INTERIM FINANCIAL STATEMENTS
SEPTEMBER 30, 2020

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 September 30, 2020 and December 31, 2019 and the Interim Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) and the Interim Condensed Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2020 and 2019. Please note the interim financial statements have not been reviewed or audited by external auditors.

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ALVOPETRO ENERGY LTD.

INTERIM CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Unaudited, thousands of United States dollars)

	Note	September 30, 2020	December 31, 2019
ASSETS			
Current			
Cash and cash equivalents		**3,167**	1,215
Restricted cash		**112**	270
Trade and other receivables		**1,944**	265
Prepaid expenditures		**92**	370
Assets held for sale	3	**121**	332
Total current assets		**5,436**	2,452
Exploration and evaluation assets	4	**30,526**	35,971
Property, plant and equipment	5	**25,277**	30,984
Right-of-use assets	6	**8,322**	219
Deferred tax asset		**4,893**	-
Other assets	7	**1,292**	1,790
Non-current assets		**70,310**	68,964
Total assets		**75,746**	71,416
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		**2,383**	3,244
Lease liabilities	6	**470**	101
Decommissioning liabilities	8	**59**	80
Other liabilities	9	**291**	5,728
Total current liabilities		**3,203**	9,153
Lease liabilities	6	**7,943**	62
Credit facility	10	**15,336**	5,027
Decommissioning liabilities	8	**967**	1,300
Total liabilities		**27,449**	15,542
Shareholders' equity			
Share capital	11	**156,686**	156,355
Contributed surplus		**2,750**	2,790
Deficit		**(73,926)**	(76,878)
Accumulated other comprehensive loss		**(37,213)**	(26,393)
Total shareholders' equity		**48,297**	55,874
Total liabilities and shareholders' equity		**75,746**	71,416

Basis of presentation (Note 1)

Commitments and contingencies (Note 17)

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)

	Note	Three Months Ended September 30, **2020**	2019	Nine Months Ended September 30, **2020**	2019
Revenue					
Natural gas, oil and condensate sales	15	**5,320**	77	**5,421**	175
Royalties		**(456)**	(11)	**(469)**	(24)
Net natural gas, oil and condensate revenue		**4,864**	66	**4,952**	151
Other income		**14**	36	**58**	167
Total revenue and other income		**4,878**	102	**5,010**	318
Expenses					
Production	16	**648**	67	**728**	225
General and administrative	16	**654**	739	**2,326**	2,062
Depletion and depreciation	5,6	**931**	65	**1,043**	171
Impairment	5	**-**	1,534	**1,381**	1,595
Exploration and evaluation expenses		**-**	8	**-**	95
Finance expenses	16	**996**	10	**1,341**	31
Share-based compensation	11	**74**	33	**141**	100
Gain on disposition		**-**	(37)	**-**	(37)
Foreign exchange (gain) loss		**(15)**	4	**(9)**	1
Total expenses		**3,288**	2,423	**6,951**	4,243
Income (loss) before taxes		**1,590**	(2,321)	**(1,941)**	(3,925)
Deferred tax recovery		**4,893**	-	**4,893**	-
Net income (loss)		**6,483**	(2,321)	**2,952**	(3,925)
Exchange (loss) on translation of foreign operations		**(1,056)**	(2,717)	**(10,820)**	(2,355)
Comprehensive income (loss)		**5,427**	(5,038)	**(7,868)**	(6,280)
Net income (loss) per share	11				
Basic		**0.07**	(0.02)	**0.03**	(0.04)
Diluted		**0.06**	(0.02)	**0.03**	(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	Nine Months Ended September 30, 2020	2019
Common Shares			
Balance, beginning of period		**156,355**	155,731
Issue of common shares – options exercised	11	**334**	-
Share issuance costs		**(3)**	-
Balance, end of period		**156,686**	155,731
Contributed surplus			
Balance, beginning of period		**2,790**	1,813
Share-based compensation expense	11	**141**	100
Share-based compensation capitalized	4,5	**20**	13
Options exercised		**(201)**	-
Balance, end of period		**2,750**	1,926
Deficit			
Balance, beginning of period		**(76,878)**	(71,847)
IFRS 16 opening adjustment		**-**	(20)
Net income (loss)		**2,952**	(3,925)
Balance, end of period		**(73,926)**	(75,792)
Accumulated Other Comprehensive Loss			
Balance, beginning of period		**(26,393)**	(25,125)
IFRS 16 opening adjustment		**-**	1
Other comprehensive (loss) gain		**(10,820)**	(2,355)
Balance, end of period		**(37,213)**	(27,479)

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 September 30, 2020	2019	Nine Months Ended September 30, 2020	2019
Operating Activities					
Net income (loss)		**6,483**	(2,321)	**2,952**	(3,925)
Adjustments:					
Depletion and depreciation	5,6	**931**	65	**1,043**	171
Impairment	5	**-**	1,534	**1,381**	1,595
Finance expenses	16	**996**	10	**1,341**	31
Share-based compensation	11	**74**	33	**141**	100
Deferred tax recovery		**(4,893)**	-	**(4,893)**	-
Gain on disposition of assets		**-**	(37)	**-**	(37)
Unrealized foreign exchange loss		**20**	4	**3**	17
Settlement of decommissioning liabilities	8	**(1)**	(67)	**(4)**	(67)
Funds flow from operations		**3,610**	(779)	**1,964**	(2,115)
Changes in non-cash working capital	14	**(1,639)**	233	**(2,027)**	217
		1,971	(546)	**(63)**	(1,898)
Financing Activities					
Advances under Credit Facility	10	**-**	-	**10,000**	-
Interest on Credit Facility	10	**(321)**	-	**(478)**	-
Unearned revenue	9	**(880)**	-	**300**	-
Issue of common shares, net of share issuance costs		**141**	-	**189**	-
Lease liabilities payments	6	**(455)**	(52)	**(544)**	(139)
Repayment of other liabilities	9	**-**	-	**(4,231)**	-
Changes in non-cash working capital	15	**43**	71	**63**	-
		(1,472)	19	**5,299**	(139)
Investing Activities					
Expenditures on exploration and evaluation assets	4	**(106)**	(1,333)	**(608)**	(1,589)
Expenditures on property, plant and equipment	5	**(1)**	(1,715)	**(2,357)**	(3,455)
Proceeds on dispositions	4	**-**	177	**158**	177
Change in other assets		**-**	12	**-**	(99)
Change in restricted cash		**3**	(21)	**120**	(143)
Changes in non-cash working capital	14	**(181)**	1,607	**(68)**	1,574
		(285)	(1,273)	**(2,755)**	(3,535)
Change in cash and cash equivalents		**214**	(1,800)	**2,481**	(5,572)
Effect of foreign exchange on cash balances		**(197)**	(152)	**(529)**	(112)
Cash and cash equivalents, beginning of period		**3,150**	3,338	**1,215**	7,070
Cash and cash equivalents, end of period		**3,167**	1,386	**3,167**	1,386
Cash and cash equivalents consist of:					
Cash		**3,167**	1,386	**3,167**	1,386
Cash equivalents		**-**	-	**-**	-
Supplemental information:					
Cash income taxes paid		**-**	-	**-**	-
Cash interest income received		**2**	24	**17**	121

See accompanying notes to these interim condensed consolidated financial statements.

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 1700, 525 8th Avenue S.W., Calgary, Alberta, Canada, T2P 1G1.

The interim condensed consolidated financial statements as at September 30, 2020 and December 31, 2019 and for the three and nine months ended September 30, 2020 and September 30, 2019 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, 2019, except as discussed in Note 2 below. 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, 2019.

These interim condensed consolidated financial statements were authorized for issuance by the Company's Board of Directors on November 12, 2020.

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 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 revenue and 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, 2019. The complexity of estimates and assumptions used to prepare these consolidated interim financial statements has increased since December 31, 2019 as described below.

The impact of the COVID-19 pandemic

The market uncertainty created by the COVID-19 pandemic has adversely impacted global commercial activity. For Alvopetro, the most significant estimates, judgments and assumptions potentially affected by COVID-19 are the valuation of Alvopetro's exploration and evaluation assets and 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, the accuracy of which is impacted by the worldwide economic climate. The results of the potential economic downturn and any potential resulting direct and indirect impact to the Company has been considered in management's estimates at the period end; however, there could be further material impact in future periods.

The recognition and measurement of deferred tax assets

In the three months ended September 30, 2020, the Company recognized a previously unrecognized deferred tax asset. The determination of deferred taxes requires interpretation of complex laws and regulations involving multiple jurisdictions. The measurement of income tax expense and deferred tax assets and liabilities is based on judgment in applying tax law and estimates on the applicable tax rates, available tax incentives, and the timing, likelihood and reversal of temporary differences between the accounting and tax bases of assets and liabilities as well as the expected recoverability of deferred tax assets. The extent to which deferred tax assets are recognized are based on estimates of future profitability which are based on estimated future commodity prices and estimates of reserves, all of which are subject to management estimates, judgments and assumptions. Tax interpretation, regulations, and legislation in both Canada and Brazil are subject to change and interpretation which can affect the timing of the reversal of temporary tax differences, the tax rates in effect when such differences reverse and the Company's ability to utilize tax losses and other tax pools in the future. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. If any of these judgments and estimates prove to be inaccurate, actual results may differ significantly from that estimated and recorded by management and future earnings may be impacted.

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

The measurement of lease obligations and corresponding right-of-use assets

The measurement of lease obligations are subject to management's judgements, including the applicable incremental borrowing rate, based on judgments of the economic environment, term and underlying risk inherent to the asset. The carrying balance of the right-of-use assets, lease obligations, and the resulting interest and depletion and depreciation expense may differ due to changes in the market conditions and expected lease terms.

Segmented Operations

All oil, natural gas and condensate sales revenue and the unearned revenue (see Note 9) on natural gas sales are derived entirely from Brazilian operations. All exploration and evaluation assets and all material property, plant and equipment are located in Brazil. Cash and cash equivalents are held in both Canada and Brazil and all of the restricted cash at September 30, 2020 and December 31, 2019 is held 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

The interim condensed consolidated financial statements have been prepared following the same accounting policies and methods of computation as the 2019 annual consolidated financial statements, with the exception of the following standards which were amended effective January 1, 2020:

- IFRS 3 *Business Combinations;*
- IAS 1 *Presentation of Financial Statement;* and
- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

These amendments did not have an effect on the financial statements as at and for the three and nine months ended September 30, 2020.

NOTE 3 – ASSETS HELD FOR SALE

	As at	
	September 30, 2020	December 31, 2019
Balance, beginning of period	**332**	202
Transferred from E&E assets (Note 4)	**-**	351
Impairment	**-**	(37)
Disposition	**(158)**	(171)
Foreign currency translation	**(53)**	(13)
Balance, end of period	**121**	332
Land	**121**	170
Equipment inventory	**-**	162
Total	**121**	332

During the three months ended March 31, 2020, the Company disposed of equipment inventory for proceeds equal to the carrying value, resulting in no gain or loss on the transaction.

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

NOTE 4 – EXPLORATION AND EVALUATION ("E&E") ASSETS

	As at	
	September 30, 2020	December 31, 2019
Balance, beginning of period	**35,971**	35,340
Capital expenditures – cash	**608**	3,276
Capital expenditures – non-cash	**3**	-
Capitalized share-based compensation	**8**	8
Change in decommissioning liabilities	**-**	48
Transfer from (to) PP&E (Note 5)	**102**	(14)
Transfer to Assets Held for Sale (Note 3)	**-**	(351)
Impairment	**-**	(1,608)
Foreign currency translation	**(6,166)**	(728)
Balance, end of period	**30,526**	35,971

The majority of the Company's carrying value of its E&E assets relates to the Gomo natural gas project, including the 183(1) and 197(1) wells. Given the results of the stimulation and initial production test of the 183(1) well, plans for a longer-term production test and additional exploration prospects on these blocks, there is no indication of impairment of this E&E asset as at September 30, 2020.

General and administrative costs totaling $0.2 million (December 31, 2019 - $0.3 million) and finance expenses totaling $0.1 million (December 31, 2019 - $nil) that were directly related to exploration and evaluation activities have been capitalized as exploration and evaluation assets.

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

	As at	
	September 30, 2020	December 31, 2019
Cost, beginning of period	**34,354**	25,631
Capital expenditures – cash	**2,357**	6,151
Capital expenditures – non-cash	**394**	3,244
Capitalized share-based compensation	**12**	15
Transfer (to) from E&E assets (Note 4)	**(102)**	14
Transfer to ROU assets (Note 6)	**-**	(30)
Change in decommissioning liabilities	**-**	196
Asset dispositions	**-**	-
Foreign currency translation	**(7,487)**	(867)
Cost, end of period	**29,528**	34,354
Accumulated depletion, depreciation and impairment, beginning of period	**(3,370)**	(3,620)
Depletion and depreciation for the period	**(729)**	(67)
Impairment	**(1,381)**	-
Foreign currency translation	**1,229**	317
Accumulated depletion, depreciation and impairment, end of period	**(4,251)**	(3,370)
Net book value, end of period	**25,277**	30,984

As a result of the significant decline in global crude oil prices and the uncertainty surrounding the economic impact of the COVID–19 global pandemic, the Company determined that indications of impairment existed as at March 31, 2020. A test for impairment was performed at the cash generating unit ("CGU") level by comparing the estimated recoverable amount to the carrying values of the assets. The estimated recoverable amount was determined based on fair value less costs of disposal using a discount rate of 15% before tax. A resultant impairment charge of $1.4 million was recognized in the three months ended March 31, 2020 related to the Bom Lugar field, reducing the carrying value of the field to $1.5 million as at March 31, 2020.

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

The key assumptions used in determining the recoverable amounts for purposes of the impairment tests are commodity prices, discount rate, reserve volumes, future capital cost estimates, future well locations, timing of future capital investment, and anticipated foreign exchange rates. In determining the estimated recoverable amount of the Bom Lugar field, the Company utilized the following forecasted commodity prices:

Brent ($/bbl)										
2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	Thereafter
34.00	45.50	52.50	57.50	62.50	62.95	64.13	65.33	66.56	67.81	Escalated at 2%

Future changes to forecasted commodity prices could result in future impairment losses or impairment reversals. Increases or decreases to the assumed discount rate could result in additional impairment charges or impairment reversals. A 2% increase in the discount rate would have resulted in an additional $0.2 million impairment whereas a 2% decrease in the discount rate would have resulted in a $0.3 million reversal. In addition, the majority of the Company's production expenses and a portion of the Company's future development costs, are denominated in Brazilian real ("BRL"). Fluctuations in the BRL relative to the USD may result in additional impairment charges or impairment reversals. As at September 30, 2020 there are no indications of further impairment losses nor of impairment reversals.

General and administrative costs totaling $0.5 million (December 31, 2019 - $0.6 million) and finance expenses totaling $0.6 million (December 31, 2019 - $0.1 million) that were directly related to property, plant, and equipment activities have been capitalized.

NOTE 6 – RIGHT-OF-USE ("ROU") ASSETS AND LEASE LIABILITIES

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

	As at	
	September 30, 2020	December 31, 2019
Net book value, beginning of period	**219**	-
ROU Assets upon adoption of IFRS 16 – formerly operating leases	**-**	226
ROU Assets upon adoption of IFRS 16 – transferred from PP&E (Note 5)	**-**	30
Additions	**8,484**	133
Depreciation of ROU assets	**(314)**	(167)
Foreign currency translation	**(67)**	(3)
Net book value, end of period	**8,322**	219
Net Book Value by Asset Class		
Natural gas facility	**8,101**	-
Office space	**123**	70
Surface land access	**98**	149
Total Net Book Value	**8,322**	219

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

The Company's lease liabilities at September 30, 2020 are as follows:

	As at	
	September 30, 2020	December 31, 2019
Lease liabilities, beginning of period	**163**	-
Lease liabilities upon adoption of IFRS 16	**-**	244
Additions	**8,484**	133
Finance expense	**356**	14
Lease payments	**(544)**	(234)
Foreign currency translation	**(46)**	6
Lease liabilities, end of period	**8,413**	163
Current	**470**	101
Non-current	**7,943**	62
Total	**8,413**	163

The additions to the right-of-use assets and the lease liabilities in 2020 primarily relate to the lease component contained in Alvopetro's 10-year contract (the "Gas Treatment Agreement") with Enerflex Ltd. ("Enerflex"). Under the Gas Treatment Agreement, Enerflex constructed and provides all operations and maintenance and warranties the onstream performance of the natural gas treatment facility ("the Facility") to process natural gas from the Company's Caburé natural gas field. Enerflex is also operating and maintaining the Company's 11-kilometre transfer pipeline. The portion of the Gas Treatment Agreement that relates to the equipment rental of the Facility is a lease. The Facility was commissioned and became available for use during the three months ended June 30, 2020 in anticipation of the July 5, 2020 commencement of commercial operations and the associated ROU asset and lease liability were recognized in the second quarter. The present value of future minimum lease payments were discounted using a rate of 16.9% and the right-of-use asset will be depreciated over the 10-year term of the contract.

The Company's weighted average rate used to discount all lease liabilities was 16.7% (December 31, 2019 – 7.0%).

During the three and nine months ended September 30, 2020 the Company incurred a nominal amount in payments related to leases for which the low-value expedient is applied in application of the relevant accounting standard.

NOTE 7 – OTHER ASSETS

Other assets represent the unamortized portion of the Company's deferred financing costs associated with the Company's Credit Facility arrangement entered into in 2019 (Note 10). The deferred financing costs are comprised of cash transactions costs as well as the fair value of the warrants issued to advisors and lenders. These costs are being amortized over the term of the Credit Facility as follows:

	As at	
	September 30, 2020	December 31, 2019
Balance, beginning of period	**1,790**	-
Additions	**-**	1,927
Amortization of deferred financing costs	**(474)**	(137)
Foreign currency translation	**(24)**	-
Balance, end of period	**1,292**	1,790

NOTE 8 – DECOMMISSIONING LIABILITIES

The decommissioning liabilities are 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.

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

	As at	
	September 30, 2020	December 31, 2019
Balance, beginning of period	**1,380**	1,231
Liabilities incurred	**-**	962
Revisions to obligations	**-**	(718)
Obligations settled	**(4)**	(67)
Accretion	**56**	52
Foreign currency translation	**(406)**	(80)
Balance, end of period	**1,026**	1,380
Current	**59**	80
Non-current	**967**	1,300
Total	**1,026**	1,380

Total undiscounted cash flows, escalated at 5.5% (December 31, 2019 - 5.5%) for inflation, required to settle the Company's decommissioning liabilities are estimated to be $4.0 million (December 31, 2019 - $5.8 million) and have been discounted using an average risk-free rate of 7.2% (December 31, 2019 – 6.7%).

NOTE 9 – OTHER LIABILITIES

	As at	
	September 30, 2020	December 31, 2019
Unearned revenue	**291**	-
Unit development capital liabilities	**-**	5,728
Total	**291**	5,728

Under the terms of the Company's GSA, Alvopetro is entitled to take-or-pay pre-payments to the extent Bahiagás is unable to accept natural gas deliveries. The take-or-pay payments are based on a fixed percentage of the firm volumes specified in the contract, with equivalent volumes to be recovered by Bahiagás at a later date. In accordance with the Company's revenue recognition accounting policy, revenue is only recognized when control of the product has transferred to the buyer and accordingly any take-or-pay amounts received are recognized as unearned revenue until the natural gas volumes are delivered. In the second quarter of 2020, Alvopetro was entitled to $1.2 million of take-or-pay payments. Of this amount, a total of $0.9 million was recognized as revenue in the three months ended September 30, 2020 with the remaining $0.3 million delivered subsequent to September 30, 2020.

NOTE 10 – CREDIT FACILITY

	As at	
	September 30, 2020	December 31, 2019
Balance at beginning of period	**5,027**	-
Advances	**10,000**	5,000
Accrued interest due upon repayment	**309**	27
Balance, end of period	**15,336**	5,027

The Credit Facility is secured by all of Alvopetro's assets and matures on October 8, 2022. As at September 30, 2020 the Company had drawn $15.0 million, which represents the full available balance under the Credit Facility.

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

The net proceeds drawn on the Credit Facility were used to fund the development of the Company's Caburé natural gas field, for Gomo development costs, payments for the well drilled on Block 57 in the third quarter of 2019, and for general operational and corporate requirements.

The Credit Facility contains certain customary financial and non-financial covenants, standard representations and warranties, and events of default. As at September 30, 2020 the Company was in compliance with all covenants. Financial covenants are computed for quarters after October 8, 2020, with the first covenant calculation effective December 31, 2020. Amounts drawn under the Credit Facility are repayable at maturity however after the first anniversary of the Credit Facility, amounts drawn may be repaid in part or full at Alvopetro's option without penalty. Interest on the Credit Facility includes monthly payments at 9.5% per annum and an additional 3.0% per annum upon repayment of any amounts drawn. Until October 8, 2020, the Credit Facility was subject to a 1.0% per annum commitment fee on the unused available balance.

NOTE 11 – 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, 2018	96,670,871	$ 155,731
Shares issued – exercise of warrants	1,249,000	621
Shares issued – exercise of options	7,296	4
Cancellation of shares	(77,379)	-
Share issue costs	-	(1)
Balance as at December 31, 2019	97,849,788	156,355
Exercise of stock options	1,272,624	334
Share issue costs	-	(3)
Balance as at September 30, 2020	**99,122,412**	**156,686**

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

Warrants outstanding at September 30, 2020 are as follows:

	Number of Warrants			
	Exercise Price			
	USD $0.50	USD $0.60	CAD[1] $0.64	Total
Balance as at December 31, 2018	3,300,000	-	376,000	3,676,000
Granted	-	8,432,868	-	8,432,868
Exercised	(1,009,000)	-	(240,000)	(1,249,000)
Expired	(1,491,000)	-	(136,000)	(1,627,000)
Balance as at December 31, 2019 and September 30, 2020	**800,000**	**8,432,868**	**-**	**9,232,868**
Weighted average remaining contractual life (years)	**0.04**	**1.97**	**-**	**1.81**

(1) Canadian dollars ("CAD")

b) Options to Purchase Common Shares

Alvopetro has a stock option plan whereby the Company may grant stock options to its directors, officers, employees and consultants as part of the Company's long-term incentive plan to align compensation with shareholders' interests. The options outstanding at September 30, 2020 are as follows:

	Number of Options	Weighted Average Exercise Price (CAD$)
Balance as at December 31, 2018	7,180,750	0.34
Granted	970,000	0.75
Expired	(72,000)	1.10
Exercised	(40,000)	0.57
Balance as at December 31, 2019	8,038,750	0.38
Granted	348,000	0.80
Adjustment for net settlement of options	(697,186)	0.41
Adjustment for cash settlement of options	(196,440)	0.41
Exercise of options for common shares	(1,272,624)	0.34
Balance as at September 30, 2020	**6,220,500**	**0.40**
Percentage of common shares outstanding	**6.3%**	

	Options Outstanding at September 30, 2020			Options Exercisable at September 30, 2020		
Exercise Price	Number of Options	Weighted Average Exercise Price (CAD$)	Weighted Average Remaining Contractual Life (Years)	Number of Options	Weighted Average Exercise Price (CAD$)	Weighted Average Remaining Contractual Life (Years)
CAD$0.18 - $0.39	3,602,500	0.27	1.50	3,181,751	0.26	1.35
CAD$0.40 - $0.75	2,270,000	0.57	3.55	473,335	0.44	3.13
CAD$0.76 - $0.80	348,000	0.80	6.38	-	-	-
CAD$0.18 - $0.80	**6,220,500**	**0.40**	**2.52**	**3,655,086**	**0.28**	**1.58**

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

d) Restricted Share Units

During the three months ended September 30, 2020 the Company granted Restricted Share Units ("RSUs") to officers and employees to purchase 900,000 common shares under Alvopetro's Stock Incentive Plan, of which 660,000 were granted to officers. These RSUs vest evenly over three years and expire on August 17, 2025.

e) Share-Based Compensation

The fair values of the stock options and RSUs granted in the three and nine months ended September 30, 2020 and 2019 have been estimated on the grant date using the Black-Scholes option pricing model. Weighted average assumptions and resultant fair values for stock options and RSUs granted are as follows:

	Three months ended September 30,		**Nine months ended September 30,**	
	2020	2019	**2020**	2019
Risk free interest rate (%)	**0.27**	-	**0.32**	1.48
Expected term (years)	**3.0**	-	**3.6**	4.0
Expected volatility (%)	**45.0**	-	**45.0**	45.0
Dividend per share (%)	**-**	-	**-**	-
Forfeiture rate (%)	**-**	-	**1.4**	5.0
Weighted average fair value (CAD$)	**0.71**	-	**0.60**	0.27

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).

f) Net Income (Loss) Per Share

Net loss per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the applicable period. The following reconciles the number of shares used in the basic and diluted net earnings per share calculations:

	Three months ended September 30,		**Nine months ended September 30,**	
	2020	2019	**2020**	2019
Weighted average basic	**98,453,064**	96,593,492	**98,399,310**	96,611,916
Dilutive securities				
Stock options	**5,631,848**	-	**5,739,556**	-
Warrants[1]	**800,000**	-	**797,080**	-
RSUs	**430,435**	-	**144,526**	-
Weighted average diluted	**105,315,347**	96,593,492	**105,080,472**	96,611,916

(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 nine months ended September 30, 2019, all stock options and warrants were excluded because the effect would be anti-dilutive.

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

NOTE 12 – CAPITAL MANAGEMENT

The Company's capital consists of the following:

	As at	
	September 30, 2020	December 31, 2019
Working capital surplus (deficit)	**2,233**	(6,701)
Credit Facility	**(15,336)**	(5,027)
Net debt	**(13,103)**	(11,728)
Lease liabilities – non-current	**(7,943)**	(62)
Shareholders' equity	**48,297**	55,874

At September 30, 2020, the Company's net debt of $13.1 million (December 31, 2019 – $11.7 million) includes $3.2 million (December 31, 2019 - $1.2 million) of cash and cash equivalents.

As of September 30, 2020, a total of $15 million was drawn under the Credit Facility which represents the full available balance. 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. The Company considers its capital structure to include lease liabilities. The majority of the lease liabilities outstanding as of September 30, 2020 relates to equipment rental for the Facility as discussed further in Note 6. As at September 30, 2020, the current portion of lease liabilities of $0.5 million (December 31, 2019 - $0.1 million) is reflected in the working capital deficit above.

The Company has a credit support 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 of Brazil ("ANP") for Alvopetro's work commitments under the terms of its concession contracts as discussed further in Note 17. 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 September 30, 2020, the total amount of LCs issued was $0.6 million (December 31, 2019 - $4.9 million), the full balance of which was supported by EDC on behalf of Alvopetro.

Current restricted cash of $0.1 million (December 31, 2019 - $0.3 million) primarily represents cash posted in respect of abandonment guarantees.

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

NOTE 13 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

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, lease liabilities, other liabilities and the Credit Facility.

Fair Value of Financial Instruments

Financial assets and liabilities measured at fair value are classified into levels reflecting the measurement method used. The Company's financial assets and liabilities fall within Levels 1 and 2. Level 1 fair values of assets and liabilities are determined by reference to quoted prices in active markets for identical assets and liabilities and Level 2 valuations use inputs other than quoted prices for which all significant inputs can be observed or corroborated in the marketplace. There were no transfers of any financial instruments between levels within the fair value hierarchy in the nine months ended September 30, 2020 or 2019.

Given the short term to maturity of the Company's financial assets and liabilities the carrying values approximate their fair values.

Financial Risk Management

The nature of Alvopetro's operations exposes the Company to market risk, liquidity risk and credit 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, 2019. As a result of the commencement of natural gas sales and the COVID-19 coronavirus pandemic and the associated impact on global economic activity, commodity prices and foreign exchange rates, Alvopetro's exposure to commodity price and foreign exchange (market) risk as well as credit risk and liquidity risk has increased since December 31, 2019. The Company has not entered into any instruments to manage commodity price or foreign exchange risk.

Fluctuations in the value of the BRL and CAD to the USD can affect the value of the Company's financial instruments, as well as its cash flows, net income or loss and comprehensive income or loss. Alvopetro's natural gas volumes, which generate the majority of its revenues in 2020, are sold pursuant to a long term gas sales agreement ("GSA"), which includes both a USD floor and ceiling price (see Note 15), reducing the Company's exposure to commodity price risk. Although the Company's natural gas price under the GSA is benchmarked to USD equivalent prices, the price is set semi-annually in BRL based on the average historical USD benchmark and the average historical foreign exchange rate of USD to BRL, with all natural gas sales volumes billed monthly in BRL. As a result, the Company is exposed to fluctuations in the BRL relative to the USD as USD equivalent revenues will be based on prevailing exchange rates in the month of the natural gas sales. 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 for the third quarter:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2020	2019	**2020**	2019
Increase (Decrease) to Natural Gas Revenues from:				
5% Appreciation of BRL to USD	**263**	-	**263**	-
10% Appreciation of BRL to USD	**555**	-	**555**	-
5% Depreciation of BRL to USD	**(238)**	-	**(238)**	-
10% Depreciation of BRL to USD	**(454)**	-	**(454)**	-

The impact of foreign exchange fluctuations on the Company's cash and cash equivalents in the three and nine months ended September 30, 2020 was $0.2 million and $0.5 million respectively (September 30, 2019 - $0.2 million and $0.1 million). The following financial instruments were denominated in currencies other than USD:

	As at			
	September 30, 2020		December 31, 2019	
	CAD (000's)	**BRL (000's)**	CAD (000's)	BRL (000's)
Cash and cash equivalents	**268**	**10,243**	91	1,656
Restricted cash	**-**	**631**	-	1,089
Trade and other receivables	**62**	**10,439**	28	891
Accounts payable and accrued liabilities	**(430)**	**(11,184)**	(315)	(11,001)
Lease liabilities	**(113)**	**(190)**	(89)	(384)
Other liabilities	**-**	**(1,640)**	-	(23,088)
Net exposure in foreign currency	**(213)**	**8,299**	(285)	(30,837)
Net exposure in USD ($000s)	**(160)**	**1,471**	(219)	(7,650)

The Company has one customer for its natural gas production providing for increased credit risk. See Note 15 for further details with respect to this risk.

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NOTE 14 – CHANGES IN NON-CASH WORKING CAPITAL

	Three months ended September30,		Nine months ended September 30,	
	2020	**2019**	**2020**	2019
Change in:				
Trade and other receivables	**(1,637)**	19	**(2,072)**	11
Prepaid expenditures	**43**	(221)	**340**	(90)
Accounts payable and accrued liabilities	**(183)**	2,113	**(300)**	1,870
	(1,777)	1,911	**(2,032)**	1,791
Changes relating to:				
Operating activities	**(1,639)**	233	**(2,027)**	217
Financing activities	**43**	71	**63**	-
Investing activities	**(181)**	1,607	**(68)**	1,574
	(1,777)	1,911	**(2,032)**	1,791

NOTE 15 – REVENUE

	Three months ended September30,		Nine months ended September 30,	
	2020	**2019**	**2020**	2019
Natural gas	**4,993**	-	**4,993**	-
Condensate	**327**	43	**367**	58
Oil	**-**	34	**61**	117
	5,320	77	**5,421**	175

Alvopetro commenced natural gas sales on July 5, 2020 with 100% of natural gas production sold under the GSA . 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 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 (see Note 13).

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.

For the three months ended September 30, 2020 the Company's 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. There were no collection issues requiring adjustment to any revenues recorded in the three or nine months ended September 30, 2020 or 2019 or in the year ended December 31, 2019.

Revenue is presented net of sales tax and measured at the consideration specified in the contracts and represents amounts receivable net of discounts. Performance obligations associated with the sale of hydrocarbons are satisfied when control of the product is transferred to the customer. This occurs when the product 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. As discussed in Note 9, to the extent Alvopetro is entitled to receive take-or-pay payments under the GSA, such amounts are not recognized as revenue until the natural gas volumes are delivered. In the three months ended June 30, 2020, the Company recorded the receipt of $1.2 million of take-or-pay payments, with the full amount reflected as unearned revenue as of June 30, 2020. During the three months ended September 30, 2020 Alvopetro delivered gas in satisfaction of $0.9 million of the June 30, 2020 unearned revenue and recognized the equivalent in revenue. The remaining $0.3 million is presented as Other Liabilities (Note 9) on the Statement of Financial Position.

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NOTE 16 – NATURE OF EXPENSES

Production expenses by nature were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	**2020**	2019
Personnel	**105**	20	**130**	80
Other fixed	**526**	43	**567**	125
Variable	**17**	4	**31**	20
Total production expenses	**648**	67	**728**	225

Included in other fixed costs are service fees paid to Enerflex for operating the Facility and Alvopetro's transfer pipeline as well as all operating costs paid to our partner for our share of costs associated with the Caburé unit.

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

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	**2020**	2019
Personnel	**365**	623	**2,173**	1,910
Travel	**1**	38	**14**	95
Office and IT	**35**	45	**88**	125
Professional fees	**104**	103	**262**	275
General corporate	**170**	163	**458**	387
Gross G&A expenses	**675**	972	**2,995**	2,792
Capitalized to E&E and PP&E	**(21)**	(233)	**(669)**	(730)
Net G&A expenses	**654**	739	**2,326**	2,062

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. In 2020 personnel expenses in the nine months ended September 30, 2020 were impacted by severance costs as well as accruals for bonuses following completion of the Caburé development.

Finance expenses by nature were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	**2020**	2019
Lease interest (Note 6)	**353**	4	**356**	11
Accretion of decommissioning liabilities (Note 8)	**14**	6	**56**	20
Amortization of deferred financing costs (Note 7)	**147**	-	**474**	-
Interest on Credit Facility (Note 10)	**482**	-	**1,192**	-
Gross finance expenses	**996**	10	**2,078**	31
Capitalized to E&E and PP&E	**-**	-	**(737)**	-
Total finance expenses	**996**	10	**1,341**	31

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

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

NOTE 17 – COMMITMENTS AND CONTINGENCIES

The following is a summary of contractual commitments as at September 30, 2020:

Commitments	< 1 Year	1-3 Years	Thereafter	Total
Minimum work commitments(1)				
Block 183	-	591	-	591
Bom Lugar	-	-	62	62
Mãe-da-lua	-	-	62	62
Minimum work commitments	-	591	124	715
Gas Treatment Agreement	950	1,900	6,413	9,263
Total commitments	**950**	**2,491**	**6,537**	**9,978**

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.

The Company's Gas Treatment Agreement with Enerflex contains a lease related to equipment rental of the Facility for which details and a corresponding obligation is reflected in the Statement of Financial Position as of September 30, 2020 (Note 6). The contract also provides for monthly service fees to Enerflex for operation and maintenance of the Facility as well as Alvopetro's 11-kilometre transfer pipeline. The committed payments for service fees are included in the table above. The Gas Treatment Agreement includes early termination penalty provisions which vary depending on timing of the termination. While the agreement also includes strict availability requirements and downtime credits, such credits may not fully offset costs incurred by Alvopetro due to ship or pay obligations under the GSA as discussed below to the extent processing in the Facility is limited due to unplanned or longer than scheduled maintenance or repair.

The Company's GSA with Bahiagás provides for ship or pay penalties applicable to Alvopetro for supply failure in respect of the firm volumes and also take or pay penalties applicable to Bahiagás should it be unable to accept the firm volumes specified in the contract. The Company believes it can meet the firm sales commitments under the GSA solely with our production from the Caburé natural gas field, however supply failure penalties may arise where there are unplanned production interruptions, or to the extent reservoir performance is below expected production rates. Supply failure penalties are a function of the shortfall of firm volumes and the prevailing natural gas price under the GSA at the time. Alvopetro can mitigate these risks by adjusting firm volumes annually and by meeting sales commitments under the GSA with third-party gas supplies, through development of existing natural gas resources, or through new gas discoveries from our prospect inventory. In May 2020, Alvopetro and Bahiagás entered into an amendment to the GSA which provides for increased firm volumes until December 31, 2020; however, as part of the amendment, any supply failure penalties in 2020 will be reduced from the original contractual penalties.

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 such work plans are not completed 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, 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.