



INTERIM FINANCIAL STATEMENTS
JUNE 30, 2021

NOTICE TO READER

Please note the interim financial statements as at and for the three and six months ended June 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	June 30, 2021	December 31, 2020
ASSETS			
Current			
Cash and cash equivalents		4,249	5,159
Restricted cash		151	125
Trade and other receivables		3,662	2,802
Prepaid expenditures		351	273
Assets held for sale	3	-	128
Total current assets		8,413	8,487
Non-current assets			
Exploration and evaluation assets	4	3,498	32,262
Property, plant and equipment	5	54,257	25,843
Right-of-use assets	6	8,466	8,092
Deferred tax asset		3,874	4,576
Other assets	7	814	1,128
Total non-current assets		70,909	71,901
Total assets		79,322	80,388
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		3,259	2,390
Lease liabilities	6	486	483
Decommissioning liabilities	8	60	63
Other liabilities		109	12
Total current liabilities		3,914	2,948
Non-current liabilities			
Lease liabilities	6	7,724	7,827
Credit facility	9	7,545	15,423
Decommissioning liabilities	8	887	1,080
Total non-current liabilities		20,070	27,278
Shareholders' equity			
Share capital	10	156,841	156,755
Contributed surplus		2,974	2,821
Deficit		(68,623)	(71,172)
Accumulated other comprehensive loss		(31,940)	(35,294)
Total shareholders' equity		59,252	53,110
Total liabilities and shareholders' equity		79,322	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 June 30,		Six Months Ended June 30,	
	Note	2021	2020	2021	2020
Revenue					
Natural gas, oil and condensate sales	11	8,182	40	15,121	101
Royalties		(607)	(5)	(1,252)	(13)
Net oil and condensate revenue		7,575	35	13,869	88
Other income		7	20	15	44
Total revenue and other income		7,582	55	13,884	132
Expenses					
Production	12	791	36	1,501	80
General and administrative	12	1,036	1,032	1,887	1,672
Depletion and depreciation	5,6	2,092	50	3,766	112
Impairment	5	-	-	-	1,381
Finance expenses	12	833	69	1,827	345
Share-based compensation	10	92	39	181	67
Risk management losses	14	166	-	108	-
Foreign exchange (gains) losses		(2,811)	(3)	(746)	6
Gain on disposition of assets	4,5	(13)	-	(16)	-
Total expenses		2,186	1,223	8,508	3,663
Income (loss) before taxes		5,396	(1,168)	5,376	(3,531)
Income taxes					
Current		295	-	295	-
Deferred		1,464	-	2,532	-
Total		1,759	-	2,827	-
Net income (loss)		3,637	(1,168)	2,549	(3,531)
Exchange gain (loss) on translation of foreign operations		4,341	(1,412)	3,354	(9,764)
Comprehensive income (loss)		7,978	(2,580)	5,903	(13,295)
Net income (loss) per share					
	10				
Basic		0.04	(0.01)	0.03	(0.04)
Diluted		0.03	(0.01)	0.02	(0.04)

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, 2021	2020
Common Shares			
Balance, beginning of period		156,755	156,355
Issue of common shares – options exercised	10	86	149
Share issuance costs		-	(3)
Balance, end of period		156,841	156,501
Contributed surplus			
Balance, beginning of period		2,821	2,790
Share-based compensation expense	10	181	67
Share-based compensation capitalized	4,5	21	18
Options exercised		(49)	(157)
Balance, end of period		2,974	2,718
Deficit			
Balance, beginning of period		(71,172)	(76,878)
Net income (loss)		2,549	(3,531)
Balance, end of period		(68,623)	(80,409)
Accumulated Other Comprehensive Loss			
Balance, beginning of period		(35,294)	(26,393)
Other comprehensive income (loss)		3,354	(9,764)
Balance, end of period		(31,940)	(36,157)

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 June 30,		Six Months Ended June 30,	
	Note	2021	2020	2021	2020
Operating Activities					
Net income (loss)		3,637	(1,168)	2,549	(3,531)
Adjustments:					
Depletion and depreciation	5,6	2,092	50	3,766	112
Impairment	5	-	-	-	1,381
Finance expenses	12	833	105	1,827	345
Share-based compensation	10	92	39	181	67
Gain on disposition of assets	4,5	(13)	-	(16)	-
Foreign exchange		(2,773)	3	(706)	(17)
Unrealized risk management losses		141	-	97	-
Deferred tax		1,464	-	2,532	-
Settlement of decommissioning liabilities	8	(2)	(2)	(3)	(3)
Funds flow from operations		5,471	(973)	10,227	(1,646)
Changes in non-cash working capital	15	194	(121)	(258)	(388)
		5,665	(1,094)	9,969	(2,034)
Financing Activities					
Credit Facility (repayments) advances	9	(5,500)	2,000	(8,000)	10,000
Interest on Credit Facility	9	(286)	(157)	(640)	(157)
Unearned revenue		-	1,180	-	1,180
Issue of common shares, net of share issuance costs		7	-	37	48
Lease liabilities payments	6	(457)	(33)	(931)	(89)
Repayment of other liabilities		-	(4,120)	-	(4,231)
Changes in non-cash working capital	15	133	112	127	20
		(6,103)	(1,018)	(9,407)	6,771
Investing Activities					
Expenditures on exploration and evaluation assets	4	(303)	(75)	(1,039)	(502)
Expenditures on property, plant and equipment	5	(615)	(1,220)	(743)	(2,356)
Proceeds on dispositions	3,4,5	16	-	141	158
Change in restricted cash		(10)	-	(19)	117
Changes in non-cash working capital	15	28	490	12	113
		(884)	(805)	(1,648)	(2,470)
Change in cash and cash equivalents		(1,322)	(2,917)	(1,086)	2,267
Effect of foreign exchange on cash balances		588	(154)	176	(332)
Cash and cash equivalents, beginning of period		4,983	6,221	5,159	1,215
Cash and cash equivalents, end of period		4,249	3,150	4,249	3,150
Cash and cash equivalents consist of:					
Cash		940	2,518	940	2,518
Cash equivalents		3,309	632	3,309	632
Supplemental information:					
Cash income taxes paid		-	-	-	-
Cash interest income received		1	11	3	15

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, 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 June 30, 2021 and December 31, 2020 and for the three and six months ended June 30, 2021 and June 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. 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 August 11, 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

The economic uncertainty created by the COVID-19 pandemic has significantly disrupted global commercial activity resulting in increased commodity price and foreign exchange volatility. 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, 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, its \$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 six months ended June 30, 2021

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 2 – CHANGES IN ACCOUNTING STANDARDS****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	
	June 30, 2021	December 31, 2020
Balance, beginning of period	128	332
Impairment	-	(4)
Disposition	(119)	(158)
Foreign currency translation	(9)	(42)
Balance, end of period	-	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	
	June 30, 2021	December 31, 2020
Balance, beginning of period	32,262	35,971
Capital expenditures	1,039	992
Capital expenditures – non-cash	-	3
Capitalized share-based compensation	10	10
Change in decommissioning liabilities (Note 8)	7	-
Transfer (to) from PP&E (Note 5)	(29,948)	99
Asset dispositions & other transfers	(3)	(1)
Impairment	-	21
Foreign currency translation	131	(4,833)
Balance, end of period	3,498	32,262

During the three months ended March 31, 2021 the Company’s \$30.0 million carrying value of its Gomo natural gas asset (subsequently renamed 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 Alvo Petro 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 \$1.8 million (December 31, 2020 - \$1.1 million) which is included in E&E assets.

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

As at and for the three and six months ended June 30, 2021

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 5 – PROPERTY, PLANT AND EQUIPMENT (“PP&E”)**

	As at	
	June 30, 2021	December 31, 2020
Cost, beginning of period	31,189	34,354
Capital expenditures – cash	743	2,425
Capital expenditures – non-cash	-	394
Capitalized share-based compensation	11	12
Transfer from (to) E&E assets (Note 4)	29,948	(99)
Adjustment to decommissioning liabilities	(296)	-
Asset disposition	(7)	-
Foreign currency translation	1,713	(5,897)
Cost, end of period	63,301	31,189
Accumulated depletion, depreciation and impairment, beginning of period	(5,346)	(3,370)
Depletion and depreciation for the period	(3,291)	(1,496)
Impairment	-	(1,381)
Asset disposition	4	-
Foreign currency translation	(411)	901
Accumulated depletion, depreciation and impairment, end of period	(9,044)	(5,346)
Net book value, end of period	54,257	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.

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	
	June 30, 2021	December 31, 2020
Net book value, beginning of period	8,092	219
Additions	136	8,494
Depreciation of ROU assets	(475)	(574)
Foreign currency translation	713	(47)
Net book value, end of period	8,466	8,092

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

As at and for the three and six months ended June 30, 2021

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

The Company's lease liabilities are as follows:

	As at	
	June 30, 2021	December 31, 2020
Lease liabilities, beginning of period	8,310	163
Additions	136	8,494
Finance expense	686	706
Lease payments	(931)	(1,014)
Foreign currency translation	9	(39)
Lease liabilities, end of period	8,210	8,310
Current	486	483
Non-current	7,724	7,827
Total	8,210	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	
	June 30, 2021	December 31, 2020
Balance, beginning of period	1,128	1,790
Amortization of deferred financing costs	(318)	(650)
Foreign currency translation	4	(12)
Balance, end of period	814	1,128

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	
	June 30, 2021	December 31, 2020
Balance, beginning of period	1,143	1,380
Liabilities incurred	7	-
Obligations settled	(3)	(5)
Revisions to obligations	(296)	-
Accretion	42	80
Foreign currency translation	54	(312)
Balance, end of period	947	1,143

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

As at and for the three and six months ended June 30, 2021

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Current	60	63
Non-current	887	1,080
Total	947	1,143

Total undiscounted cash flows, escalated at 5.5% (December 31, 2020 - 5.5%) for inflation, required to settle the Company's decommissioning liabilities are estimated to be \$6.0 million (December 31, 2020 - \$5.8 million). These estimated cash flows are discounted using an average risk-free rate of 8.2% (December 31, 2020 - 6.9%).

NOTE 9 – CREDIT FACILITY

	As at	
	June 30, 2021	December 31, 2020
Balance at beginning of period	15,423	5,027
(Repayments) advances	(8,000)	10,000
Accrued interest due upon repayment	122	396
Balance at end of period	7,545	15,423

During the three months ended June 30, 2021, the Company negotiated an amendment to the Credit Facility which consists of a one-year extension of the maturity date to October 8, 2023, elimination of the 3% per annum interest payable upon repayment (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 and capital expenditures 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 (being those covenant calculations ending on December 31, 2020, March 31, 2021 and June 30, 2021), Adjusted Consolidated EBITDA is 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	
	June 30, 2021	December 31, 2020
Adjusted Consolidated EBITDA	15,216	6,639
Consolidated Debt Service	4,257	1,858
Debt Service Ratio (Minimum of 1.30:1)	3.57:1	3.57:1

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

As at and for the three and six months ended June 30, 2021

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

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	
	June 30, 2021	December 31, 2020
Adjusted Consolidated Indebtedness	3,644	10,435
Consolidated EBITDA	18,389	7,865
Leverage Ratio (Maximum of 2:25:1)	0.20:1	1.33

The Company is in compliance with all financial and non-financial covenants as of June 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.

Issued and Outstanding Common Shares

	Number of Shares	Amount (\$)
Balance as at December 31, 2019	97,849,788	156,355
Exercise of stock options	1,611,612	403
Share issue costs	-	(3)
Balance as at December 31, 2020	99,461,400	156,755
Exercise of stock options	366,895	86
Share issue costs	-	-
Balance as at June 30, 2021	99,828,295	156,841

At June 30, 2021, there were 8,432,868 warrants outstanding that are exercisable into an equal number of common shares at USD\$0.60 per warrant. The warrants expire on September 20, 2022.

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

As at and for the three and six months ended June 30, 2021

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

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 June 30, 2021 are as follows:

	Number of Options	Weighted Average Exercise Price (CAD\$)
Balance as at December 31, 2019	8,038,750	0.38
Granted	1,308,000	0.81
Exercise of options for common shares	(1,611,612)	0.29
Adjustment for net settlement of options	(859,711)	0.40
Adjustment for cash settlement of options	(123,677)	0.40
Balance as at December 31, 2020	6,751,750	0.47
Granted	60,000	0.99
Exercise of options for common shares	(366,895)	0.29
Adjustment for net settlement of options	(117,605)	0.28
Balance as at June 30, 2021	6,327,250	0.49
Percentage of common shares outstanding	6.3%	

Options Outstanding at June 30, 2021				Options Exercisable at June 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\$0.18 - \$0.39	2,689,250	0.26	1.1	2,689,250	0.26	1.1
CAD\$0.40 - \$0.75	2,270,000	0.57	2.8	1,230,004	0.52	2.6
CAD\$0.76 - \$1.00	1,368,000	0.82	4.7	16,000	0.80	3.9
CAD\$0.18 - \$1.00	6,327,250	0.49	2.5	3,935,254	0.34	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. In 2020, Alvopetro granted 900,000 RSUs and in the three months ended June 30, 2021, the Company granted 500,000 DSUs. No PSUs have been granted to date.

	Number of RSUs & DSUs	Weighted Average Remaining Contractual Life (Years)
Balance as at December 31, 2020	900,000	4.1
Granted	500,000	5.0
Balance as at June 30, 2021	1,400,000	4.4
Percentage of common shares outstanding	1.4%	

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

As at and for the three and six months ended June 30, 2021

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***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, RSUs and DSUs granted are as follows:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2021	2020	2021	2020
Risk free interest rate (%)	0.71	0.45	0.71	0.45
Expected term (years)	4.0	5.4	4.0	5.4
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\$)	0.91	0.32	0.91	0.32

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 (loss).

d) Net Income (Loss) Per Share

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2021	2020	2021	2020
Weighted average basic	99,794,077	98,436,508	99,750,028	98,372,137
Dilutive securities				
Stock options	2,245,401	-	2,035,211	-
Warrants ⁽¹⁾	1,751,026	-	1,227,984	-
RSUs & DSUs	910,989	-	905,525	-
Weighted average diluted	104,701,493	98,436,508	103,918,748	98,372,137

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

In determination of the weighted average number of diluted common shares outstanding for the three and six months ended June 30, 2020, all stock options and warrants were excluded because the effect would be anti-dilutive.

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

As at and for the three and six months ended June 30, 2021

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 11 – REVENUE FROM CONTRACTS WITH CUSTOMERS**

	Three months ended		Six months ended	
	June 30,		June 30,	
	2021	2020	2021	2020
Natural gas	7,447	-	13,820	-
Condensate	709	6	1,275	40
Oil	26	34	26	61
Total	8,182	40	15,121	101

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 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 June 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 EXPENSES

Production expenses by nature were as follows:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2021	2020	2021	2020
Personnel	69	10	129	25
Facility and pipeline	424	-	796	-
Other fixed	233	18	458	41
Variable	49	8	83	14
Workover	16	-	35	-
Total production expenses	791	36	1,501	80

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

	Three months ended		Six months ended	
	June 30,		June 30,	
	2021	2020	2021	2020
Personnel	753	1,200	1,270	1,808
Travel	6	2	7	13
Office and IT	39	19	71	53
Professional fees	207	76	376	158
General corporate	256	172	492	288
Gross G&A expenses	1,261	1,469	2,216	2,320
Capitalized to E&E	(111)	(42)	(153)	(157)
Capitalized to PP&E	(114)	(395)	(176)	(491)
Net G&A expenses	1,036	1,032	1,887	1,672

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

As at and for the three and six months ended June 30, 2021

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

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.

Finance expenses by nature are as follows:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2021	2020	2021	2020
Lease interest (Note 6)	330	1	686	3
Accretion of decommissioning liabilities (Note 8)	22	23	42	42
Amortization of deferred financing costs (Note 7)	160	167	318	327
Interest on Credit Facility (Note 9)	321	443	781	710
Gross finance expenses	833	634	1,827	1,082
Capitalized to E&E	-	(5)	-	(114)
Capitalized to PP&E	-	(560)	-	(623)
Total finance expenses	833	69	1,827	345

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	
	June 30, 2021	December 31, 2020
Cash and cash equivalents	4,249	5,159
Non-cash working capital surplus	250	380
Credit Facility	(7,545)	(15,423)
Net debt	(3,046)	(9,884)
Lease liabilities – non-current	(7,724)	(7,827)
Shareholders' equity	59,252	53,110

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:

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

As at and for the three and six months ended June 30, 2021

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

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 June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Increase (decrease) to natural gas revenues from:				
5% Appreciation of BRL to USD	392	-	727	-
10% Appreciation of BRL to USD	827	-	1,536	-
5% Depreciation of BRL to USD	(355)	-	(658)	-
10% Depreciation of BRL to USD	(677)	-	(1,256)	-

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 June 30, 2021, the Company has a total of BRL10.8 million forward exchange contracts with settlements based on fixed rates between 4.99 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 June 30, 2021 was a liability of \$0.1 million (December 31, 2020 – liability of \$0.01 million).

The realized and unrealized losses recognized are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2021	2020	2021	2020
Realized losses	25	-	11	-
Unrealized losses	141	-	97	-
Total	166	-	108	-

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

As at and for the three and six months ended June 30, 2021

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

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

	As at			
	June 30, 2021		December 31, 2020	
	CAD (000's)	BRL (000's)	CAD (000's)	BRL (000's)
Cash and cash equivalents	121	16,551	64	4,282
Restricted cash – current	-	755	-	651
Trade and other receivables	29	18,203	40	14,156
Other assets and liabilities	-	(543)	-	(65)
Accounts payable and accrued liabilities	(310)	(13,190)	(415)	(10,371)
Net exposure in foreign currency	(160)	21,776	(311)	8,653
Net exposure in USD (\$000s)	(129)	4,353	(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 gain of \$0.3 million for the six months ended June 30, 2021 (June 30, 2020 – nil) related to the change in the BRL to USD exchange rate on this 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 six months ended June 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 June 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.

NOTE 15 – CHANGES IN NON-CASH WORKING CAPITAL

	Three months ended		Six months ended	
	June 30, 2021	2020	June 30, 2021	2020
Change in:				
Trade and other receivables	168	(374)	(301)	(435)
Prepaid expenditures	160	102	(109)	297
Accounts payable and accrued liabilities	27	753	291	(117)
	355	481	(119)	(255)
Changes relating to:				
Operating activities	194	(121)	(258)	(388)
Financing activities	133	112	127	20
Investing activities	28	490	12	113
	355	481	(119)	(255)

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

As at and for the three and six months ended June 30, 2021

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 16 – COMMITMENTS AND CONTINGENCIES**

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

Commitments	< 1 Year	1-3 Years	Thereafter	Total
Minimum work commitments ⁽¹⁾				
Block 183	667	-	-	667
Bom Lugar	-	70	-	70
Mãe-da-lua	-	-	70	70
Minimum work commitments	667	70	70	807
Gas Treatment Agreement	1,204	2,408	7,224	10,836
Total commitments	1,871	2,478	7,294	11,643

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 Alvo Petro's 11-kilometre transfer pipeline.

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.