

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

(Unaudited, thousands of United States dollars)

	Note	June 30, 2014	December 31, 2013
ASSETS			
Current			
Cash and cash equivalents		\$ 54,667	\$ 100,268
Restricted cash	3	11,068	-
Trade and other receivables		486	342
Prepaid expenditures		342	147
Total current assets		66,563	100,757
Restricted cash	3	15,951	-
Other assets		877	-
Exploration and evaluation assets	4	59,459	45,002
Property, plant and equipment	5	10,188	9,697
Non-current assets		86,475	54,699
Total assets		\$ 153,038	\$ 155,456
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		\$ 2,859	\$ 2,250
		2,859	2,250
Deferred tax liability		3,495	3,791
Decommissioning liabilities	6	3,209	2,833
		9,563	8,874
Shareholders' equity			
Share capital	7	151,937	151,937
Contributed surplus		522	74
Deficit		(9,004)	(3,679)
Accumulated other comprehensive loss		20	(1,750)
Total shareholders' equity		143,475	146,582
Total liabilities and shareholders' equity		\$ 153,038	\$ 155,456

Commitments and contingencies (Note 11)

See accompanying notes to these interim condensed consolidated financial statements.

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

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

Note	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Revenue and other income				
Oil sales	\$ 323	\$ 401	\$ 637	\$ 699
Royalties and production taxes	(33)	(19)	(67)	(34)
Oil and gas revenue	290	382	570	665
Other income	114	-	266	30
Total revenue and other income	404	382	836	695
Expenses				
Production	363	429	687	659
Transportation	15	22	26	20
General and administrative	1,653	1,358	2,757	2,162
Depletion and depreciation	89	128	180	209
Accretion of decommissioning liabilities	6 29	-	52	6
Share-based compensation	7 154	101	316	201
Foreign exchange (gain) loss	(119)	(19)	2,415	(15)
Total expenses	2,184	2,019	6,433	3,242
Loss before taxes and non-controlling interest	(1,780)	(1,637)	(5,597)	(2,547)
Income tax (recovery) expense	(476)	7	(272)	18
Net loss	(1,304)	(1,644)	(5,325)	(2,565)
Exchange gain (loss) on translation of foreign operations	774	(2,228)	1,770	(2,039)
Comprehensive loss	\$ (530)	\$ (3,872)	\$ (3,555)	\$ (4,604)
Net loss attributable to:				
Common shareholders	(1,304)	(1,273)	(5,325)	(2,003)
Non-controlling interest	-	(371)	-	(562)
Net loss	\$ (1,304)	\$ (1,644)	\$ (5,325)	\$ (2,565)
Comprehensive loss attributable to:				
Common shareholders	(530)	(2,944)	(3,555)	(3,532)
Non-controlling interest	-	(928)	-	(1,072)
Comprehensive loss	\$ (530)	\$ (3,872)	\$ (3,555)	\$ (4,604)
Net loss per share attributable to common shareholders				
Basic	(0.02)	(0.01)	(0.06)	(0.02)
Diluted	(0.02)	(0.01)	(0.06)	(0.02)

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)

	Note	Six months ended June 30,		
		2014	2013	
		Alvopetro Shareholders' Equity	Net Investment	Non-controlling Interest
Share capital				
Balance, beginning of period		\$ 151,937	\$ -	\$ -
Issued during the period		-	-	-
Balance, end of period		\$ 151,937	\$ -	\$ -
Contributed surplus				
Balance, beginning of period		\$ 74	\$ -	\$ -
Share-based compensation expense	7	316	-	-
Share-based compensation capitalized	7	132	-	-
Balance, end of period		\$ 522	\$ -	\$ -
Deficit				
Balance, beginning of period		\$ (3,679)	\$ -	\$ -
Net loss		(5,325)	-	-
Balance, end of period		\$ (9,004)	\$ -	\$ -
Accumulated other comprehensive income (loss)				
Balance, beginning of period		\$ (1,750)	-	-
Other comprehensive income		1,770	-	-
Balance, end of period		\$ 20	\$ -	\$ -
Net Investment				
Balance, beginning of period		\$ -	\$ 37,094	\$ 10,326
Net loss		-	(2,003)	(562)
Other comprehensive loss		-	(1,529)	(510)
Contributions and net change in investment		-	2,293	-
Share-based compensation expense	7	-	201	-
Balance, end of period		\$ -	\$ 36,056	\$ 9,254

See accompanying notes to these interim condensed consolidated financial statements.

ALVOPETRO ENERGY LTD.
INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW
(Unaudited, thousands of United States dollars)

		Three months ended June 30,		Six months ended June 30,	
	Note	2014	2013	2014	2013
Operating Activities					
Net loss		\$ (1,304)	\$ (1,644)	\$ (5,325)	\$ (2,565)
Adjustments for non-cash items:					
Depletion and depreciation		89	128	180	209
Accretion of decommissioning liability	6	29	-	52	6
Deferred tax expense		(488)	-	(297)	-
Share-based compensation	7	154	101	316	201
Unrealized foreign exchange (gain) loss		(373)	-	165	-
		(1,893)	(1,415)	(4,909)	(2,149)
Changes in non-cash working capital		(379)	39	(195)	36
		(2,272)	(1,376)	(5,104)	(2,113)
Investing Activities					
Expenditures on exploration and evaluation assets	4	(5,165)	(473)	(12,245)	(617)
Expenditures on property, plant and equipment	5	(51)	(74)	(342)	(183)
Expenditures on other assets		(877)	-	(877)	-
Change in restricted cash	3	620	-	(26,689)	-
Changes in non-cash working capital		(2,176)	-	58	-
		(7,649)	(547)	(40,095)	(800)
Financing Activities					
Net contributions from Petrominerales Ltd.	1	-	1,825	-	2,293
		-	1,825	-	2,293
Change in cash and cash equivalents		(9,921)	(98)	(45,199)	(620)
Effect of foreign exchange on cash balances		183	(1)	(402)	(148)
Cash and cash equivalents, beginning of period		64,405	460	100,268	1,129
Cash and cash equivalents, end of period		\$ 54,667	\$ 361	\$ 54,667	\$ 361
Cash and cash equivalents consist of:					
Cash		\$ 54,667	\$ 361	\$ 54,667	\$ 361
Cash equivalents		\$ -	\$ -	\$ -	\$ -

See accompanying notes to these interim condensed consolidated financial statements.

ALVOPETRO ENERGY LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As at June 30, 2014 and December 31, 2013, and for the three and six months ended June, 2014 and 2013

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

NOTE 1 – CORPORATE INFORMATION AND BASIS OF PRESENTATION

Alvopetro Energy Ltd. (“Alvopetro” or “the Company”) is engaged in the exploration, development and production of hydrocarbons in Brazil. Alvopetro is a publicly traded company listed on the TSX Venture Exchange (TSXV: ALV.V), was incorporated under the Business Corporations Act (Alberta) on September 25, 2013 as 1774501 Alberta Ltd., and subsequently changed its name to Alvopetro Energy Ltd. on November 19, 2013. The Company’s head office and records are located at 1175, 332 6th Avenue S.W., Calgary, Alberta, Canada, T2P 0B2.

The interim condensed consolidated financial statements for the three and six months ended June 30, 2014 and June 30, 2013 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, 2013, except as noted in Note 2 below with respect to the adoption of new accounting standards. 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, 2013.

These interim condensed consolidated financial statements were authorized for issuance by the Company’s Board of Directors on August 20, 2014.

2013 Arrangement

On September 29, 2013, Petrominerales Ltd. (“Petrominerales”), Pacific Rubiales Energy Corp. (“Pacific Rubiales”), and 1774501 Alberta Ltd. (now Alvopetro Energy Ltd. and at that time a wholly-owned subsidiary of Petrominerales) entered into an agreement pursuant to which the parties agreed to complete an arrangement (the “Arrangement”) under section 193 of the Business Corporations Act (Alberta). Under the Arrangement, Pacific Rubiales acquired Petrominerales, with each Petrominerales shareholder receiving cash consideration of Canadian dollars (“CAD”) \$11.00 and one common share of Alvopetro for each Petrominerales share held. On November 27, 2013, Petrominerales shareholders approved the Arrangement which was completed on November 28, 2013.

In connection with the Arrangement, Petrominerales transferred to Alvopetro its entire interest in the Recôncavo, Tucano, Camamu-Almada and Sergipe-Alagoas basins onshore Brazil consisting of three producing fields and 16 exploration blocks (the “Brazil Properties”) and approximately \$85.6 million (CAD\$91.0 million) in cash. Following completion of the Arrangement, Alvopetro began carrying on the exploration, development and production previously carried on by Petrominerales with respect to the Brazil Properties.

Transactions occurring prior to the Arrangement on November 28, 2013 were derived from the accounting records of Petrominerales. The Brazil Properties now owned by Alvopetro were acquired by Petrominerales on December 11, 2012 and the financial information from this date to November 28, 2013 is intended to be representative of the Brazil Properties had Alvopetro been operating them as a stand-alone entity, subject to Petrominerales’ control, during this time. The financial information related to this period has been prepared by Alvopetro’s management in accordance with IFRS and requires the use of significant judgments made in allocating reported amounts related to the Brazil Properties. In the opinion of management, these interim condensed consolidated financial statements reflect all adjustments necessary to present fairly the interim condensed consolidated statements of the financial position and the results of operations in accordance with IFRS, however they may not reflect Alvopetro’s financial position, results of operations and cash flows had the Company been operating in its current structure for the reporting periods presented in these interim condensed consolidated financial statements during which time it was a subsidiary of Petrominerales.

Presentation of the Interim Condensed Consolidated Statements of Financial Position

As Alvopetro Energy Ltd. was a wholly-owned subsidiary of Petrominerales until the closing of the Arrangement, the transfer of assets and liabilities was recorded by the Company at the carrying amounts recorded in Petrominerales’ consolidated statement of financial position at the time of the transfer, other than certain amounts that are recorded as exploration and evaluation assets

ALVOPETRO ENERGY LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As at June 30, 2014 and December 31, 2013, and for the three and six months ended June, 2014 and 2013

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by Alvopectro rather than goodwill with respect to the December 11, 2012 acquisition, as explained in Note 5 in the December 31, 2013 audited consolidated financial statements.

Presentation of the Interim Condensed Consolidated Statements of Operations and Comprehensive Loss

All revenue, royalties and production taxes, operating expenses and transportation expenses on the interim condensed consolidated statements of operations and comprehensive loss are directly attributable to the Brazil Properties now owned by Alvopectro. General and administrative expenses recorded prior to the Arrangement have been determined based on actual Brazil general and administrative expenses and time charges by Petrominerales' employees to the Brazil Properties. Share-based compensation recorded by Petrominerales up to the Arrangement date has been allocated to Alvopectro based on the percentage of the direct time charged to the Brazil Properties divided by total general and administrative costs for the Petrominerales Calgary office. For reporting periods after the date of the Arrangement, amounts recorded for general and administrative and share-based compensation expenses are based on amounts incurred by Alvopectro as a stand-alone entity.

Presentation of the Interim Condensed Consolidated Statements of Changes in Equity

For reporting periods prior to the Arrangement, Petrominerales' direct ownership of the net assets is shown as a net investment because share capital did not exist. Petrominerales' investment includes the accumulated net loss and net cash investments, including any foreign exchange translation effect of the foreign operations in Brazil. At the close of the Arrangement, the carrying amount of the net investment of \$151.9 million was ascribed to the common share capital of Alvopectro.

Segmented Operations

All oil sales revenue is derived from Brazilian operations. All material exploration and evaluation assets and property, plant and equipment are located in Brazil. The majority of the Company's cash as well as all current and non-current restricted cash is located in Canada as at June 30, 2014. The Company does not have any significant income in Canada other than interest earned on cash balances.

NOTE 2 – CHANGES IN ACCOUNTING STANDARDS

New Accounting Standards

The interim condensed consolidated financial statements have been prepared following the same accounting policies and methods of computation as the 2013 annual consolidated financial statements with the exception of the following new standards and interpretations adopted on January 1, 2014:

Standard and Description	Adoption Impact on Interim Financial Statements
IAS 32 <i>Financial Instruments: Presentation</i> - addresses inconsistencies when applying the offsetting criteria outlined in this standard. These amendments clarify certain of the criteria required to be met in order to permit the offsetting of financial assets and financial liabilities.	Adoption of this standard did not impact these interim financial statements.
IFRIC 21 <i>Levies</i> - clarifies the requirements for recognizing a liability for a levy imposed by a government.	Adoption of this standard did not impact these interim financial statements.
IAS 36 – <i>Impairment of assets</i> – requires additional disclosure on the recoverable amount of an impaired Cash Generating Unit.	Adoption of this standard did not impact these interim financial statements.

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

As at June 30, 2014 and December 31, 2013, and for the three and six months ended June, 2014 and 2013

*All tabular amounts are expressed in thousands of United States dollars, except share and per share amounts or as otherwise noted***Standards issued but not yet effective**

The Company continues to assess the impact of adopting new standards as described in the 2013 annual consolidated financial statements as well as any new pronouncements from the International Accounting Standards Board including the following:

- IFRS 9 *Financial Instruments* which provides requirements for the classification and measurement of financial assets. This standard does not yet have a mandatory effective date but early adoption is allowed.
- IFRS 15 *Revenue from Contracts with Customers* which supersedes IAS 18 *Revenue*, IAS 11, *Construction Contracts* and certain revenue-related interpretations. This standard will be effective for annual periods beginning on or after January 1, 2017.

NOTE 3 – RESTRICTED CASH AND CREDIT FACILITY

	As at	
	June 30, 2014	December 31, 2013
Restricted cash – current	\$ 11,068	\$ -
Restricted cash – non-current	15,951	-
Balance, end of period	\$ 27,019	\$ -

In the first quarter of 2014, the Company entered into a credit support facility (the “Facility”) with a Canadian bank, for up to CAD\$30.0 million which was increased to CAD \$45.0 million subsequent to June 30, 2014. This Facility allows for the issuance of letters of credit and letters of guarantee in support of the financial guarantees required by the National Agency of Petroleum, Natural Gas and Biofuels (the “ANP”), an agency of the Brazil government, for Alvo Petro’s work commitments under the terms of its concession contracts as discussed further in Note 11. These types of financial guarantees for work commitments are required by the ANP for all operators in Brazil.

Pursuant to the terms of the Facility, the issuance of letters of credit and letters of guarantee must be fully cash collateralized by Alvo Petro. Cash collateral amounts posted by Alvo Petro may at times be in excess of actual committed amounts due to additional amounts required to be deposited for foreign currency risk margins, in accordance with the terms of our Facility. During the six months ended June 30, 2014, the Company issued irrevocable letters of credit through the Facility for a total of Brazilian real (“BRL”) 51.3 million and, accordingly, posted cash collateral of approximately \$26.7 million, of which \$10.8 million is classified as current and \$16.0 million is classified as non-current at June 30, 2014. The Company earns interest income on these cash deposits under the Facility at rates of between 0.21 and 0.35 percent per annum based on current terms. Subsequent to June 30, 2014, the Company issued additional letters of credit of BRL 6.1 million and posted cash collateral of approximately \$3.1 million. Additional letters of credit and letters of guarantee, and any required accompanying cash collateralization, will be issued and posted, as applicable and as required, for any future blocks acquired by Alvo Petro in Brazil.

There is an additional \$0.3 million of cash collateral posted with respect to corporate credit cards which is classified as current.

NOTE 4 – EXPLORATION AND EVALUATION ASSETS

	As at	
	June 30, 2014	December 31, 2013
Balance, beginning of period	\$ 45,002	\$ 35,530
Capital expenditures	12,245	5,606
Capitalized share-based compensation	100	7
Transfer from other assets	-	6,886
Change in decommissioning liabilities	135	59
Foreign currency translation	1,977	(3,086)
Balance, end of period	\$ 59,459	\$ 45,002

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

As at June 30, 2014 and December 31, 2013, and for the three and six months ended June, 2014 and 2013

*All tabular amounts are expressed in thousands of United States dollars, except share and per share amounts or as otherwise noted***NOTE 5 – PROPERTY, PLANT AND EQUIPMENT**

	As at	
	June 30, 2014	December 31, 2013
Cost, beginning of period	\$ 10,529	\$ 7,535
Capital expenditures	342	1,217
Capitalized share-based compensation	32	5
Change in decommissioning liabilities	-	2,004
Foreign currency translation	313	(232)
Cost, end of period	\$ 11,216	\$ 10,529
Accumulated depletion and depreciation, beginning of period	(832)	(26)
Depletion and depreciation for the period	(180)	(403)
Impairment	-	(431)
Foreign currency translation	(16)	28
Accumulated depletion and depreciation, end of period	(1,028)	(832)
Net book value, end of period	\$ 10,188	\$ 9,697

NOTE 6 – DECOMMISSIONING LIABILITIES

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

	As at	
	June 30, 2014	December 31, 2013
Balance, beginning of period	\$ 2,833	\$ 1,014
Liabilities incurred	135	59
Revisions to obligations	-	2,004
Accretion	52	79
Foreign currency translation	189	(323)
Balance, end of period	\$ 3,209	\$ 2,833

Total undiscounted cash flows, escalated at 6.0% for inflation, required to settle the Company's decommissioning provision are estimated to be \$5.4 million (December 31, 2013 – \$4.9 million) and have been discounted using an average risk free rate of 3.38%, which represents an estimated U.S. Treasury bill rate for a period of 15 years, the average remaining years to abandonment.

NOTE 7 – 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.

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

As at June 30, 2014 and December 31, 2013, and for the three and six months ended June, 2014 and 2013

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

	Number of Shares	Amount (\$000s)
Balance as at June 30, 2014 and December 31, 2013	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 volume weighted five-day 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. Alvopetro granted 2,995,436 stock options on December 16, 2013 and another 72,000 options during the three months ended June 30, 2014.

Exercise Price	Options Outstanding	Remaining Contractual Life (years)	Options Exercisable	Remaining Contractual Life (years)
CAD\$1.02	2,995,436	4.46	-	-
CAD\$1.10	72,000	4.95	-	-
	3,067,436	4.47	-	-

d) Share-Based Compensation

The fair value of the stock options granted in 2014 has been estimated on the grant date using the Black-Scholes option pricing model, assuming a risk-free interest rate of 1.31%, an expected term of 4.0 years and expected volatility of 50%, for a resultant fair value of CAD\$0.51 per option. Total share-based compensation of \$225,000 and \$448,000 (June 30, 2013 – \$nil), respectively was computed for the three and six months ended June 30, 2014 relating to options granted under Alvopetro's stock option plan. Of this amount, approximately \$71,000 and \$132,000 (June 30, 2013 - \$nil), respectively was capitalized to exploration and evaluation assets and property, plant and equipment, for the three and six months ended June 30, 2014, with the remainder recognized as share-based compensation expense on the interim condensed consolidated statements of operations and comprehensive loss.

Share-based compensation for the periods preceding the Arrangement on November 28, 2013 represent an allocated portion of Petrominerales' share-based compensation expense based on time charged to the Brazil Properties by Petrominerales employees. The total share-based compensation expense of \$0.2 million recognized for the six months ended June 30, 2013, relates to this allocation of Petrominerales' share-based compensation.

e) Net Loss Per Share Attributable to Common Shareholders

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

	Three and six months ended June 30,	
	2014	2013
Weighted average common shares outstanding, basic and diluted	85,166,871	85,166,871

ALVOPETRO ENERGY LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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In determination of the weighted average number of diluted common shares outstanding for the three and six months ended June 30, 2014, all stock options were excluded because the effect would be anti-dilutive. As there were no shares outstanding for Alvo Petro at June 30, 2013, the per share amounts for the period ended June 30, 2013 are based on the number of shares issued pursuant to the Arrangement.

NOTE 8 – CAPITAL MANAGEMENT

Alvo Petro 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.

At June 30, 2014 the Company's net working capital surplus was \$63.7 million (December 31, 2013 - \$98.5 million) which includes \$54.7 million (December 31, 2013 - \$100.3 million) of cash and \$11.1 million (December 31, 2013 - \$nil) of current restricted cash but excludes non-current restricted cash of \$16.0 million (December 31, 2013 - \$nil).

The Company's current portion of restricted cash of \$11.1 million includes \$10.8 million of cash collateral pledged for letters of credit associated with work commitments in Brazil expiring within the next twelve months (ranging from November 2014 to May 2015). The cash posted as collateral for these letters of credit may be available earlier pending completion of the related work commitments. Additional current restricted cash relates to cash pledged for corporate credit cards (\$0.3 million).

Alvo Petro has \$16.0 million of non-current restricted cash related to collateral posted for work commitments in Brazil for letters of credit with expiry dates subsequent to June 30, 2015 (March 2017 to November 2017). Funds may be made available to Alvo Petro earlier pending completion of the related work commitments.

Alvo Petro has the ability to adjust its capital structure by issuing new equity or debt and making adjustments to its capital expenditure program, other than with respect to work commitments. The Company considers its capital structure at this time to include shareholders' equity which at June 30, 2014 was \$143.5 million (December 31, 2013 - \$146.6 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 programs.

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

NOTE 9 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

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

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.

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

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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 Alvo Petro's financial instruments at June 30, 2014 is as follows. The Company does not currently have any fair value measurements classified as Level 2 or Level 3.

	June 30, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Carried at fair value through profit or loss				
Cash and cash equivalents ⁽¹⁾	54,667	54,667	100,268	100,268
Restricted cash – current and long-term ⁽¹⁾⁽²⁾	27,019	27,019	-	-
	81,686	81,686	100,268	100,268
Carried at cost or amortized cost				
Trade and other receivables	486	486	342	342
Accounts payable and accrued liabilities	(2,859)	(2,859)	(2,250)	(2,250)
	(2,373)	(2,373)	(1,908)	(1,908)

(1) Level 1

(2) Restricted cash balances include amounts pledged as collateral for work commitments (Note 3).

Risks Associated with Financial Assets and Liabilities

The nature of Alvo Petro's operations exposes the Company to credit risk, foreign currency risk, commodity price risk, interest rate risk, and liquidity risk. The Company has several practices and policies in place to help mitigate these risks. A description of the nature and extent of risks arising from the Company's financial instruments can be found in the notes to the audited consolidated financial statements for the year ended December 31, 2013. The Company's exposure to these risks has not changed significantly since then, other than with respect to foreign currency risk as during the six months ended June 30, 2014 the Company converted approximately CAD\$84.8 million of Canadian dollars held at December 31, 2013 to U.S. dollars ("USD") of \$77.5 million. The following financial instruments were denominated in currencies other than USD as at June 30, 2014 and December 31, 2013:

	As at			
	June 30, 2014		December 31, 2013	
	CAD (000's)	BRL (000's)	CAD (000's)	BRL (000's)
Cash and cash equivalents	3,641	787	90,727	2,075
Restricted cash – current	350	-	-	-
Trade and other receivables	46	921	7	785
Accounts payable and accrued liabilities	(37)	(4,775)	(31)	(3,264)
Net exposure in foreign currency	4,000	(3,067)	90,703	(404)
Net exposure in USD (\$000s)	3,749	(1,393)	85,280	(173)

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

As at June 30, 2014 and December 31, 2013, and for the three and six months ended June, 2014 and 2013

*All tabular amounts are expressed in thousands of United States dollars, except share and per share amounts or as otherwise noted***NOTE 10 – RELATED PARTY TRANSACTIONS**

Alvopetro is party to non-material office-related administrative transactions with Touchstone Exploration Inc. (formerly Petrobank Energy and Resources Ltd.), a related party of the Company due to common directors. These transactions include administrative consulting fees and office sub-lease expenses charged to Alvopetro, summarized as follows:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2014	2013	2014	2013
Office rent and related costs	\$ 57	\$ -	\$ 113	\$ -
Administrative consulting fees	\$ 1	\$ -	\$ 7	\$ -

As at June 30, 2014, the Company owed Touchstone \$nil (June 30, 2013 - \$nil).

NOTE 11 – COMMITMENTS AND CONTINGENCIES

The following is a summary of contractual commitments as at June 30, 2014:

Commitments	< 1 Year	1-3 Years	Thereafter	Total
Minimum work commitments ⁽¹⁾	\$ 9,672	\$ 15,949	\$ 431	\$ 26,052
Office leases ⁽²⁾	266	98	-	364
Total commitments	\$ 9,938	\$ 16,047	\$ 431	\$ 26,416

Notes:

- (1) Under the terms of the ANP concession contracts for each of our exploration blocks, the Company has work commitments which must be completed prior to the applicable phase expiry date. Amounts above include the one well commitment required under the current exploratory phase of Block 197, fulfilled by our 197(1) well drilled on this block during the three months ended March 31, 2014, subject to ANP approval. Alvopetro has applied to the ANP for an extension to the work commitment phase deadline for our 9th Brazil Bid Round blocks. While we expect that this will be granted, the Company cannot guarantee that the ANP will grant the requested extension. To the extent the extension is not granted on one or more of the requested blocks, the associated concession contract(s) may be revoked, amounts recognized as exploration and evaluation assets with respect to these blocks may be subject to impairment at that time, and Alvopetro may be required to pay to the ANP an amount representing the value, calculated pursuant to the contract, of the unfulfilled portion of the related work commitments, estimated as up to a maximum of \$9.7 million for all of our 9th Brazil Bid Round blocks.
- (2) The Company is committed to future minimum payments for office space in Canada and Brazil.

Alvopetro's activities in Brazil are subject to minimum local content requirements with respect to materials and supplies utilized. The specific local content requirements for the exploration phase were determined during the bidding process for each particular block and are assessed at the phase expiry date. Management undertakes considerable effort to adhere to these requirements; however, there may be circumstances when it is not advantageous 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 fine, 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 fines and, as of June 30, 2014, the potential estimated fine is not material.