

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

(Unaudited, thousands of United States dollars)

	Note	September 30, 2016	December 31, 2015
<b>ASSETS</b>			
<b>Current</b>			
Cash and cash equivalents		21,827	28,733
Restricted cash	3	108	2,288
Trade and other receivables		282	247
Prepaid expenditures		152	280
<b>Total current assets</b>		<b>22,369</b>	<b>31,548</b>
<b>Other assets</b>			
Other assets		-	34
Exploration and evaluation assets	4	53,252	48,409
Property, plant and equipment	5	5,144	4,293
<b>Non-current assets</b>		<b>58,396</b>	<b>52,736</b>
<b>Total assets</b>		<b>80,765</b>	<b>84,284</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		3,993	2,143
Current portion of decommissioning liabilities	6	41	13
		<b>4,034</b>	<b>2,156</b>
Deferred tax liability		-	330
Decommissioning liabilities	6	1,379	1,066
		<b>5,413</b>	<b>3,552</b>
<b>Shareholders' equity</b>			
Share capital		151,937	151,937
Contributed surplus		1,562	1,444
Deficit		(60,019)	(47,812)
Accumulated other comprehensive loss		(18,128)	(24,837)
<b>Total shareholders' equity</b>		<b>75,352</b>	<b>80,732</b>
<b>Total liabilities and shareholders' equity</b>		<b>80,765</b>	<b>84,284</b>

Commitments and contingencies (Note 13)

See accompanying notes to these interim condensed consolidated financial statements.

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

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

	Note	Three months ended September 30,		Nine months ended September 30,	
		2016	2015	2016	2015
<b>Revenue</b>					
Oil sales		74	97	353	419
Royalties and production taxes		(8)	(7)	(37)	(28)
Oil revenue		66	90	316	391
Other income		29	19	83	73
Total revenue and other income		95	109	399	464
<b>Expenses</b>					
Production	11	264	180	983	692
Transportation		4	8	22	29
General and administrative	11	854	1,104	2,735	3,616
Depletion and depreciation	5	87	104	312	321
Impairment	4	4,491	968	7,480	968
Exploration and evaluation expenses	4	61	(9)	213	42
Accretion of decommissioning liabilities	6	6	18	19	56
Share-based compensation	7	37	88	89	267
Foreign exchange loss (gain)		10	276	(19)	233
Loss on asset disposition	5	41	-	41	-
Total expenses		5,855	2,737	11,875	6,224
Loss before taxes		(5,760)	(2,628)	(11,476)	(5,760)
Income tax (recovery) expense		(68)	(2,544)	731	(3,133)
Net loss		(5,692)	(84)	(12,207)	(2,627)
Exchange (loss) gain on translation of foreign operations		(453)	(10,293)	6,709	(16,056)
Comprehensive loss		(6,145)	(10,377)	(5,498)	(18,683)
<b>Net loss per share</b>					
	7				
Basic		(0.07)	-	(0.14)	(0.03)
Diluted		(0.07)	-	(0.14)	(0.03)

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)

		Nine months ended	
		September 30,	
	Note	2016	2015
<b>Common Shares</b>			
Balance, beginning of period		151,937	151,937
Net change		-	-
<b>Balance, end of period</b>		<b>151,937</b>	<b>151,937</b>
<b>Contributed surplus</b>			
Balance, beginning of period		1,444	975
Share-based compensation expense	7	89	267
Share-based compensation capitalized	7	29	80
<b>Balance, end of period</b>		<b>1,562</b>	<b>1,322</b>
<b>Deficit</b>			
Balance, beginning of period		(47,812)	(35,388)
Net loss		(12,207)	(2,627)
<b>Balance, end of period</b>		<b>(60,019)</b>	<b>(38,015)</b>
<b>Accumulated Other Comprehensive Loss</b>			
Balance, beginning of period		(24,837)	(9,699)
Other comprehensive income (loss)		6,709	(16,056)
<b>Balance, end of period</b>		<b>(18,128)</b>	<b>(25,755)</b>

See accompanying notes to these interim condensed consolidated financial statements.

**ALVOPETRO ENERGY LTD.****INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited, thousands of United States dollars)

		Three months ended September 30,		Nine months ended September 30,	
		2016	2015	2016	2015
<b>Operating Activities</b>					
Net loss		(5,692)	(84)	(12,207)	(2,627)
Adjustments for non-cash items:					
Depletion and depreciation	5	87	104	312	321
Impairment	4	4,491	968	7,480	968
Accretion of decommissioning liability	6	6	18	19	56
Share-based compensation	7	37	88	89	267
Deferred tax		(68)	(2,544)	731	(3,133)
Unrealized foreign exchange loss		5	210	6	167
Loss on asset disposition	5	41	-	41	-
Non-cash exploration & evaluation expenses		-	-	-	32
Settlement of decommissioning liability	6	(62)	-	(160)	-
		(1,155)	(1,240)	(3,689)	(3,949)
Changes in non-cash working capital	10	593	(974)	320	(889)
		(562)	(2,214)	(3,369)	(4,838)
<b>Investing Activities</b>					
Expenditures on exploration and evaluation assets		(3,412)	(2,490)	(6,960)	(9,652)
Expenditures on property, plant and equipment		(373)	(128)	(726)	(857)
Expenditures on other assets		-	(18)	-	(83)
Proceeds on dispositions	4, 5	311	-	311	-
Change in restricted cash	3	(108)	7,334	2,180	10,814
Changes in non-cash working capital	10	2,082	(818)	1,373	(3,098)
		(1,500)	3,880	(3,822)	(2,876)
<b>Change in cash and cash equivalents</b>		(2,062)	1,666	(7,191)	(7,714)
<b>Effect of foreign exchange on cash balances</b>		110	(580)	285	(841)
<b>Cash and cash equivalents, beginning of period</b>		23,779	31,279	28,733	40,920
<b>Cash and cash equivalents, end of period</b>		21,827	32,365	21,827	32,365
Cash and cash equivalents consist of:					
Cash		5,621	12,365	5,621	12,365
Cash equivalents		16,206	20,000	16,206	20,000
Supplemental information:					
Cash income taxes paid		-	-	-	16
Cash interest income received		22	14	71	54

See accompanying notes to these interim condensed consolidated financial statements.

## ALVOPETRO ENERGY LTD.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As at and for the three and nine months ended September 30, 2016

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 8<sup>th</sup> Avenue S.W., Calgary, Alberta, Canada, T2P 1G1.

The interim condensed consolidated financial statements as at September 30, 2016 and December 31, 2015 and for the three and nine months ended September 30, 2016 and September 30, 2015 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, 2015, except as discussed in Note 2 below with respect to the adoption of revised accounting standards. These statements do not contain all disclosures required for full annual financial statements and should be read in conjunction with the audited consolidated financial statements as at and for the year ended December 31, 2015.

These interim condensed consolidated financial statements were authorized for issuance by the Company’s Board of Directors on November 16, 2016.

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 located in Canada. The Company does not have any 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 2015 annual consolidated financial statements with the exception of the following standard which was amended effective January 1, 2016.

Standard and Description	Date of Adoption	Adoption Impact on Consolidated Financial Statements
IFRS 11 <i>Joint Arrangements</i> – was amended regarding the accounting for the acquisition of an interest in a joint operation that constitutes a business.	January 1, 2016	The amendment to this standard did not impact these interim condensed consolidated financial statements.

#### Standards issued but not yet effective

The Company continues to assess the impact of adopting the new and revised accounting pronouncements that have been issued but are not yet effective. These include new and revised accounting pronouncements as described in the 2015 annual consolidated financial statements as well as amendments to IFRS 2, *Share-based Payment*, issued in June 2016.

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

As at and for the three and nine months ended September 30, 2016

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 3 – RESTRICTED CASH AND CREDIT FACILITY**

	As at	
	September 30, 2016	December 31, 2015
Restricted cash – current	108	2,288
Restricted cash – non-current	-	-
Restricted cash - total	108	2,288

The Company has a credit support facility (the “Facility”) with a Canadian bank for up to \$45.0 million Canadian dollars (“CAD”). This Facility allows for the issuance of letters of credit (“LC’s”) and letters of guarantee in support of the financial guarantees required by the National Agency of Petroleum, Natural Gas and Biofuels (the “ANP”) for Alvo Petro’s work commitments under the terms of its concession contracts as discussed further in Note 13. Letters of credit and letters of guarantee issued under the Facility are supported by either cash collateral posted by Alvo Petro or through an Account Performance Security Guarantee from Export Development Canada (“EDC”). EDC supports up to \$15.5 million of Alvo Petro’s LC’s issued under the Facility.

As at September 30, 2016, the total amount of LC’s issued under the Facility was \$14.1 million (December 31, 2015 - \$17.6 million), the full balance of which was satisfied by EDC (December 31, 2015 - \$15.3 million). All LC’s supported by restricted cash as at December 31, 2015 were released during the first quarter of 2016. The current restricted cash as at September 30, 2016 relates to abandonment guarantees posted in Brazil during the three months ended September 30, 2016 for the Bom Lugar and Jiribatuba fields and are not covered by LC’s issued under the Facility or by EDC.

LC’s supported by EDC at September 30, 2016 include \$0.4 million with respect to Block 256 and \$3.1 million with respect to Block 107. The work commitment for Block 256 was satisfied with the 256(A1) well, which was drilled in the three months ended September 30, 2016, subject to ANP approval. The work commitments associated with Block 107 were farmed out to a third party during the three months ended September 30, 2016, subject to receipt of environmental permits for the two wells to be drilled on the block and ANP approval of the transfer.

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

	As at	
	September 30, 2016	December 31, 2015
Balance, beginning of period	48,409	62,204
Capital expenditures	6,960	11,221
Capitalized share-based compensation	23	95
Transfer from other assets	-	272
Transfer to PP&E	(114)	-
Inventory used in operating workover	(72)	-
Change in decommissioning liabilities	247	104
Farmout	(300)	-
Impairment	(7,480)	(11,514)
Foreign currency translation	5,579	(13,973)
Balance, end of period	53,252	48,409

General and administrative costs totaling \$0.8 million (December 31, 2015 - \$1.0 million) that were directly related to exploration and evaluation activities have been capitalized as exploration and evaluation assets.

During the three months ended September 30, 2016, the Company entered into a farmout agreement whereby an independent third party (“the Farmee”) acquired a 95% participating interest in Block 107 subject to drilling two wells in satisfaction of work

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

As at and for the three and nine months ended September 30, 2016

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commitments on the block. Under the terms of the agreement, Alvo Petro received an upfront cash payment of \$0.3 million, and, upon completion of the work commitments and approval by the ANP, Alvo Petro will be entitled to exchange its 5% participating interest for a 5% gross-override royalty ("GORR") on the block. Subject to a drilling success on Block 107, Alvo Petro will also be entitled to a 5% GORR on an adjacent exploration block held by the Farmee. The closing of the farmout is conditional on, among other things, ANP approval and the timely receipt of environmental permits for the commitment wells to be drilled by the Farmee.

**Impairment**

During the three months ended September 30, 2016 the Company recorded an impairment of \$4.4 million related to costs incurred to date on Block 256. The 256(A1) well was drilled on this block during the period and with no commercial quantities of hydrocarbons discovered, the well was abandoned. Given limited prospectivity on this block, all costs incurred to date were impaired to bring the carrying value of the block to \$nil at September 30, 2016. The Company also recorded an impairment of \$0.1 million on inventory during the three months ended September 30, 2016.

The Company recorded an impairment of \$3.0 million in the three months ended March 31, 2016 with respect to costs incurred on the 170(B1) well which was drilled during the period. No commercial quantities of oil or gas were discovered in the well and, on March 29, 2016, the Company notified the ANP of its intention to relinquish this block. All costs incurred up to December 31, 2015 had been impaired in the 2015 financial statements and the 2016 impairment charge of \$3.0 million reduced the carrying value of the block to \$nil at March 31, 2016 (December 31, 2015 - \$nil). Any costs incurred on this block subsequent to March 31, 2016 have been recorded in exploration and evaluation expenditures and included in net loss.

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

	As at	
	September 30, 2016	December 31, 2015
Cost, beginning of period	8,696	10,717
Capital expenditures	726	886
Transferred from other assets	-	6
Transferred from E&E	114	-
Asset disposition	(52)	-
Capitalized share-based compensation	6	7
Change in decommissioning liabilities	-	(1,043)
Foreign currency translation	1,749	(1,877)
Cost, end of period	11,239	8,696
Accumulated depletion, depreciation and impairment, beginning of period	(4,403)	(3,228)
Depletion and depreciation for the period	(312)	(429)
Impairment	-	(1,524)
Foreign currency translation	(1,380)	778
Accumulated depletion, depreciation and impairment, end of period	(6,095)	(4,403)
Net book value, end of period	5,144	4,293

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

During the three months ended September 30, 2016 the Company disposed of under-utilized office assets and furniture. The total amount received for these items was \$0.01 million and the carrying value was \$0.05 million for a resultant loss on disposition of \$0.04 million.

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

As at and for the three and nine months ended September 30, 2016

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 6 – DECOMMISSIONING LIABILITIES**

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

	As at	
	September 30, 2016	December 31, 2015
Balance, beginning of period	1,079	3,454
Liabilities incurred	247	113
Revisions to obligations	-	(1,052)
Obligations settled	(160)	-
Disposition	-	(363)
Accretion	19	72
Foreign currency translation	235	(1,145)
Balance, end of period	1,420	1,079

Total undiscounted cash flows, escalated at 6.5% (December 31, 2015 - 6.5%) for inflation, required to settle the Company's decommissioning provision are estimated to be \$2.3 million (December 31, 2015 - \$1.9 million) and have been discounted using a weighted-average risk free rate of 2.7% (December 31, 2015 - 2.5%), which represents an estimated U.S. Treasury bill rate for a period consistent with the approximate remaining years to abandonment for each property.

Of the total \$1.4 million in decommissioning liabilities as at September 30, 2016, \$0.04 million (December 31, 2015 - \$0.01 million) relates to costs expected to be incurred within one year and accordingly, is classified as current in the consolidated statement of financial position.

**NOTE 7 – SHARE CAPITAL****a) Authorized**

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

**b) Issued and Outstanding Common Shares**

	Number of Shares	Amount (\$000s)
<b>Balance as at September 30, 2016 and December 31, 2015</b>	<b>85,166,871</b>	<b>151,937</b>



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

As at and for the three and nine months ended September 30, 2016

*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**

Alvopetro has a stock option plan whereby the Company may grant stock options to its directors, officers, employees and consultants. The plan allows for the issuance of up to ten percent of the outstanding common shares of the Company. The exercise price of each option is not less than the volume weighted five-day average price of the Company's common shares on the TSX Venture Exchange prior to the date of grant. Stock option terms are determined by the Company's Board of Directors but typically, options granted vest over a period of three years from the date of grant and expire five years from the date of grant. The options outstanding at September 30, 2016 are as follows:

	Number of Options	Weighted Average Exercise Price (CAD)
Balance as at December 31, 2014	4,567,436	0.82
Granted	2,303,500	0.34
Expired	(10,000)	1.02
Forfeited	(17,500)	0.75
Balance as at December 31, 2015	6,843,436	0.66
Granted	908,000	0.29
Expired	(797,498)	0.83
Forfeited	(747,502)	0.42
<b>Balance as at September 30, 2016</b>	<b>6,206,436</b>	<b>0.62</b>

Options Outstanding at September 30, 2016				Options Exercisable at September 30, 2016		
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\$0.24 - \$0.50	3,739,000	0.35	3.80	1,014,662	0.43	3.35
CAD\$0.51 - \$1.00	40,000	0.57	3.06	20,000	0.57	3.06
CAD\$1.01 - \$1.24	2,427,436	1.03	2.23	2,022,841	1.03	2.23
<b>CAD\$0.24 - \$1.24</b>	<b>6,206,436</b>	<b>0.62</b>	<b>3.18</b>	<b>3,057,503</b>	<b>0.83</b>	<b>2.61</b>

**d) Share-Based Compensation**

The fair value of the stock options granted under the Alvopetro stock option plan for the three and nine months ended September 30, 2016 and September 30, 2015 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 September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Risk free interest rate (%)	0.60	0.58	0.45	0.48
Expected term (years)	4.0	4.0	2.2	2.3
Expected volatility (%)	45.0	50.0	49.7	50.0
Dividend per share (%)	-	-	-	-
Forfeiture rate (%)	5.0	5.0	5.0	5.0
Weighted average fair value (CAD)	0.09	0.16	0.10	0.13

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

As at and for the three and nine months ended September 30, 2016

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

Total share-based compensation of \$0.05 million and \$0.1 million, respectively was computed for the three and nine months ended September 30, 2016 (September 30, 2015 – \$0.1 million and \$0.3 million) related to the AlvoPetro 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.

**e) Net Loss Per Share Attributable to Common Shareholders**

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

	Three and nine months ended September 30,	
	2016	2015
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 nine months ended September 30, 2016 and 2015, all stock options were excluded because the effect would be anti-dilutive.

**NOTE 8 – CAPITAL MANAGEMENT**

The Company's capital consists of the following:

	As at	
	September 30, 2016	December 31, 2015
Working capital, including current restricted cash	18,376	29,405
Shareholders' equity	75,352	80,732

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), non-current restricted cash, and shareholders' equity. At September 30, 2016, the Company's net working capital surplus of \$18.4 million (December 31, 2015 - \$29.4 million), included \$21.8 million (December 31, 2015 - \$28.7 million) of cash and \$0.1 million (December 31, 2015 - \$2.3 million) of current restricted cash.

During the three months ended September 30, 2016, the Company posted \$0.1 million with the ANP for abandonment guarantees related to the Bom Lugar and Jiribatuba fields. The Company does not have any other restricted cash balances at September 30, 2016 as the \$2.3 million of restricted cash at December 31, 2015 was released on March 31, 2016.

The Company has performance security guarantees with EDC which support up to \$15.5 million of LC's provided in respect of work commitments in Brazil. As at September 30, 2016, \$14.1 million (December 31, 2015 - \$15.3 million) of LC's were satisfied by EDC and the Company had \$1.4 million (December 31, 2015 - \$0.2 million) in available capacity for new LC's. Additional capacity may become available as work commitments are met and the related LC's are released.

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 \$75.4 million (December 31, 2015 - \$80.7 million). In the event that adjustments to the capital structure are necessary, the Company may consider issuing additional equity, raising debt or revising its capital investment programs.

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

As at and for the three and nine months ended September 30, 2016

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

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

**NOTE 9 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT**

The Company's financial instruments consist of cash and cash equivalents, restricted cash, trade and other receivables and accounts payable and accrued liabilities. The nature of Alvo Petro's operations exposes the Company to credit risk, liquidity risk, and market risk. Alvo Petro'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 policies.

*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 carrying values and respective fair values of Alvo Petro's financial instruments at September 30, 2016 and December 31, 2015 is set forth in the table below. The Company does not currently have any financial instruments classified as Level 2 or Level 3.

	As at			
	September 30, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Carried at fair value through profit or loss</b>				
Cash and cash equivalents <sup>(1)</sup>	21,827	21,827	28,733	28,733
Restricted cash – current <sup>(1)(2)</sup>	108	108	2,288	2,288
	<b>21,935</b>	<b>21,935</b>	31,021	31,021
<b>Carried at cost or amortized cost</b>				
Trade and other receivables	282	282	247	247
Accounts payable and accrued liabilities	(3,993)	(3,993)	(2,143)	(2,143)
	<b>(3,711)</b>	<b>(3,711)</b>	(1,896)	(1,896)

(1) Level 1

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

*Risks Associated with Financial Assets and Liabilities*

The nature of Alvo Petro's operations exposes the Company to credit risk, foreign currency risk, commodity price risk, interest rate risk, and liquidity risk. The Company has several practices and policies in place to help mitigate these risks. A description of the

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

As at and for the three and nine months ended September 30, 2016

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

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, 2015 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 September 30, 2016:

	As at			
	September 30, 2016		December 31, 2015	
	CAD (000's)	BRL (000's)	CAD (000's)	BRL (000's)
Cash and cash equivalents	388	1,097	197	1,482
Restricted cash, current	-	350	-	-
Trade and other receivables	8	896	10	933
Accounts payable and accrued liabilities	(69)	(11,385)	(54)	(7,315)
Net exposure in foreign currency	327	(9,042)	153	(4,900)
Net exposure in USD (\$000s)	249	(2,785)	111	(1,255)

The Company had no forward exchange rate contracts in place as at or during the periods ended September 30, 2016 or December 31, 2015.

**NOTE 10 – CHANGES IN NON-CASH WORKING CAPITAL**

Change in:	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Trade and other receivables	65	(11)	23	(21)
Prepaid expenditures	81	58	188	52
Accounts payable and accrued liabilities	2,529	(1,839)	1,482	(4,018)
	2,675	(1,792)	1,693	(3,987)
Changes relating to:				
Operating activities	593	(974)	320	(889)
Investing activities	2,082	(818)	1,373	(3,098)
	2,675	(1,792)	1,693	(3,987)

**NOTE 11 – NATURE OF EXPENSES**

Production expenses by nature were as follows:

Production expenses:	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Personnel	59	113	266	376
Production facilities rental	-	-	277	-
Other fixed	48	43	178	129
Variable	31	24	136	186
Workover	126	-	126	1
Total production expenses	264	180	983	692

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

As at and for the three and nine months ended September 30, 2016

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Workover costs are related to the producing well on the Bom Lugar field. The majority of the Company's year-to-date production expenses relate to personnel costs and production facilities rental costs for the 182(B1) well. This rental contract was cancelled during the three months ended June 30, 2016.

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

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
G&A expenses:				
Personnel	795	793	2,286	2,702
Travel	46	53	129	312
Office and IT	109	144	354	465
Professional fees	202	179	485	557
General corporate	76	154	359	485
Gross G&A expenses	1,228	1,323	3,613	4,521
Capitalized to E&E and PP&E	(374)	(219)	(878)	(905)
Net G&A expenses	854	1,104	2,735	3,616

The majority of the Company's G&A relates to personnel costs. General corporate expenses include public company costs, corporate insurance, directors' fees, rental vehicle costs, cell phones and other miscellaneous expenses. G&A expenses that are directly attributable to exploration and development projects are capitalized. The majority of capitalized costs relate to personnel.

**NOTE 12 – RELATED PARTY TRANSACTIONS**

Alvopetro has been party to non-material office-related administrative transactions with Touchstone Exploration Inc. ("Touchstone"), a related party of the Company due to common directors, summarized as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Office rent and related costs	13	50	60	151

This contract was terminated during the three months ended September 30, 2016. As at September 30, 2016 and December 31, 2015 the amount owed by the Company to Touchstone was \$nil.

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

As at and for the three and nine months ended September 30, 2016

*All tabular amounts are expressed in thousands of United States dollars, except per share amounts or as otherwise noted***NOTE 13 – COMMITMENTS AND CONTINGENCIES**

The following is a summary of contractual commitments as at September 30, 2016:

<b>Commitments</b>	<b>&lt; 1 Year</b>	<b>1-3 Years</b>	<b>Thereafter</b>	<b>Total</b>
Minimum work commitments <sup>(1)</sup>				
Block 183	1,027	-	-	1,027
Block 106	351	-	-	351
Block 107 <sup>(2)</sup>	2,341	-	-	2,341
Block 177	2,215	-	-	2,215
Block 169	1,171	-	-	1,171
Block 198	1,171	-	-	1,171
Block 255	1,401	-	-	1,401
Block 256 <sup>(3)</sup>	311	-	-	311
Block 57 <sup>(4)</sup>	-	273	-	273
Block 62 <sup>(4)</sup>	-	273	-	273
Block 71 <sup>(4)</sup>	-	187	-	187
Block 145 <sup>(4)</sup>	-	273	-	273
Bom Lugar	-	-	108	108
Jiribatuba	-	-	108	108
Total minimum work commitments	9,988	1,006	216	11,210
Office leases <sup>(5)</sup>	179	229	-	408
<b>Total commitments</b>	<b>10,167</b>	<b>1,235</b>	<b>216</b>	<b>11,618</b>

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) During the three months ended September 30, 2016, the Company entered into a farmout agreement with respect to Block 107. Under the terms of the agreement, the Farmee is responsible to drill two wells in satisfaction of the work commitments included in the table above. The farmout is subject to ANP approval and the receipt of environmental permits for the two wells to be drilled by the Farmee.
- (3) During the three months ended September 30, 2016, the Company completed drilling the 256(A1) well in satisfaction of the work commitment in the table above, subject to ANP approval.
- (4) Alvo Petro holds a 65% interest in each of these blocks and the amounts provided in the table above represent Alvo Petro's share of the related commitments.
- (5) The Company is committed to future minimum payments for office space in Canada and Brazil.

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 possible for the Company to do so. If the Company does not meet the local content requirements for a particular phase as specified according to the respective concession contract, a fine, which varies by concession depending on exploration phase and type of cost, will be incurred. The Company is continually monitoring its local content compliance and actual or potential fines and, as of September 30, 2016, the potential estimated fine was \$0.1 million (December 31, 2015 - \$0.1 million), which is included in accounts payable and accrued liabilities in the respective consolidated statements of financial position.