



INTERIM FINANCIAL STATEMENTS
JUNE 30, 2018

NOTICE TO READER

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

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

(Unaudited, thousands of United States dollars)

	Note	June 30, 2018	December 31, 2017
ASSETS			
Current			
Cash and cash equivalents		5,839	9,189
Restricted cash		91	106
Trade and other receivables		211	153
Prepaid expenditures		100	208
Assets held for sale	3	203	236
Total current assets		6,444	9,892
Exploration and evaluation assets	4	36,532	54,585
Property, plant and equipment	5	19,174	4,238
Non-current assets		55,706	58,823
Total assets		62,150	68,715
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		972	1,111
Current portion of decommissioning liabilities	6	18	19
Total current liabilities		990	1,130
Long-term liabilities	7	608	-
Decommissioning liabilities	6	1,409	1,445
Total liabilities		3,007	2,575
Shareholders' equity			
Share capital	8	151,937	151,937
Contributed surplus		1,693	1,662
Deficit		(69,524)	(67,507)
Accumulated other comprehensive loss		(24,963)	(19,952)
Total shareholders' equity		59,143	66,140
Total liabilities and shareholders' equity		62,150	68,715

Commitments and contingencies (Note 14)

See accompanying notes to these interim condensed consolidated financial statements.

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

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

		Three months ended June 30,		Six months ended June 30,	
	Note	2018	2017	2018	2017
Revenue					
Oil sales		216	86	332	257
Royalties and production taxes		(19)	(12)	(32)	(29)
Oil revenue		197	74	300	228
Other income		37	54	66	100
Total revenue and other income		234	128	366	328
Expenses					
Production	13	179	250	415	465
Transportation		5	4	9	13
General and administrative	13	758	599	1,472	1,302
Depletion and depreciation	5	54	45	87	113
Impairment	4	196	-	196	-
Exploration and evaluation expenses		141	(6)	153	57
Accretion of decommissioning liabilities	6	10	9	20	18
Share-based compensation	8	24	21	27	46
Loss on disposition of assets		-	18	-	18
Foreign exchange (gain) loss		(5)	2	4	3
Total expenses		1,362	942	2,383	2,035
Loss before taxes		(1,128)	(814)	(2,017)	(1,707)
Income tax expense		-	-	-	-
Net loss		(1,128)	(814)	(2,017)	(1,707)
Exchange loss on translation of foreign operations		(4,821)	(1,534)	(5,011)	(622)
Comprehensive loss		(5,949)	(2,348)	(7,028)	(2,329)
Net loss per share					
	8				
Basic		(0.01)	(0.01)	(0.02)	(0.02)
Diluted		(0.01)	(0.01)	(0.02)	(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,	
		2018	2017
Common Shares			
Balance, beginning of period		151,937	151,937
Net change		-	-
Balance, end of period		151,937	151,937
Contributed surplus			
Balance, beginning of period		1,662	1,558
Share-based compensation expense	8	27	46
Share-based compensation capitalized		4	12
Balance, end of period		1,693	1,616
Deficit			
Balance, beginning of period		(67,507)	(60,390)
Net loss		(2,017)	(1,707)
Balance, end of period		(69,524)	(62,097)
Accumulated Other Comprehensive Loss			
Balance, beginning of period		(19,952)	(19,330)
Other comprehensive loss		(5,011)	(622)
Balance, end of period		(24,963)	(19,952)

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)

	Note	Three months ended June 30,		Six months ended June 30,	
		2018	2017	2018	2017
Operating Activities					
Net loss		(1,128)	(814)	(2,017)	(1,707)
Adjustments for non-cash items:					
Depletion and depreciation	5	54	45	87	113
Impairment		196	-	196	-
Accretion of decommissioning liabilities	6	10	9	20	18
Share-based compensation	8	24	21	27	46
Loss on disposition of assets		-	18	-	18
Unrealized foreign exchange loss		1	12	2	18
Settlement of decommissioning liabilities	6	(1)	(14)	(1)	(26)
Funds flow from operations		(844)	(723)	(1,686)	(1,520)
Changes in non-cash working capital	11	(191)	(616)	(77)	(501)
		(1,035)	(1,339)	(1,763)	(2,021)
Investing Activities					
Expenditures on exploration and evaluation assets		(598)	(544)	(1,872)	(2,909)
Expenditures on property, plant and equipment		(332)	(22)	(334)	(30)
Proceeds on disposition of assets	4	59	55	59	82
Long-term liabilities	7	608	-	608	-
Changes in non-cash working capital	11	(268)	(307)	126	(531)
		(531)	(818)	(1,413)	(3,388)
Change in cash and cash equivalents		(1,566)	(2,157)	(3,176)	(5,409)
Effect of foreign exchange on cash balances		(137)	184	(174)	200
Cash and cash equivalents, beginning of period		7,542	14,552	9,189	17,788
Cash and cash equivalents, end of period		5,839	12,579	5,839	12,579
Cash and cash equivalents consist of:					
Cash		1,286	2,474	1,286	2,474
Cash equivalents		4,553	10,105	4,553	10,105
Supplemental information:					
Cash income taxes paid		-	-	-	-
Cash interest income received		28	57	58	91

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 six months ended June 30, 2018

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

NOTE 1 – CORPORATE INFORMATION AND BASIS OF PRESENTATION

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

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

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

These interim condensed consolidated financial statements were authorized for issuance by the Company’s Board of Directors on August 15, 2018.

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

Segmented Operations

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

NOTE 2 – CHANGES IN ACCOUNTING STANDARDS

New and Revised Accounting Standards

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

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

Standards issued but not yet effective

The Company has reviewed the following new and revised accounting pronouncement that has been issued but is not yet effective and may have a potential impact on the consolidated financial statements of the Company:

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

As at and for the three and six months ended June 30, 2018

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

Standard and Description	Date of Adoption	Expected Adoption Impact on Consolidated 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 3 – ASSETS HELD FOR SALE

	As at	
	June 30, 2018	December 31, 2017
Balance, beginning of period	236	410
Transferred from E&E (Note 4)	-	322
Disposal – cash proceeds	-	(105)
Disposal – in exchange for drilling services	-	(396)
Foreign currency translation	(33)	5
Balance, end of period	203	236

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

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

	As at	
	June 30, 2018	December 31, 2017
Balance, beginning of period	54,585	53,259
Capital expenditures	1,872	5,355
Capitalized share-based compensation	2	18
Change in decommissioning liabilities	170	189
Transfer to PP&E (Note 5)	(15,184)	-
Transfer to assets held for sale (Note 3)	-	(322)
Other transfers	(2)	10
Asset dispositions	(59)	(122)
Impairment	(196)	(3,189)
Foreign currency translation	(4,656)	(613)
Balance, end of period	36,532	54,585

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

Pursuant to the Company’s E&E accounting policy, E&E assets are transferred to PP&E when the assets are considered technically feasible and commercially viable which is generally when proved and/or probable reserves have been assigned. Accordingly, the \$15.2 million carrying value of the Caburé natural gas field was transferred to PP&E as at May 31, 2018, the effective date of the independent reserves evaluation, as management considers that technical feasibility and commercial viability criteria have been

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

As at and for the three and six months ended June 30, 2018

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

met. At the time of the transfer to PP&E, the Company tested the asset for impairment and, as the estimated recoverable amount exceeded the carrying value, no impairment was recorded.

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

During the three months ended June 30, 2018 the Company disposed of equipment inventory classified as E&E assets in several separate transactions, all to third parties of Alvo Petro. Total proceeds were \$0.06 million, resulting in no gain or loss on the transactions.

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

General and administrative costs totaling \$0.5 million (December 31, 2017 - \$1.1 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.

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

	As at	
	June 30, 2018	December 31, 2017
Cost, beginning of period	9,514	9,599
Capital expenditures	334	77
Capitalized share-based compensation	2	1
Transferred from E&E assets (Note 4)	15,184	-
Foreign currency translation	(1,821)	(163)
Cost, end of period	23,213	9,514
Accumulated depletion and depreciation and impairment, beginning of period	(5,276)	(4,739)
Depletion and depreciation for the period	(87)	(205)
Impairment	-	(472)
Foreign currency translation	1,324	140
Accumulated depletion and depreciation and impairment, end of period	(4,039)	(5,276)
Net book value, end of period	19,174	4,238

The balance transferred from E&E represents the carrying value of the Caburé natural gas field for which the Company has a 49.1% working interest. The Company is party to a unitization agreement (“UOA”) with the adjacent concession holder and Alvo Petro's operating partner. Pursuant to this agreement, substantially all the 2018 and 2019 field development will initially be funded by this third-party, with Alvo Petro's share due upon commencement of production allocations, or March 2020, whichever occurs first. During the three months ended June 30, 2018 capital expenditures related to this arrangement totaled \$0.6 million, \$0.3 million incurred while the property was still classified as E&E assets and \$0.3 million subsequent to the transfer to PP&E.

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

As at and for the three and six months ended June 30, 2018

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

General and administrative costs that were directly related to property, plant, and equipment activities have been capitalized.

NOTE 6 – DECOMMISSIONING LIABILITIES

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

	As at	
	June 30, 2018	December 31, 2017
Balance, beginning of period	1,464	1,399
Liabilities incurred	209	189
Revisions to obligations	(39)	-
Obligations settled	(1)	(139)
Accretion	20	37
Foreign currency translation	(226)	(22)
Balance, end of period	1,427	1,464

Total undiscounted cash flows, escalated at a weighted average rate of 6.1% (December 31, 2017 - 6.5%) for inflation, required to settle the Company's decommissioning liabilities are estimated to be \$2.2 million (December 31, 2017 - \$2.3 million) and have been discounted using an average risk-free rate of 2.9% (December 31, 2017 - 2.5%), which represents an estimated U.S. Treasury bill rate for a period of 15 years, the approximate weighted average remaining years to abandonment.

The Company expects to incur \$0.02 million (December 31, 2017 - \$0.02 million) of decommissioning costs within one year from June 30, 2018 and accordingly this amount is classified as current on the consolidated statements of financial position. The Company recorded a revision to decommissioning liabilities associated with the Caburé and Gomo natural gas assets as the timing of abandonment and reclamation was adjusted to coincide with the independent reserve report.

NOTE 7 – LONG-TERM LIABILITIES

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

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

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

b) Issued and Outstanding Common Shares

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

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

As at and for the three and six months ended June 30, 2018

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

c) Options to Purchase Common Shares

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

	Number of Options	Weighted Average Exercise Price (CAD\$)
Balance as at December 31, 2016	6,874,102	0.53
Granted	64,000	0.19
Expired	(352,166)	0.65
Forfeited	(47,000)	0.28
Balance as at December 31, 2017	6,538,936	0.52
Granted	1,302,250	0.33
Balance as at June 30, 2018	7,481,186	0.49

Options Outstanding at June 30, 2018				Options Exercisable at June 30, 2018		
Exercise Price	Number of Options	Weighted Average Exercise Price (CAD\$)	Weighted Average Remaining Contractual Life (years)	Number of Options	Weighted Average Exercise Price (CAD\$)	Weighted Average Remaining Contractual Life (years)
CAD\$0.18 - \$0.39	4,328,750	0.27	3.55	2,000,503	0.25	2.92
CAD\$0.40 - \$0.75	1,540,000	0.42	1.68	1,480,000	0.42	1.54
CAD\$1.01 - \$1.10	1,972,436	1.02	0.48	1,972,436	1.02	0.48
CAD\$0.18 - \$1.10	7,841,186	0.49	2.41	5,452,939	0.58	1.66

Share-Based Compensation

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

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Risk free interest rate (%)	2.12	0.87	2.12	0.87
Expected term (years)	4.0	4.0	4.0	4.0
Expected volatility (%)	45.0	45.0	45.0	45.0
Dividend per share (%)	-	-	-	-
Forfeiture rate (%)	5.0	5.0	5.0	5.0
Weighted average fair value (CAD\$)	0.11	0.06	0.11	0.06

Total share-based compensation of \$0.03 million was computed for the six months ended June 30, 2018 (June 30, 2017 - \$0.06 million) related to the Alvo Petro stock option plan. Share-based compensation that was directly related to exploration and evaluation assets and property, plant and equipment has been capitalized with the remainder recognized as share-based compensation expense on the consolidated statements of operations and comprehensive loss.

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

As at and for the three and six months ended June 30, 2018

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***d) Net Loss Per Share Attributable to Common Shareholders**

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

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

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

NOTE 9 – CAPITAL MANAGEMENT

The Company's capital consists of the following:

	As at	
	June 30, 2018	December 31, 2017
Working capital	5,454	8,762
Shareholders' equity	59,143	66,140

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

The Company considers its capital structure to include working capital (including current restricted cash and assets held for sale) and shareholders' equity. At June 30, 2018, the Company's net working capital surplus of \$5.5 million (December 31, 2017 - \$8.8 million) included \$5.8 million (December 31, 2017 - \$9.2 million) of cash, \$0.1 million (December 31, 2017 - \$0.1 million) of current restricted cash, \$0.2 million (December 31, 2017 - \$0.2 million) of assets held for sale, net of a working capital deficit of \$0.7 million (December 31, 2017 - \$0.8 million).

Alvopetro has the ability to adjust its capital structure by issuing new equity or debt and making adjustments to its capital expenditure program, other than with respect to work commitments. The Company considers its capital structure at this time to include shareholders' equity of \$59.1 million (December 31, 2017 - \$66.1 million).

During the three months ended June 30, 2018 Alvopetro concluded the unitization process and entered into a long-term natural gas sales agreement ("GSA") with respect to our share of gas to be produced from the Caburé and Gomo natural gas assets. Alvopetro will require financing to fund its share of the future development costs associated with these assets, including shared unit development costs (Alvopetro 49.1%) and wholly-owned midstream infrastructure development costs. The Company's work commitments or other projects on its exploration blocks as well as development prospects on our mature fields may also require funding. Financing alternatives include project financing, vendor financing, capital leases for facilities, strategic partnerships, other debt issuances or equity issuances. The Company may also explore asset sales or farmouts to assist with funding. Pursuant to the terms of Alvopetro's UOA with respect to the Caburé field, substantially all shared unit development costs are carried by the operating partner with payment by Alvopetro anticipated to occur on or after January 1, 2020, allowing Alvopetro to defer these cash outlays for over one year.

The 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 14. 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 June 30, 2018, the total

ALVOPETRO ENERGY LTD.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

As at and for the three and six months ended June 30, 2018

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

amount of LCs issued under the Facility was \$6.1 million (December 31, 2017 - \$12.1 million), the full balance of which was supported by EDC on behalf of Alvopetro.

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

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

NOTE 10 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

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

Fair Value of Financial Instruments

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

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

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

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

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

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

As at and for the three and six months ended June 30, 2018

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

	June 30, 2018		December 31, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Carried at fair value through profit or loss				
Cash and cash equivalents ⁽¹⁾	5,839	5,839	9,189	9,189
Restricted cash – current ⁽¹⁾⁽²⁾	91	91	106	106
	5,930	5,930	9,295	9,295
Carried at cost or amortized cost				
Trade and other receivables	211	211	153	153
Accounts payable and accrued liabilities	(972)	(972)	(1,111)	(1,111)
Long-term liabilities	(608)	(636)	-	-
	(1,369)	(1,397)	(958)	(958)

(1) Level 1

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

Risks Associated with Financial Assets and Liabilities

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

	As at			
	June 30, 2018		December 31, 2017	
	CAD (000's)	BRL (000's)	CAD (000's)	BRL (000's)
Cash and cash equivalents	163	850	128	635
Restricted cash – current	-	350	-	350
Trade and other receivables	17	744	36	407
Accounts payable and accrued liabilities	(228)	(2,849)	(186)	(2,636)
Long term liabilities	-	(2,344)	-	-
Net exposure in foreign currency	(48)	(3,249)	(22)	(1,244)
Net exposure in USD (\$000s)	(36)	(843)	(18)	(376)

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

NOTE 11 – CHANGES IN NON-CASH WORKING CAPITAL

Change in:	Three months ended		Six months ended	
	June 30, 2018	2017	June 30, 2018	2017
Trade and other receivables	(44)	(102)	(85)	38
Prepaid expenditures	23	(39)	68	(30)
Accounts payable and accrued liabilities	(438)	(782)	66	(1,040)
	(459)	(923)	49	(1,032)
Changes relating to:				
Operating activities	(191)	(616)	(77)	(501)
Investing activities	(268)	(307)	126	(531)
	(459)	(923)	49	(1,032)

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

As at and for the three and six months ended June 30, 2018

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 12 – REVENUE**

The Company's oil sales revenues are derived from two customers, under contracts based on floating prices, specifically the Brent benchmark adjusted for contracted discounts based on both a fixed cost per barrel and a fixed percentage of Brent. In the six months ended June 30, 2018, discounts averaged 5% of the Brent price (six months ended June 30, 2017 - 10%).

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

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

NOTE 13 – NATURE OF EXPENSES

Production expenses by nature were as follows:

	Three months ended		Six months ended	
	June 30,		June 30,	
Production expenses:	2018	2017	2018	2017
Personnel	78	93	162	186
Other fixed	45	59	118	120
Variable	56	30	72	51
Workover	-	68	63	108
Total production expenses	179	250	415	465

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

	Three months ended		Six months ended	
	June 30,		June 30,	
G&A expenses:	2018	2017	2018	2017
Personnel	594	638	1,251	1,289
Travel	14	32	50	55
Office and IT	79	92	171	183
Professional fees	278	140	431	265
General corporate	64	(15)	149	69
Gross G&A expenses	1,029	887	2,052	1,861
Capitalized to E&E and PP&E	(271)	(288)	(580)	(559)
Net G&A expenses	758	599	1,472	1,302

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

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

As at and for the three and six months ended June 30, 2018

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 14 – COMMITMENTS AND CONTINGENCIES**

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

Commitments	< 1 Year	1-3 Years	Thereafter	Total
Minimum work commitments ⁽¹⁾				
<i>Minimum work commitments to be completed</i>				
Block 183 ⁽²⁾	-	865	-	865
Block 169 ⁽³⁾	986	-	-	986
Block 255 ⁽³⁾	1,180	-	-	1,180
Block 57	38	-	-	38
Block 62	38	-	-	38
Block 71	32	-	-	32
Block 145	38	-	-	38
Bom Lugar	-	-	91	91
Jiribatuba	-	-	91	91
Minimum work commitments to be completed	2,312	865	182	3,359
<i>Minimum work commitments completed</i>				
Block 106	296	-	-	296
Minimum work commitments completed	296	-	-	296
Total minimum work commitments	2,608	865	182	3,655
Office leases⁽⁴⁾	113	-	-	113
Total commitments	2,721	865	182	3,768

Notes:

- (1) Under the terms of the ANP concession contracts for each of our exploration blocks, the Company has commitments which must be completed prior to the applicable phase expiry date. The Company is required to post a performance guarantee with the ANP for all commitments in the table above.
- (2) The ANP approved a suspension to the portion of Block 183 currently in the second exploration phase to which the above commitment is applicable. The Company will have 517 days from receipt of the environmental permit for the well to be drilled to meet the required work commitment.
- (3) Due to an ongoing injunction against unconventional activities on all 12th Brazil Bid Round Blocks, in December 2017 the Company filed a request with the ANP to cancel the Block 169 and 255 concession contracts, including the commitment noted in the table above, and return the bid round bonuses paid.
- (4) The Company is committed to future minimum payments for office space in Canada and Brazil.

During the three months ended June 30, 2018 Alvo Petro entered into a long-term GSA with deliveries set to commence on January 1, 2020, or earlier with mutual consent. The GSA initially provides for the sale of 5.3 million cubic feet per day (150,000 cubic metres per day) on a firm basis and provides standard penalties for supply failure.

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 practical for the Company to do so. If the Company does not meet the local content requirements for a particular phase, as specified according to the respective concession contract, a penalty, which varies by concession depending on exploration phase and type of cost, will be incurred. In 2018, the ANP introduced revised local content regulations which reduced the local content requirements and, as a result, the Company's estimated local content penalties decreased from \$0.3 million at December 31, 2017 to \$0.1 million at June 30, 2018, the full balance of which is included in accounts payable and accrued liabilities.