MANAGEMENT'S REPORT

Management is responsible for the integrity and objectivity of the information contained in this report and for the consistency between the consolidated financial statements and other financial and operating data contained elsewhere in this report. The accompanying consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards using estimates and careful judgment, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying consolidated financial statements have been prepared using policies and procedures established by management and fairly reflect the Company's financial position, financial performance and cash flows, in accordance with International Financial Reporting Standards. Management has established and maintains a system of internal controls that is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and the financial information is reliable and accurate.

The Company's external auditors, Deloitte LLP, have audited the consolidated financial statements. Their audit provides an independent view as to the fairness of reported financial results and the financial performance of the Company.

The Audit Committee of the Board of Directors has reviewed in detail the consolidated financial statements with management and the external auditors. The Audit Committee has reported its findings to the Board of Directors who have approved the consolidated financial statements.

Corey C. Ruttan
President & Chief Executive Officer & Director

Alison Howard
Chief Financial Officer

Calgary, Canada
March 21, 2019

Deloitte.

Deloitte LLP
700, 850 2 Street SW
Calgary, AB T2P 0R8
Canada

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Independent Auditor's Report

To the Shareholders of Alvopetro Energy Ltd.

Opinion

We have audited the consolidated financial statements of Alvopetro Energy Ltd. (the "Company"), which comprise the consolidated statements of financial position as at December 31, 2018 and 2017, and the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Material Uncertainty Related to Going Concern

We draw attention to Note 2 in the financial statements, which describe the events and conditions that indicate the existence of material uncertainties that may cast significant doubt about the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards ("Canadian GAAS"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information comprises:

- Management's Discussion and Analysis

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon. In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis prior to the date of this auditor's report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in this auditor's report. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian GAAS will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian GAAS, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Sippy Chhina.

Deloitte LLP

Chartered Professional Accountants
Calgary, Alberta
March 21, 2019

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Thousands of United States dollars)

	Note	December 31, 2018	December 31, 2017
ASSETS			
Current			
Cash and cash equivalents		**7,070**	9,189
Restricted cash		**135**	106
Trade and other receivables		**284**	153
Prepaid expenditures		**330**	208
Assets held for sale	5	**202**	236
Total current assets		**8,021**	9,892
Exploration and evaluation assets	6	**35,340**	54,585
Property, plant and equipment	7	**22,011**	4,238
Non-current assets		**57,351**	58,823
Total assets		**65,372**	68,715
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		**1,221**	1,111
Current portion of decommissioning liabilities	8	**71**	19
Total current liabilities		**1,292**	1,130
Long-term liabilities	9	**2,348**	-
Decommissioning liabilities	8	**1,160**	1,445
Total liabilities		**4,800**	2,575
Shareholders' equity			
Share capital	10	**155,731**	151,937
Contributed surplus		**1,813**	1,662
Deficit		**(71,847)**	(67,507)
Accumulated other comprehensive loss		**(25,125)**	(19,952)
Total shareholders' equity		**60,572**	66,140
Total liabilities and shareholders' equity		**65,372**	68,715

Basis of presentation and going concern (Note 2)
Commitments and contingencies (Note 18)

The accompanying notes are an integral part of these consolidated financial statements.

Approved by:

John D. Wright
Chairman of the Board of Directors

Firoz Talakshi
Chairman of the Audit Committee

ALVOPETRO ENERGY LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Thousands of United States dollars, except per share amounts)

		Year ended December 31,	
	Note	**2018**	2017
Revenue			
Oil sales	15	**519**	462
Royalties and production taxes		**(55)**	(51)
Oil revenue		**464**	411
Other income		**152**	144
Total revenue and other income		**616**	555
Expenses			
Production	16	**840**	824
Transportation		**13**	23
General and administrative	16	**2,762**	2,607
Depletion and depreciation	7	**144**	205
Impairment	6,7	**765**	3,661
Accretion of decommissioning liabilities	8	**41**	37
Exploration and evaluation expense		**209**	212
Share-based compensation	10	**95**	85
Foreign exchange		**32**	2
Loss on disposition of assets	5,6,7	**55**	16
Total expenses		**4,956**	7,672
Loss before taxes		**(4,340)**	(7,117)
Income tax	11	**-**	-
Net loss		**(4,340)**	(7,117)
Exchange loss on translation of foreign operations		**(5,173)**	(622)
Comprehensive loss		**(9,513)**	(7,739)
Net loss per share	10		
Basic		**(0.05)**	(0.08)
Diluted		**(0.05)**	(0.08)

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Thousands of United States dollars)

		Year Ended December 31,	
	Note	**2018**	2017
Common shares			
Balance, beginning of year		**151,937**	151,937
Issue of common shares – gross proceeds		**4,019**	-
Share issuance costs – cash		**(184)**	-
Share issuance costs – warrants issued		**(41)**	-
Balance, end of year	10	**155,731**	151,937
Contributed surplus			
Balance, beginning of year		**1,662**	1,558
Share-based compensation expense		**95**	85
Share-based compensation capitalized		**15**	19
Share issuance costs – warrants issued		**41**	-
Balance, end of year	10	**1,813**	1,662
Deficit			
Balance, beginning of year		**(67,507)**	(60,390)
Net loss		**(4,340)**	(7,117)
Balance, end of year		**(71,847)**	(67,507)
Accumulated other comprehensive loss			
Balance, beginning of year		**(19,952)**	(19,330)
Other comprehensive loss		**(5,173)**	(622)
Balance, end of year		**(25,125)**	(19,952)

The accompanying notes are an integral part of these consolidated financial statements.

ALVOPETRO ENERGY LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Thousands of United States dollars)

		Year ended December 31,	
	Note	**2018**	2017
Operating Activities			
Net loss		**(4,340)**	(7,117)
Adjustments for non-cash items:			
Depletion and depreciation	7	**144**	205
Impairment	6,7	**765**	3,661
Accretion of decommissioning liability	8	**41**	37
Share-based compensation	10	**95**	85
Loss on disposition of assets	5,6,7	**55**	16
Unrealized foreign exchange (gain) loss		**(14)**	8
Non-cash exploration & evaluation		**-**	(10)
Settlement of decommissioning liabilities	8	**(12)**	(139)
Funds flow from operations		**(3,266)**	(3,254)
Changes in non-cash working capital	14	**8**	(563)
		(3,258)	(3,817)
Investing Activities			
Expenditures on exploration and evaluation assets	6	**(1,904)**	(4,906)
Expenditures on property, plant and equipment	7	**(719)**	(77)
Proceeds on dispositions	5,6,7	**156**	162
Change in restricted cash		**(44)**	-
Changes in non-cash working capital	14	**(16)**	(71)
		(2,527)	(4,892)
Financing Activities			
Issue of common shares	10	**4,019**	-
Share issuance costs	10	**(184)**	-
		3,835	-
Change in cash and cash equivalents		**(1,950)**	(8,709)
Effect of foreign exchange on cash balances		**(169)**	110
Cash and cash equivalents, beginning of year		**9,189**	17,788
Cash and cash equivalents, end of year		**7,070**	9,189
Cash and cash equivalents consist of:			
Cash		**1,210**	1,782
Cash equivalents		**5,860**	7,407
Supplemental information:			
Cash income taxes paid		**-**	-
Cash interest income received		**133**	143

The accompanying notes are an integral part of these consolidated financial statements.

NOTE 1 – NATURE OF OPERATIONS

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.

NOTE 2 – BASIS OF PRESENTATION AND GOING CONCERN

Basis of Measurement and Statement of Compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and were authorized for issuance by the Company's Board of Directors on March 21, 2019.

The consolidated financial statements are presented in U.S dollars ("USD") which is the parent Company's functional currency.

Going Concern

These financial statements have been prepared on a going concern basis, which assumes that the Company will continue its operations for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. While the Company had positive working capital of $6.7 million as at December 31, 2018, it has not yet achieved commercial operations and had a net loss of $4.3 million and negative cash flows from operations of $3.3 million for the year ended December 31, 2018 and had an accumulated deficit of $71.8 million as at December 31, 2018. Furthermore, as a part of the Unit Operating Agreement ("UOA"), Gas Sales Agreement and Gas Treatment Agreement entered into in 2018, the Company has anticipated payments totaling $10.7 million on the Caburé natural gas field and related midstream infrastructure to ensure the Company is able to commence gas deliveries in 2020. Should the Company be delayed in commencement of gas deliveries, it may incur ship or pay penalties under the Gas Sales Agreement and additional charges under the Gas Treatment Agreement as discussed further in Note 18. The Company's ability to continue as a going concern is dependent on management's ability to identify additional sources of capital and to raise sufficient resources to fund the Caburé and Gomo development as planned and scheduled, the Company's plans and commitments on its exploration blocks and mature fields, and ongoing operating expenses. There is no assurance that financing initiatives will be successful. These conditions indicate the existence of material uncertainties that cast significant doubt regarding the applicability of the going concern assumption. These financial statements do not give effect to adjustments that would be necessary to the carrying values and classification of assets and liabilities should the Company be unable to continue as a going concern. These adjustments could be material.

Use of Judgments, Estimates and Assumptions

The preparation of financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that impact the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, if any, as at the date of the consolidated statements of financial position as well as the reported amounts of revenue, expenses and cash flows during the periods presented. Management makes judgments regarding the application of IFRS for each accounting policy. Estimates and assumptions relate primarily to unsettled transactions and events as of the date of the consolidated financial statements and actual results could differ materially from estimated amounts. Judgments, estimates and assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and on a prospective basis. Estimates are subject to measurement uncertainty and changes in such estimates in future years could require a material change in the consolidated financial statements.

Judgments, estimates and assumptions made by management that have the most significant effect on the amounts recognized in the consolidated financial statements are discussed in further detail below.

Going Concern

The preparation of financial statements requires management to make judgments regarding the going concern assumption for the Company as discussed in Note 2.

Exploration and Evaluation ("E&E") Assets

Costs incurred after the legal right to explore an area has been obtained and prior to establishing technical feasibility and commercial viability are capitalized as exploration and evaluation assets. Exploration and evaluation assets are transferred to property, plant and equipment upon establishment of technical feasibility and commercial viability. The determination of technical feasibility and commercial viability involves significant estimates and assumptions and management's application of the Company's accounting policy for exploration and evaluation assets requires judgment.

The carrying amount of exploration and evaluation assets are reviewed at the end of each reporting period to determine whether there is an indication of impairment or impairment reversal. This requires significant judgment, estimates and assumptions with respect to future prospects, drilling success, well results from other activities including completions and stimulations, existing commitments and expiry of rights to explore, available funds, projected production rates, future market conditions and other significant changes (technological, economic, legal, regulatory) that could have an adverse effect on the Company.

Property, Plant and Equipment ("PP&E")

Oil and natural gas assets classified as property, plant and equipment are aggregated into cash-generating units ("CGUs"). The determination of the Company's CGUs is subject to judgment. Factors considered in the classification of CGUs include any integration between assets, shared infrastructures, sales points and sales contracts, geography, geologic structure, exposure to market risks and management's intentions with respect to future development plans. Each CGU is tested for impairment based on estimates of discounted future cash flows. The estimation of future cash flows, including reserves, is an inherently complex process which involves professional judgment and geoscientific interpretation as well as estimates of future production rates, future commodity prices and the timing and amount of future expenditures, all of which are subject to uncertainty.

Decommissioning Liabilities

In estimating future decommissioning liabilities various assumptions are required with respect to the amount and timing of abandonment and reclamation costs, inflation factors, future interest rates and potential changes in the legal, regulatory, environmental and political environments.

Foreign Exchange

The designation of the Company's functional currencies is a judgment made by management based on the currency of the primary economic environment in which the Company operates. The functional currency of the Brazilian subsidiaries is the Brazilian Real ("BRL"). Despite the fact that the benchmark price for oil is set in USD and the contracted price for natural gas under the Company's long-term natural gas sales agreement is derived from benchmark USD prices, due to the business environment as well as policies and regulations in Brazil, management is of the opinion that the primary economic environment influencing the Company's labour, material and other costs as well as actual cash receipts from oil sales is Brazil.

NOTE 3 – SIGNIFICANT ACCOUNTING POLICIES

Consolidation

These consolidated financial statements include the accounts of Alvopetro and its controlled subsidiaries. Intercompany transactions and balances are eliminated on consolidation. As at December 31, 2018 and 2017, the Company controls 100 percent of its subsidiaries.

Joint Operations

The Company has oil and gas exploration activities that are conducted jointly with others and these consolidated financial statements reflect the Company's proportionate share of the assets, liabilities, expenses and cash flows from such activities.

A joint arrangement is either a joint operation, whereby the parties have rights to the assets and obligations for the liabilities, or a joint venture, whereby the parties have rights to the net assets. Determination of the parties' rights requires management judgment with respect to the structure of the arrangement as well as rights to the assets and obligations of the liabilities.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand and investments and deposits with an initial maturity of three months or less. Cash and cash equivalents are initially recorded at fair value.

Restricted Cash

Restricted cash consists of cash, cash equivalents, and short-term cash deposits (deposits with an initial maturity of one year or less) held as collateral to ensure the Company's fulfillment of work commitments and other obligations pursuant to concession contracts and credit agreements. Restricted cash is initially recorded at fair value. Restricted cash held as collateral for letters of credit expiring in less than one year is classified as current, with the remainder classified as non-current.

Assets Held for Sale

Assets are classified as held for sale if the carrying amount will be recovered principally through a highly probable sale transaction rather than through continued use. In accordance with IFRS, a sale is considered highly probable if the assets are available for immediate sale and management has stated their intention to sell the properties within one year. Assets classified as held for sale are measured at the lower of the carrying amount and the fair value less costs to sell, and are not depreciated.

Exploration and Evaluation ("E&E") Assets

Pre-exploration and pre-licensing costs associated with the investigating, bidding and acquisition of petroleum properties are expensed as exploration and evaluation expense when the targeted petroleum lease or concession is not obtained. Additionally, any costs incurred in advance of obtaining the lease or concession are also expensed.

Costs incurred subsequent to obtaining the rights to explore, and prior to establishing commercial viability and technical feasibility, are classified as E&E assets. Such costs include land and license acquisition, technical services and studies, exploration drilling and testing, and directly attributable employee compensation. E&E assets include equipment inventory for use on future exploration wells. E&E assets are not depleted and are classified as such until they are considered technically feasible and commercially viable.

When E&E assets are considered technically feasible and commercially viable they are reclassified to PP&E. Technical feasibility and commercial viability is initially indicated by the assignment of proved and/or probable reserves and then further subject to management judgement considering all relevant factors. Upon determination of technical feasibility and commercial viability, the E&E assets are tested for impairment and the estimated recoverable amount is transferred to PP&E.

When it has been determined that the Company will not be continuing activities in an area classified as an E&E asset or that the accumulated costs are not recoverable, the unrecoverable costs are charged to the consolidated statements of operations and comprehensive loss as impairment expense. Any related costs incurred subsequent to this determination are directly expensed as exploration and evaluation expense.

Property, Plant and Equipment ("PP&E")

PP&E consists primarily of oil and natural gas development and production assets and, to a lesser extent, operational equipment for use on future exploration and development projects and corporate assets.

Oil and natural gas assets include all costs directly associated with the development of oil and natural gas reserves. These expenditures include proved property acquisitions, geological and geophysical costs, development drilling and completions on productive and non-productive wells, infrastructure, decommissioning liabilities, directly attributable employee compensation and transfers from exploration and evaluation assets where technical feasibility and commercial viability has been established.

Oil and natural gas assets are accumulated on a CGU basis. Costs accumulated within each CGU are depleted using the unit-of-production method based on proved plus probable reserves before royalties as determined by independent petroleum reservoir engineers. Included in the depletion base are capitalized costs and estimated future costs to be incurred in developing proved and probable reserves.

Costs related to replacing parts of assets included in PP&E are capitalized only when they increase the future economic benefits to be derived from the specific asset to which they relate. All other expenditures are recognized as an expense in the consolidated statements of operations and comprehensive loss as incurred. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property, plant and equipment are recognized as an expense in profit and loss as incurred.

Corporate assets included within PP&E consist primarily of computer equipment, leasehold improvements and office furniture and equipment. Depreciation of operational equipment and corporate assets is calculated on a straight-line basis over the estimated useful life of the related assets.

Impairment

E&E assets are comprised of the accumulated expenditures for each block for which technical feasibility and commercial viability has not yet been determined. E&E assets are reviewed quarterly for indicators of impairment and at the time of transfer to PP&E. Indicators of impairment consist of facts and circumstances suggesting that the carrying amount of an exploration and evaluation asset may exceed its recoverable amount. Where the carrying amount exceeds the estimated recoverable amount, the unrecoverable costs are charged to the consolidated statements of operations and comprehensive loss.

PP&E assets are grouped for impairment purposes by CGU and reviewed quarterly for indicators of impairment. An impairment test is performed whenever events or changes in circumstances indicate that the carrying value of the asset or CGU may not be recoverable. The CGUs recoverable amount is the greater of its fair value less costs of disposal and its value-in-use. Fair value less costs of disposal is determined using discounted future cash flows of proved plus probable reserves using forecasted prices and costs. The value-in-use is determined by estimating the present value of the future net cash flows expected to be derived from the continued use of the asset or CGU. If the carrying amount exceeds the estimated recoverable amount, the CGU is written down with an impairment loss recorded in the consolidated statement of operations and comprehensive loss.

Impairment losses from previous periods are assessed at each reporting date for indications that the impairment loss no longer exists or has decreased. Impairment losses can be reversed if there is a change in the estimates used to determine the recoverable amount but cannot exceed the carrying value of the asset prior to impairment less any depreciation and depletion that would have been taken if no impairment had been recognized.

Decommissioning Liabilities

The Company recognizes the estimated fair value of future decommissioning liabilities related to statutory, contractual or other legal obligations associated with the retirement of assets, when a reasonable estimate of the provision can be determined and it is probable that an outflow of resources will be required to settle the obligation. A corresponding increase to the carrying amount of the related asset is recorded.

Decommissioning liabilities are based on the estimated costs to abandon and reclaim all wells and facilities as required under the terms of concession contracts and laws and regulations within Brazil. The estimate is evaluated on a quarterly basis and any adjustment to the estimate is applied prospectively. The liability is estimated by discounting expected future cash outflows required to settle the obligation using a risk-free rate. As all abandonment and reclamation activities are expected to be funded in USD, in determining the risk-free rate the Company uses the U.S. treasury bill rate for maturities coinciding with the estimated remaining years to abandonment. The change in net present value of the future decommissioning liabilities due to the passage of time is expensed as accretion expense on the consolidated statements of operations and comprehensive loss. The costs capitalized to the related assets are amortized to earnings in a manner consistent with the depletion and depreciation of the underlying assets. Revisions to the estimated timing of cash flows, inflation rates, discount rates or to the original estimated undiscounted costs also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligations are charged against the obligation to the extent of the liability recorded.

Revenue Recognition

Revenue is recognized when the significant risks and rewards of ownership have transferred to the buyer, when the amounts of revenue and the costs incurred or to be incurred can be measured reliably, and when collection is reasonably assured.

Share-based Compensation

The Company accounts for share-based compensation using the Black-Scholes option-pricing model to determine the fair value of stock options and warrants on grant date using various estimates, based on management's judgment and assumptions, including expected share price volatility, risk-free interest rate and expected term of the options.

Share-based compensation is measured at fair value on the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. Forfeitures are estimated at the grant date and adjusted as actual forfeitures occur, until the options are fully vested. Consideration paid upon the exercise of stock options and warrants, together with corresponding amounts previously recognized in contributed surplus, is recorded as an increase to share capital. The Company capitalizes the portion of share-based compensation directly attributable to its exploration and development activities, with a corresponding decrease to share-based compensation expense.

Income Taxes

Income tax expense is comprised of current and deferred income taxes. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity.

Current tax expense is based on estimated taxable income and tax rates which are determined pursuant to tax law enacted or substantively enacted at the reporting date.

The Company follows the liability method of accounting for deferred taxes. Under this method, deferred income tax assets or liabilities are recorded to reflect the difference between the accounting and tax base of assets and liabilities and unused tax losses. Deferred income taxes are measured using tax rates that are expected to apply to the period when the deferred tax asset is realized or the deferred tax liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted by the end of the reporting period.

Deferred income tax assets are recognized for deductible temporary differences to the extent it is probable that future taxable profit will be available. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent it is no longer probable that sufficient taxable profits will be available to allow the assets to be recovered. Deferred income tax assets and liabilities are offset only if there is a legally enforceable right to offset and they relate to income taxes levied by the same tax authority on the same taxable entity or on different tax entities to the extent they could be realized simultaneously.

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. The measurement of income tax expense, related provisions and deferred tax liabilities and assets is based on judgments in applying income tax law and estimates on the applicable tax rates and the timing, likelihood and reversal of temporary differences between the accounting and tax bases of assets and liabilities as well the expected recoverability of deferred tax assets. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. If these judgments and estimates prove to be inaccurate, the actual income tax liability may differ significantly from that estimated and recorded by management and future earnings may be impacted.

Per Share Amounts

The Company computes basic earnings or loss per share using net income or loss divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated using the treasury stock method which assumes that any proceeds received by the Company upon the exercise of in-the-money stock options, plus unamortized stock compensation costs, would be used to buy back common shares at the average market price for the period.

Foreign and Reporting Currency

The Company's functional currencies are the BRL for all Brazil entities and the USD for all Canadian entities. Given that the Company conducts the majority of its business in international markets and its revenues are largely dependent on international commodity prices, Alvopetro has chosen to present its consolidated financial statements in USD.

Transactions in currencies other than the entity's functional currencies are recognized at the rates of exchange prevailing at the date of the transactions. At the end of each reporting period, monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect at the reporting period date. Non-monetary assets, liabilities, revenues and expenses are translated at transaction date exchange rates. Exchange gains or losses are included in the determination of net loss as foreign exchange gains or losses.

The assets and liabilities of all Brazil entities are translated to USD at exchange rates at the reporting date. The income and expenses of foreign operations are translated to USD at exchange rates at the date of the transactions. Resultant foreign currency differences are recognized in other comprehensive loss.

Financial Instruments

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. All financial assets and liabilities are initially recognized at fair value on the consolidated statements of financial position with subsequent measurement based on the classification of the financial instrument into one of the following categories: subsequently measured at amortized cost, fair value through profit or loss ("FVPL"), or fair value through other comprehensive income ("FVOCI").

Financial instruments classified as FVPL are subsequently carried at fair value, with changes recognized in net income. Financial assets and liabilities classified as amortized cost are subsequently carried at amortized cost using the effective interest rate method. Financial instruments classified as FVOCI are subsequently carried at fair value, with changes recognized in other comprehensive income.

Financial instruments classified as FVPL include cash and cash equivalents and restricted cash. Financial instruments subsequently measured at amortized cost include trade and other receivables, accounts payable and accrued liabilities, and long-term liabilities.

At each reporting date, the Company assesses whether there is objective evidence that a financial asset carried at amortized cost is impaired. The Company has adopted the simplified approach in calculating expected credit losses for its trade and other receivables. The Company uses judgment in making these assumptions and selecting the inputs into the expected loss calculation based on past history, including historical loss experience, existing market conditions and forward-looking estimates at the end of each reporting period. Any impairment is recorded in profit or loss and impairment losses can be reversed in subsequent periods. Prior to January 1, 2018, the Company recorded the financial asset at carrying value, with any expected loss provided for through the use of an allowance account.

Segmented Operations

All oil sales revenue is derived from Brazilian operations. All exploration and evaluation assets and all material property, plant and equipment are located in Brazil. The majority of the Company's cash and cash equivalents are held in Canada. The Company does not have any significant revenue in Canada other than interest earned on cash.

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

NOTE 4 – CHANGES IN ACCOUNTING STANDARDS

New and Revised Accounting Standards

On January 1, 2018, the Company retrospectively adopted IFRS 15 *Revenue from Contracts with Customers* which replaced existing revenue guidance to require entities recognize revenue to reflect the transfer of goods and services for the amount it expects to receive when control is transferred to the purchaser. Adoption of this standard did not have any adjustments to the Company's consolidated financial statements with the exception of expanded note disclosure (see Note 15).

Effective January 1, 2018, the Company adopted IFRS 9 *Financial Instruments*. IFRS 9 introduced new models for the classification and measurement of financial instruments, hedge accounting and impairment of financial assets. The Corporation elected to apply the standard on a retrospective method whereby all prior year statements are restated. Financial assets previously classified as loans and receivables (trade and other receivables) as well as financial liabilities previously classified as other financial liabilities (accounts payable and accrued liabilities) have been reclassified to amortized cost. The carrying value and measurement of all financial instruments remains unchanged and there were no impacts to the consolidated financial statements upon the adoption of the new standard.

The amendments to IFRS 2, *Share-based Payment* were adopted January 1, 2018 with no effect on the consolidated financial statements. The amendments clarify the classification and measurement of certain types of share-based payment transactions.

Standards Issued but not Yet Effective

IFRS 16, *Leases* was issued in January 2016 and replaces IAS 17 *Leases* and IFRIC 4 *Determining Whether an Arrangement Contains a Lease*. Under the current guidance, finance leases are recognized on the balance sheet while operating leases are recognized in the consolidated statements of income when the expense is incurred. Under IFRS 16, substantially all lease contracts, with the exception of those that qualify for certain exemptions as provided by the guidance, require recognition of a lease liability and a corresponding right-of-use asset. The recognition of the present value of minimum lease payments for certain of the Company's contracts currently classified as operating leases will result in an increase in assets, liabilities, depletion, depreciation and amortization and finance expense. Consequently G&A expenses will be reduced. Although cash movement will be unchanged, presentation in the statement of cash flows will be different under this new standard. The Company continues to assess and quantify the effect of this standard on the consolidated financial statements.

The Company will adopt IFRS 16 on the effective date of January 1, 2019 under the modified retrospective transition approach. Optional exemptions to not recognize certain short-term leases or leases of low value will be applied by the Company. In addition, the Company has elected to separate non-lease components from lease components for all underlying asset classes as at January 1, 2019.

NOTE 5 – ASSETS HELD FOR SALE

	Year Ended December 31,	
	2018	2017
Balance, beginning of year	**236**	410
Transferred from E&E assets (Note 6)	**-**	322
Disposal – cash proceeds	**-**	(105)
Disposal – in exchange for drilling services	**-**	(396)
Foreign currency translation	**(34)**	5
Balance, end of year	**202**	236

The balance at December 31, 2018 and 2017 represents land owned by the Company which was listed for sale in 2017 and the Company anticipates selling in 2019.

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

In several separate transactions during the year ended December 31, 2017, the Company disposed of equipment inventory classified as held for sale. Upon transfer to held for sale, all inventory was written down to the estimated recoverable amount and a nominal gain resulted on these dispositions from total cash and non-cash proceeds of $0.5 million. All dispositions were to third parties of Alvopetro and the drilling services received in exchange were measured at fair value.

NOTE 6 – EXPLORATION AND EVALUATION ASSETS

	Year Ended December 31,	
	2018	2017
Balance, beginning of year	**54,585**	53,259
Capital expenditures – cash	**1,904**	4,906
Capital expenditures – non-cash[(1)]	**313**	449
Capitalized share-based compensation	**3**	18
Change in decommissioning liabilities	**(31)**	189
Transfer to PP&E (Note 7)	**(15,527)**	-
Transfer to assets held for sale (Note 5)	**-**	(322)
Other transfers	**(4)**	10
Asset dispositions	**(426)**	(122)
Impairment	**(765)**	(3,189)
Foreign currency translation	**(4,712)**	(613)
Balance, end of year	**35,340**	54,585

(1) Non-cash capital expenditures of $0.3 million in 2018 relate to costs initially funded by our partner under the terms of the UOA (Note 9) and $0.4 million in 2017, largely in respect of drilling services received in exchange for assets held for sale.

In April 2018, the Company finalized the terms of the UOA with the resource owner adjacent to Alvopetro's Caburé natural gas asset. An independent reserves evaluation, with an effective date of May 31, 2018, assigned proved plus probable reserves to the Caburé natural gas field, a shared gas field which extends across Alvopetro's Blocks 197 and 198 and two other blocks held by our partner, and the Gomo gas discovered from our 183(1) and 197(1) wells on Blocks 183 and 197 respectively. Consequently, the Company realigned its cash-generating units to combine Blocks 183, 197 and 198 to comprise a single cash-generating unit ("CGU") based on geographical proximity, shared infrastructure, a common gas sales agreement and management's intentions with respect to development of this area.

Pursuant to the Company's E&E accounting policy, E&E assets are transferred to PP&E when the assets are considered technically feasible and commercially viable, which is initially indicated by the assignment of proved and/or probable reserves. Management's evaluation of the facts and circumstances determined the criteria for technical feasibility and commercial viability was met for the Caburé natural gas field and the $15.2 million carrying value of the field was transferred to PP&E as at May 31, 2018. At the time of the transfer to PP&E, the Company tested the asset for impairment and, as the estimated recoverable amount exceeded the carrying value, no impairment was recorded.

During 2018 the Company recognized a $0.7 million transfer of equipment classified as E&E assets to the jointly-owned Caburé natural gas unit. Of the total amount, $0.3 million represented the Company's share and is included in the $15.5 million transfer to PP&E. Alvopetro's operating partner's share of the equipment transferred ($0.4 million) was recorded as a disposition. The value assigned to this equipment pursuant to the UOA was equivalent to Alvopetro's net book value of the equipment and no gain or loss was recorded on the transfer.

The reserves assigned to Alvopetro's Gomo gas discovery from the 183(1) and 197(1) wells in the May 31, 2018 and December 31, 2018 independent reserves evaluations are limited to the drainage area around the two existing wells and do not reflect any further potential of the asset beyond this area. As such, the Company will continue to evaluate the commercial viability and technical feasibility of this asset and plans to perform a stimulation of the 183(1) well in 2019, followed by long-term production testing. The carrying value of this portion of the CGU remains in E&E as at December 31, 2018, to be re-evaluated with additional information obtained from the stimulation and production testing results. Given the positive results to date, the Gomo gas discovery from our 183(1) and 197(1) wells, and the Company's future plans for this project, there is no indication of impairment of this E&E asset as at December 31, 2018.

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

General and administrative costs totaling $0.6 million (December 31, 2017 - $1.1 million) that were directly related to exploration and evaluation activities have been capitalized as exploration and evaluation assets.

The Company holds equipment inventory which has historically been primarily used for exploration wells and, accordingly, the carrying value of the equipment inventory is included in E&E assets. During 2018, the Company disposed of equipment inventory classified as E&E assets in several separate transactions, all to third parties of Alvopetro. Total proceeds were $0.1 million and there were no gains or losses on the transactions. During 2017, the Company disposed of equipment inventory classified as E&E assets in several separate transactions, all to third parties of Alvopetro. Proceeds, including both cash and non-cash consideration, totaled $0.1 million, resulting in a loss of $0.02 million.

Impairment

The Company recorded impairment losses as follows on its E&E assets:

	Year ended December 31,	
	2018	2017
Block 62	**(129)**	-
Block 71	**(122)**	-
Block 106	**(196)**	-
Block 145	**(105)**	-
Block 177	**-**	(2,384)
Block 169	**(101)**	(269)
Block 255	**(71)**	(337)
Equipment inventory and other E&E assets	**(41)**	(199)
Net E&E impairment loss	**(765)**	(3,189)

Blocks 62, 71 and 145 were relinquished in early 2019 and accordingly, the carrying values at December 31, 2018 were written down to $nil with an impairment loss of $0.4 million.

The Company relinquished Block 106 in July 2018. As such, an impairment loss of $0.2 million was recorded to reduce the carrying value of this block to $nil at June 30, 2018.

Blocks 169 and 255 were awarded to Alvopetro in the 12th Brazil Bid Round. In 2014, an injunction was issued by a Brazilian Federal Court prohibiting unconventional activities on all 12th Brazil Bid Round Blocks, including Blocks 169 and 255. As a result of this continuing injunction, in December 2017 Alvopetro filed a request with the National Agency of Petroleum, Natural Gas and Biofuels of Brazil ("ANP") to cancel these concession contracts including the associated work commitments and refund the original bid round bonuses paid in 2014. At that time Alvopetro recorded impairment losses for Blocks 169 and 255, to reduce the carrying value of each of these blocks to reflect only the bid round bonuses expected to be returned pursuant to this request. At December 31, 2018, with no affirmative response from the ANP, the Company recorded an impairment loss totaling $0.2 million on these blocks, reducing the carrying value of these blocks to $nil at December 31, 2018.

The drilling results from the 177(A1) well drilled on Block 177 in 2017 indicated limited prospectivity and the Company relinquished the block in early 2018. An impairment loss was recorded to reduce the carrying value of the block to $nil as of December 31, 2017.

The Company is continually assessing the value of its inventory and provides for impairment on any items which are considered to have a book value in excess of its recoverable amount. As at December 31, 2018, the Company held $1.9 million (December 31, 2017 - $2.9 million) of equipment to be utilized for future operations.

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

NOTE 7 – PROPERTY, PLANT AND EQUIPMENT

	Year Ended December 31,	
	2018	2017
Cost, beginning of year	**9,514**	9,599
Capital expenditures - cash	**719**	77
Capital expenditures – non-cash – initially funded by partner (Note 9)	**2,408**	-
Capitalized share-based compensation	**12**	1
Transferred from E&E assets (Note 6)	**15,527**	-
Change in decommissioning liabilities	**189**	-
Asset dispositions	**(814)**	-
Foreign currency translation	**(1,924)**	(163)
Cost, end of year	**25,631**	9,514
Accumulated depletion and depreciation and impairment, beginning of year	**(5,276)**	(4,739)
Depletion and depreciation	**(144)**	(205)
Asset dispositions	**441**	-
Impairment	**-**	(472)
Foreign currency translation	**1,359**	140
Accumulated depletion and depreciation and impairment, end of year	**(3,620)**	(5,276)
Net book value, end of year	**22,011**	4,238

Costs of $15.5 million transferred from E&E in 2018 include the May 31, 2018 carrying value of the Caburé natural gas field of $15.2 million in which the Company has a 49.1% working interest. Pursuant to the UOA, substantially all the 2018 and 2019 field development will initially be funded by the Company's partner, with Alvopetro's share due within 30 days of Alvopetro's commencement of production allocations, or March 31, 2020, whichever occurs first. Alvopetro's share of equipment inventory transferred from E&E assets to the unit represents the remaining $0.3 million transferred during the period.

During 2018 the Company executed an agreement to sell 100% of its Jiribatuba property for gross proceeds of $0.1 million and a release of all future liabilities associated with the field, including the future abandonment and reclamation obligations, subject to customary approval by the ANP. The property had a net book value of $0.3 million and associated decommissioning obligations of $0.2 million resulting in a loss on disposition of $0.1 million recognized in the period. Dispositions for the period also include $0.05 million, representing Alvopetro's operating partner's share of equipment held in PP&E transferred to the jointly-owned Caburé natural gas project. As the value assigned to this equipment pursuant to the UOA was equivalent to Alvopetro's net book value of the equipment there was no resultant gain or loss on the transfer.

General and administrative costs totaling $0.4 million (December 31, 2017 - $0.03 million) that were directly related to property, plant, and equipment activities have been capitalized.

Impairment

At the end of each reporting period the Company assesses impairment and impairment reversal indicators related to all of its CGUs.

With respect to the Company's Mãe-da-lua field, the decline in the current and projected production volumes indicated an impairment as at December 31, 2017. This property was not assigned any probable reserves at December 31, 2017 and an impairment of $0.5 million was recorded to reduce the carrying value of the property $nil. While the Company was assigned proved and probable reserves on this field as at December 31, 2018, there were no indicators of impairment reversal on this field.

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There were no indicators of impairment for the Company's Caburé natural gas field or the Bom Lugar oil field at December 31, 2018.

Sensitivity Analysis

In assessing impairment, the estimated recoverable amounts for the Company's assets are determined based on fair value less costs of disposal calculations. The Company incorporates the net present value of the future cash flows from proved plus probable oil reserves estimated by the Company's external reserve evaluator as at the reporting date, discounted at a rate of 15%. 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. The Company utilizes forecasted commodity prices from its external reserves evaluator.

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. The majority of the Company's production expenses and a portion of the Company's future development costs, are denominated in BRL. For purposes of estimating these future costs, any costs denominated in BRL were translated to USD assuming the exchange rate forecasted by Alvopetro's independent reserves engineer. Fluctuations in the BRL relative to the USD may result in additional impairment charges or impairment reversals.

Based on the assumptions used at December 31, 2018, fluctuations of 5% in forecasted commodity prices and foreign exchange rates and a 2% change to the discount rate would not change the impairment recognized for any of the Company's PP&E properties in 2018.

NOTE 8 – DECOMMISSIONING LIABILITIES

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

	As at December 31,	
	2018	2017
Balance, beginning of year	**1,464**	1,399
Liabilities incurred	**155**	189
Revisions to obligations	**3**	-
Obligations settled	**(12)**	(139)
Disposition of obligations	**(185)**	-
Accretion	**41**	37
Foreign currency translation	**(235)**	(22)
Balance, end of year	**1,231**	1,464

Total undiscounted cash flows, escalated at 5.5% (December 31, 2017 - 6.5%) for inflation, required to settle the Company's decommissioning liabilities are estimated to be $2.0 million (December 31, 2017 - $2.3 million) and have been discounted using an average risk-free rate of 2.9% (December 31, 2017 – 2.5%), which represents an estimated U.S. Treasury bill rate for a period of 15 years, the approximate weighted average remaining years to abandonment.

The Company expects to incur $0.07 million (December 31, 2017 - $0.02 million) of decommissioning costs within one year and accordingly this amount is classified as current on the consolidated statements of financial position.

During the year the Company recorded a revision to decommissioning liabilities associated with the Caburé and Gomo natural gas assets as the timing of abandonment and reclamation was adjusted to coincide with the independent reserve report and expected costs to abandon and reclaim all properties were revised to align with actual costs incurred by the Company for similar activities.

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

These revisions resulted in an increase to the estimated provision which was almost entirely offset by the reduction in the inflation rate in 2018.

The disposition of $0.2 million represents the estimated decommission liabilities associated with the Company's Jiribatuba field.

NOTE 9 – LONG-TERM LIABILITIES

The Company's long-term liabilities at December 31, 2018 represent the accrued payable related to Alvopetro's share of the costs incurred to date with respect to joint development of the Caburé natural gas field (Note 7). Under the terms of the UOA, Alvopetro will reimburse the operating partner for its share of the development costs, including adjustments for inflation, within 30 days of the earlier of commencement of production allocations to Alvopetro, which is anticipated to be in January 2020, or March 31, 2020.

	As at	
	December 31, 2018	December 31, 2017
Balance, beginning of year	**-**	-
Alvopetro's share of expenditures incurred (including estimated inflation)	**2,721**	-
Partner share of equipment contributed by Alvopetro (Notes 6 & 7)	**(405)**	-
Foreign currency translation	**32**	-
Balance, end of year	**2,348**	-

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.

b) Issued and Outstanding Common Shares

	Number of Shares	Amount
Balance as at December 31, 2017	**85,166,871**	**$ 151,937**
Issuance of shares	11,504,000	4,019
Share issue costs, net of tax	**-**	(225)
Balance as at December 31, 2018	**96,670,871**	**155,731**

In October 2018 the Company completed a private placement for aggregate gross proceeds of $4.0 million, issuing 11,504,000 common shares at $0.35 ($0.45 CAD) per share. In conjunction with the placement the Company also issued 3,676,000 share purchase warrants, each convertible into one common share with an exercise price of $0.50 (CAD $0.64). Of these warrants, 2,876,000 have an expiry date of December 15, 2019 and 800,000 have an expiry date of October 16, 2020. Share issue costs for the year ended December 31, 2018 include $0.2 million of cash outlays plus share-based compensation related to the 800,000 warrants issued to brokers and advisors of the private placement.

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

Warrants outstanding at December 31, 2018 are as follows:

	Number of Warrants Outstanding at December 31,		**Weighted Average Remaining Contractual Life (years) at December 31,**	
Exercise Price	**2018**	2017	**2018**	2017
USD $0.50	**2,500,000**	**-**	0.96	-
CAD $0.64	**376,000**	**-**	0.96	-
USD $0.50	**800,000**	**-**	1.79	-
Balance, as at December 31, 2018	**3,676,000**	**-**	1.14	-

Of the total warrants issued, 800,000 were in respect of services provided in connection with the private placement. As the fair value of the services provided could not be reliably measured, the Black-Scholes option pricing model was used to determine the fair value of the warrants granted, and $0.04 million of share-based compensation was recognized as share issuance costs. Weighted average assumptions and resultant fair values for these warrants are as follows:

	Year ended December 31,	
	2018	2017
Risk free interest rate (%)	**2.18**	-
Expected term (years)	**2.0**	-
Expected volatility (%)	**45.0**	-
Dividend per share (%)	**-**	-
Forfeiture rate (%)	**-**	-
Weighted average fair value (CAD)	**0.07**	-

With respect to the remaining 2,876,000 warrants, there was no value assigned on issuance.

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 five-day volume weighted 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 December 31, 2018 are as follows:

	Number of Options	Weighted Average Exercise Price (CAD$)
Balance as at December 31, 2016	6,874,102	0.53
Granted	64,000	0.19
Expired	(352,166)	0.65
Forfeited	(47,000)	0.28
Balance as at December 31, 2017	6,538,936	0.52
Granted	2,542,250	0.38
Expired	(1,900,436)	1.02
Balance as at December 31, 2018	**7,180,750**	**0.34**
Percentage of common shares outstanding	**7.4%**	

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

	Options Outstanding at December 31, 2018			Options Exercisable at December 31, 2018		
Exercise Price	Number of Options	Weighted Average Exercise Price (CAD$)	Weighted Average Remaining Contractual Life (years)	Number of Options	Weighted Average Exercise Price (CAD$)	Weighted Average Remaining Contractual Life (years)
CAD$0.18 - $0.39	4,328,750	0.27	3.05	3,102,084	0.26	2.69
CAD$0.40 - $0.75	2,780,000	0.43	2.84	1,480,000	0.42	1.04
CAD$1.01 - $1.10	72,000	1.10	0.44	72,000	1.10	0.44
CAD$0.18 - $1.10	**7,180,750**	**0.34**	**2.94**	**4,654,084**	**0.32**	**2.13**

d) Share-Based Compensation – Stock Options

The fair value of the stock options granted under the Alvopetro stock option plan for the years ended December 31, 2018 and 2017 has been estimated on the grant date using the Black-Scholes option pricing model. Weighted average assumptions and resultant fair values for stock options granted are as follows:

	Year ended December 31,	
	2018	2017
Risk free interest rate (%)	**2.26**	1.03
Expected term (years)	**4.0**	4.0
Expected volatility (%)	**45.0**	45.0
Dividend per share (%)	**-**	-
Forfeiture rate (%)	**5.0**	5.0
Weighted average fair value (CAD)	**0.14**	0.07

Total share-based compensation of $0.1 million was computed for the year ended December 31, 2018 (2017 - $0.1 million) related to the Alvopetro stock option plan. Of this amount, approximately $0.02 million (2017 - $0.02 million) was capitalized to exploration and evaluation assets and property, plant and equipment, with the remainder recognized as share-based compensation expense on the consolidated statements of operations and comprehensive loss.

e) Net Loss Per Share

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:

	Year ended December 31,	
	2018	2017
Weighted average common shares outstanding, basic	**87,562,224**	85,166,871

In determination of the weighted average number of diluted common shares outstanding for the years ended December 31, 2018 and 2017, all stock options and warrants were excluded because the effect would be anti-dilutive.

NOTE 11 – TAXES

Alvopetro computes Brazil corporate income tax under the actual profit regime. Under this regime, the corporate tax rate on taxable income is 34% and tax losses may be carried forward indefinitely; however, any utilization of losses in a subsequent taxation year is limited to 30% of the taxable income in that period. The Company expects to be entitled to a tax benefit which reduces the tax rate on eligible activities to 15.25% within Brazil for a period of 10 years. Accordingly, the Company’s expected future tax rate was adjusted to 15.25% in 2018.

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

Income tax expense differs from the amount that would have been expected by applying the statutory income tax rate to loss before taxes. The principal reasons for this difference are as follows:

	Year ended December 31,	
	2018	2017
Loss before taxes	**(4,340)**	(7,117)
Statutory income tax rate	**15%**	34%
Expected income tax recovery	**(662)**	(2,420)
(Increase) decrease resulting from:		
Change in future tax rate and unrecognized deferred tax asset	**(6,381)**	1,573
Change in estimated tax pools	**(6)**	199
Permanent difference on impairment and E&E expense	**66**	393
Share-based compensation	**17**	33
Impact of foreign exchange fluctuations	**6,997**	(57)
Other	**(31)**	279
Income tax recovery	**-**	-

The components of the Company's deferred tax assets and liabilities arising from temporary differences and loss carry-forwards as well as the associated amount of deferred tax recovery or expense recognized in the Company's consolidated statements of operations and comprehensive loss are outlined below.

Deferred tax liability (asset)	PP&E and E&E assets	Decommissioning liabilities	Tax loss carryforwards	Other Brazil tax pools	Unrealized taxable foreign exchange gains	Unrecognized deferred tax asset	Total
As at December 31, 2016	2,306	(477)	(9,523)	(2,815)	433	10,076	-
Deferred tax expense (recovery)	536	(21)	(1,852)	42	(278)	1,573	-
As at December 31, 2017	2,842	(498)	(11,375)	(2,773)	155	11,649	-
Deferred tax (recovery) expense	(1,231)	310	5,680	1,711	(89)	(6,381)	-
As at December 31, 2018	**1,611**	**(188)**	**(5,695)**	**(1,062)**	**66**	**5,268**	**-**

A deferred tax asset of $5.3 million exists at December 31, 2018 (December 31, 2017 - $11.6 million), the full balance of which has not been recognized. Of the full balance of the unrecognized deferred tax asset, $4.1 million relates to Brazil (December 31, 2017 - $10.7 million) and $1.2 million relates to Canada (December 31, 2017 - $0.9 million). Total tax loss carryforwards include $29.6 million attributable to Brazil, which carryforward indefinitely but are limited to annual utilization of up to 30% of taxable income in subsequent periods, and $4.4 million attributable to Canada which expire between 2032 and 2038.

NOTE 12 – CAPITAL MANAGEMENT

The Company’s capital consists of the following:

	As at December 31,	
	2018	2017
Working capital	**6,729**	8,762
Shareholders’ equity	**60,572**	66,140

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

The Company considers its capital structure to include working capital (including current restricted cash and assets held for sale) and shareholders’ equity. At December 31, 2018, the Company’s net working capital surplus was $6.7 million (December 31, 2017 - $8.8 million), which includes $7.1 million (December 31, 2017 - $9.2 million) of cash, $0.1 million (December 31, 2017 - $0.1 million) of current restricted cash, and assets held for sale of $0.2 million (December 31, 2017 - $0.2 million).

Alvopetro may adjust its capital structure by issuing new equity or debt and making adjustments to its capital expenditure program, as allowed pursuant to contracted work commitments. The Company considers its capital structure at this time to include shareholders' equity of $60.6 million (December 31, 2017 - $66.1 million). Although to date the Company has relied on existing cash balances to fund exploration and development as well as ongoing operational activities, the Company requires financing to execute the full development of its Caburé and Gomo natural gas assets, as discussed further in Note 2.

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 ANP for Alvopetro's work commitments under the terms of its concession contracts as discussed further in Note 18. 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 December 31, 2018, the total amount of LCs issued under the Facility was $6.1 million (December 31, 2017 - $12.1 million), the full balance of which was supported by EDC on behalf of Alvopetro. LCs supported by EDC at December 31, 2018 include $1.2 million (December 31, 2017 - $6.0 million) of LCs related to commitments which have been met. This includes $0.7 million for blocks 62, 71 and 145 which were met in 2018, subject to ANP approval, as well as $0.5 million on Block 106 which was met and approved by the ANP in 2018 but not released by the financial institutions until 2019.

The current restricted cash of $0.1 million (December 31, 2017 - $0.1 million) relates to cash posted in Brazil in support of abandonment guarantees on the oil fields. Half of the current restricted cash balance at December 31, 2018 relates to cash collateral posted by Alvopetro in respect of the Jiribatuba field (which has been sold as of September 30, 2018). Upon approval by the ANP of the transfer of this field, the abandonment guarantee and associated restricted cash will be released.

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

NOTE 13 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

Overview

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

Credit Risk

Credit risk is the risk of financial loss to the Company if counterparties do not fulfill their contractual obligations. The Company has credit risk on cash and cash equivalents, restricted cash, and trade and other receivables.

At December 31, 2018, accounts receivable consisted of $0.01 million (December 31, 2017 - $0.02 million) from crude oil customers with most of the remainder related to other trade and tax credit receivables. Crude oil production is sold to two counterparties, one of which represented 40 percent of the Company's oil sales revenues in 2018 (2017 – 67 percent). Alvopetro routinely assesses the recoverability of the accounts receivable from its crude oil customers and the risk of non-collection from these counterparties is not expected to have a significant impact on the financial statements.

The Company closely monitors other trade receivables, specifically those outstanding for greater than 60 days. There were no expected credit losses recognized in 2018 (December 31, 2017 - $0.01 million).

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations when due, under both normal and unusual conditions without incurring unacceptable losses or jeopardizing the Company's business objectives. The Company manages this risk by forecasting cash flows for a minimum period of twelve months. This involves preparing annual capital expenditure budgets (for discretionary and non-discretionary activities), operating expense budgets and general and administrative expense budgets, which are monitored and updated as considered necessary. Alvopetro does not currently derive positive cash flow from its operations. Capital expenditures and ongoing production and G&A expenses to date have been funded from the Company's cash balances. Although positive cash flows are expected upon commencement of production from the Caburé field in January 2020, the Company does not currently have the financial resources to complete the infrastructure required to develop this asset to the sales point and requires financing to execute the full development as discussed in Note 2.

In addition, $6.1 million of the LCs for work commitments are currently supported by EDC. This coverage is reviewed annually and to the extent some or all of the EDC coverage were limited in the future, the Company may be required to provide the required amount from its existing cash balance which would reduce the Company's available funds, limiting its ability to fund future capital projects and further increase the need for additional financing.

Market Risk

Market risk is the risk that changes in the foreign exchange rates, commodity prices and interest rates will affect the Company's cash flows, net income or loss or comprehensive income or loss. The objective of managing market risk is to mitigate the effects of these risks within acceptable limits while maximizing returns.

Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in foreign currency exchange rates. All of the Company's oil sales are denominated in BRL based on a USD oil price and all operational, administrative and capital activities related to the Brazil properties are transacted primarily in BRL. In Canada the Company has expenditures in both CAD and USD. To minimize foreign currency risk, the Company's cash balances are typically held primarily in USD within Canada. Management transfers funds to Brazil only as needed to fund immediate capital and operational requirements and attempts to maintain minimal cash balances in BRL. At December 31, 2018, the Company held BRL$13.7 million of cash and cash equivalents in Brazil (December 31, 2017 – BRL$0.6 million). These funds are to be utilized for anticipated payments in 2019 primarily in connection with construction of the Company's pipeline for the Caburé project. In Canada, USD funds are converted to CAD on an as-needed basis.

As at December 31, 2018 and 2017, the following financial instruments were denominated in currencies other than the USD:

	Year Ended December 31			
	2018		2017	
	CAD (000's)	**BRL (000's)**	CAD (000's)	BRL (000's)
Cash and cash equivalents	**434**	**13,653**	128	635
Restricted cash – current	**-**	**525**	-	350
Trade and other receivables	**31**	**991**	36	407
Accounts payable and accrued liabilities	**(312)**	**(3,362)**	(186)	(2,636)
Long term liability	**-**	**(9,098)**	-	-
Net exposure in foreign currency	**153**	**2,709**	(22)	(1,244)
Net exposure in USD ($000s)	**112**	**699**	(18)	(376)

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

Based on financial instruments held at December 31, 2018 and 2017, fluctuations in the exchange rates as indicated below would have the following estimated effect on net loss and other comprehensive loss:

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

	Year Ended December 31,	
	2018	2017
Effect of 5% appreciation in CAD and BRL to USD		
Decrease (increase) to net loss	**4**	(2)
Decrease (increase) to accumulated other comprehensive loss	**41**	(22)
Effect of 5% depreciation in CAD and BRL to USD		
(Increase) decrease to net loss	**(4)**	2
(Increase) decrease to accumulated other comprehensive loss	**(38)**	20

Commodity Price Risk

Although the Company is not dependent on cash flows derived from its oil sales, changes in commodity prices may have a significant impact on the assessment of the carrying value of the Company's properties and any impairment losses recorded as a result of a decline in those values would increase the Company's net loss. Fluctuations in commodity prices can also affect the Company's ability to obtain future financings and the capacity of those future financings. Given its level of sales, the Company did not have any forward contracts in place as at or during the years ended December 31, 2018 and 2017. To the extent sales increase in the future, the Company may consider a hedging program to protect cash flows and manage commodity price risk.

Interest Rate Risk

The Company is exposed to interest rate cash flow risk on cash and cash equivalents and restricted cash due to fluctuations in market interest rates applied to cash balances. The effect of this risk on the Company is assessed as minimal.

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 Alvopetro's financial instruments at December 31, 2018 and 2017 is set forth in the table below. The Company does not currently have any financial instruments classified as Level 2 or Level 3. During the year ended December 31, 2018, there were no transfers of financial instruments between any of the above levels.

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

	December 31, 2018		December 31, 2017	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
Carried at fair value through profit or loss				
Cash and cash equivalents[(1)]	**7,070**	**7,070**	9,189	9,189
Restricted cash – current [(1)(2)]	**135**	**135**	106	106
	7,205	**7,205**	9,295	9,295
Carried at amortized cost				
Trade and other receivables	**284**	**284**	153	153
Accounts payable and accrued liabilities	**(1,221)**	**(1,221)**	(1,111)	(1,111)
Long-term liabilities[(3)]	**(2,348)**	**(2,271)**	-	-
	(3,285)	**(3,208)**	(958)	(958)

(1) Level 1
(2) Restricted cash balances include amounts pledged as collateral for work commitments on the Company's Bom Lugar and Jiribatuba fields (Note 18).
(3) The carrying value of the long-term liability includes adjustments for inflation, according to the contract, to be calculated from when the liability was incurred.

NOTE 14 – CHANGES IN NON-CASH WORKING CAPITAL

	Year ended December 31,	
Change in:	**2018**	2017
Trade and other receivables	**(161)**	390
Prepaid expenditures	**(170)**	(12)
Accounts payable and accrued liabilities	**323**	(1,012)
	(8)	(634)
Changes relating to:		
Operating activities	**8**	(563)
Investing activities	**(16)**	(71)
	(8)	(634)

NOTE 15 – REVENUE

The Company's oil sales revenues are derived from two customers, under contracts based on floating prices, specifically the Brent benchmark adjusted for contracted discounts based on both a fixed cost per barrel and a fixed percentage of Brent. In the year ended December 31, 2018, discounts averaged 6% of the Brent price (year ended December 31, 2017 - 12%).

As at December 31, 2018, accounts receivable included $0.01 million of accrued sales revenue which related to December 2018 production. There were no collection issues requiring adjustment to revenue recorded in 2017 or in the year ended December 31, 2018.

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

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

NOTE 16 – NATURE OF EXPENSES

Production expenses by nature were as follows:

	Year Ended December 31,	
Production expenses:	**2018**	2017
Personnel	**325**	359
Other fixed	**292**	230
Variable	**116**	111
Workover	**107**	124
Production expenses	**840**	824

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

	Year Ended December 31,	
G&A expenses:	**2018**	2017
Personnel	**2,410**	2,493
Travel	**93**	104
Office and IT costs	**312**	368
Professional fees	**657**	522
General corporate	**348**	214
Gross G&A expenses	**3,820**	3,701
Capitalized to E&E and PP&E	**(1,058)**	(1,094)
Net G&A expenses	**2,762**	2,607

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 17 – RELATED PARTY TRANSACTIONS

Key management personnel are comprised of Alvopetro’s directors and officers. Compensation for these individuals is set forth as follows:

	Year ended December 31,	
	2018	2017
Short-term benefits(1)	**423**	425
Share-based compensation(1)	**77**	74
Total	**500**	499

Notes:

(1) Before capitalization of any directly attributable compensation to E&E or PP&E.

Alvopetro directors and officers participated in the October 2018 private placement. Of the total common shares issued under the private placement, 860,000 common shares were subscribed for by three insiders of Alvopetro for total proceeds of CAD$387,000. Of the total 3,676,000 warrants issued, 215,000 were issued to these insiders with an expiry date of December 15, 2019 and an exercise price of CAD$0.64. The terms of these subscriptions by directors and officers were equivalent to the subscription terms by other investors.

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

The following table lists the Company's subsidiaries and their respective places of incorporation, each owned 100% directly and indirectly at December 31, 2018:

Subsidiary Name	Country of Incorporation
Alvopetro Oil and Gas Investments Inc.	Canada
Alvopetro S.A. Extração de Petróleo e Gás Natural	Brazil
Alvopetro Investimentos e Participações Ltda.	Brazil
Alvopetro Participações em Petróleo E Gás Ltda.	Brazil

NOTE 18 – COMMITMENTS AND CONTINGENCIES

The following is a summary of contractual commitments as at December 31, 2018:

Commitments	< 1 Year	1-3 Years	Thereafter	Total
Minimum work commitments(1)				
Minimum work commitments to be completed				
Block 183(2)	-	861	-	861
Block 169(3)	981	-	-	981
Block 255(3)	1,174	-	-	1,174
Block 57(4)	38	-	-	38
Bom Lugar	-	-	90	90
Minimum work commitments to be completed	**2,193**	**861**	**90**	**3,144**
Minimum work commitments completed				
Block 62(5)	31	-	-	31
Block 71(5)	22	-	-	22
Block 145(5)	31	-	-	31
Minimum work commitments completed	**84**	**-**	**-**	**84**
Total minimum work commitments	**2,277**	**861**	**90**	**3,228**
Gas Treatment Agreement	**-**	**5,810**	**23,239**	**29,049**
Office leases(6)	**103**	**4**	**-**	**107**
Total commitments	**2,380**	**6,675**	**23,329**	**32,384**

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) In February 2018, the ANP approved a suspension to the portion of Block 183 currently in the second exploration phase to which the above commitment is applicable. The Company will have 517 days from receipt of the environmental permit for the well to be drilled to meet the required work commitment.

(3) Due to an ongoing injunction against unconventional activities on all 12th Brazil Bid Round Blocks, in December 2017 the Company filed a request with the ANP to cancel the Block 169 and 255 concession contracts, including the commitments noted in the table above.

(4) Alvopetro holds a 65% working interest in Block 57 and the amount provided in the table above represents Alvopetro's share of the related work commitment.

(5) As at December 31, 2018 the Company had incurred all costs to fulfill the commitments related to Alvopetro's 65% interest in these blocks, subject to ANP approval. In early 2019 these blocks were relinquished to the ANP.

(6) The Company is committed to future minimum payments for office space in Canada and Brazil.

In May 2018, Alvopetro entered into a long-term gas sales agreement ("GSA" or "Gas Sales Agreement") with Bahiagás which provides for the sale of 5.3 mmcfpd (150,000 m3/d) on a firm basis and 12.4 million mmcfpd (350,000 m3/d) on an interruptible basis and provides penalties 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 construction of the gas processing facility or pipeline is delayed (other than due to permitting delays), unit development is delayed, 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, which is determined based on a trailing weighted average basket of benchmark reference prices including Henry Hub and National Balancing Point natural gas prices and Brent crude oil prices. Alvopetro can mitigate these risks by meeting sales commitments under the GSA with third-party gas supplies, through development of existing gas resources, or through new gas discoveries from our prospect inventory. Firm gas deliveries under the GSA were originally set to commence on January 1, 2020 (the Firm Start Date) with interruptible deliveries commencing earlier with mutual consent. As neither Alvopetro nor Bahiagás had regulatory permits in place by December 1, 2018, the Firm Start Date has been automatically extended and will be set following receipt of all permits by both parties (based on an equivalent number of days from December 1, 2018 to the date both parties are in receipt of the required permits). The Company expects to commence gas deliveries on an interruptible basis in January 2020 and expects Bahiagás to accept these interruptible volumes; however firm sales volumes (and the applicable potential penalties to both parties) will not commence until the adjusted Firm Start Date.

In September 2018, Alvopetro entered into the 10-year contract (the "Gas Treatment Agreement") with Enerflex Ltd. ("Enerflex") to build, own, operate and maintain a natural gas treatment facility (the "Facility"). Under the terms of the Gas Treatment Agreement, Alvopetro is committed to integrated service fees totaling approximately $2.9 million per year once the Facility is operational. Alvopetro anticipates that the Facility will be operational by January 1, 2020 and has reflected the associated commitment in the table above based on this start date. A portion of the payments are in BRL and therefore exposed to foreign exchange fluctuations. Management has assessed that this agreement contains a lease component under IFRS 16 which will affect the presentation of these fees in future consolidated financial statements of the Company. The Gas Treatment Agreement includes customary penalties and standby charges to the extent Alvopetro is unable to receive the services on the start date. In addition, the Gas Treatment Agreement includes early termination penalty provisions which vary depending on timing of the termination. While the Gas Treatment 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 above to the extent processing in the Facility is limited due to unplanned or longer than scheduled maintenance or repair.

The Company has a credit support facility with a Canadian bank which allows for the issuance of LCs and letters of guarantee in support of the financial guarantees required by the ANP for Alvopetro's work commitments under the terms of its concession contracts associated with its exploration blocks. Letters of credit and letters of guarantee issued may be supported by either cash collateral posted by Alvopetro or through an Account Performance Security Guarantee from Export Development Canada ("EDC"). As at December 31, 2018, the total amount of LCs issued under the credit support facility was $6.1 million (December 31, 2017 - $12.1 million), the full balance of which was satisfied by EDC. Total LCs outstanding at December 31, 2018 include $0.5 million in respect of Block 106, the work commitment for which was approved by the ANP in 2018 (but the LC was not released by all involved banks until 2019) and $0.7 million for work commitments on Blocks 62, 71 and 145, the work commitments for which were met by Alvopetro in 2018 subject to the approval of the ANP. Work commitments for the Bom Lugar field relate to an abandonment guarantee which is supported by cash collateral posted by Alvopetro and classified as current restricted cash. Half of the current restricted cash balance at December 31, 2018 also relates to cash collateral posted by Alvopetro in respect of an abandonment guarantee on the Jiribatuba field (which has been sold as of September 30, 2018). Upon approval by the ANP of the transfer of this field, the abandonment guarantee and associated restricted cash will be released.

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.

Alvopetro's activities in Brazil are subject to minimum local content requirements with respect to materials and supplies utilized. The specific local content requirements for the exploration phase were determined during the bidding process for each particular block. 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 penalty, which varies by concession depending on exploration phase and type of cost, will be incurred. In 2018, the ANP revised local content regulations which reduced the local content requirements and, as a result, the Company's estimated local content penalties decreased from \$0.3 million at December 31, 2017 to \$0.06 million at December 31, 2018, the full balance of which is included in accounts payable and accrued liabilities.