Lugar	-	64	-	64
Mãe-da-lua	-	-	64	64
Minimum work commitments	613	64	64	741
Gas Treatment Agreement	1,247	3,054	8,781	13,082
Total commitments	1,860	3,118	8,845	13,823

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.

Amounts presented above for the Gas Treatment Agreement represent the monthly service fees for operation and maintenance of the Facility and Alvopetro's 11-kilometre transfer pipeline and anticipated monthly costs associated with the facility expansion expected to be completed in June 2022.

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