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 opinion on the Company's consolidated financial statements as at and for the year ended December 31, 2020. Their report is presented with the consolidated financial statements.

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 24, 2021

Deloitte.

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

Tel: 403-267-1700
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www.deloitte.ca

Independent Auditor's Report

To the Shareholders of Alvopetro Energy Ltd:
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, 2020 and 2019, 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, 2020 and 2019, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audits 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 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 24, 2021

ALVOPETRO ENERGY LTD.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Thousands of United States dollars)

	Note	December 31, 2020	December 31, 2019
ASSETS			
Current			
Cash and cash equivalents		**5,159**	1,215
Restricted cash		**125**	270
Trade and other receivables		**2,802**	265
Prepaid expenditures		**273**	370
Assets held for sale	5	**128**	332
Total current assets		**8,487**	2,452
Exploration and evaluation assets	6	**32,262**	35,971
Property, plant and equipment	7	**25,843**	30,984
Right-of-use assets	8	**8,092**	219
Deferred tax asset	16	**4,576**	-
Other assets	9	**1,128**	1,790
Non-current assets		**71,901**	68,964
Total assets		**80,388**	71,416
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		**2,390**	3,244
Lease liabilities	8	**483**	101
Decommissioning liabilities	10	**63**	80
Other liabilities	11	**12**	5,728
Total current liabilities		**2,948**	9,153
Lease liabilities	8	**7,827**	62
Credit facility	12	**15,423**	5,027
Decommissioning liabilities	10	**1,080**	1,300
Total liabilities		**27,278**	15,542
Shareholders' equity			
Share capital	13	**156,755**	156,355
Contributed surplus		**2,821**	2,790
Deficit		**(71,172)**	(76,878)
Accumulated other comprehensive loss		**(35,294)**	(26,393)
Total shareholders' equity		**53,110**	55,874
Total liabilities and shareholders' equity		**80,388**	71,416

Commitments and contingencies (Note 21)

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	**2020**	2019
Revenue			
Natural gas, oil and condensate sales	14	**11,308**	240
Royalties		**(740)**	(34)
Net natural gas, oil and condensate revenue		**10,568**	206
Other income		**75**	194
Total revenue and other income		**10,643**	400
Expenses			
Production	15	**1,336**	276
General and administrative	15	**3,070**	2,793
Depletion and depreciation	7,8	**2,070**	234
Impairment	15	**1,455**	1,645
Finance expenses	15	**2,337**	259
Exploration and evaluation expense		**-**	95
Share-based compensation	13	**242**	141
Risk management losses	18	**12**	-
Foreign exchange (gain) loss		**(1,840)**	6
Gain on disposition of assets	5	**-**	(38)
Total expenses		**8,682**	5,411
Income (loss) before taxes		**1,961**	(5,011)
Deferred tax recovery	16	**3,745**	-
Net income (loss)		**5,706**	(5,011)
Exchange loss on translation of foreign operations		**(8,901)**	(1,269)
Comprehensive loss		**(3,195)**	(6,280)
Net income (loss) per share	13		
Basic		**0.06**	(0.05)
Diluted		**0.05**	(0.05)

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	**2020**	2019
Share capital			
Balance, beginning of year		**156,355**	155,731
Issue of common shares – options exercised		**403**	4
Issue of common shares – warrants exercised		**-**	621
Share issuance costs		**(3)**	(1)
Balance, end of year	13	**156,755**	156,355
Contributed surplus			
Balance, beginning of year		**2,790**	1,813
Share issuance costs – warrants issued	12	**-**	818
Share-based compensation expense	13	**242**	141
Share-based compensation capitalized	13	**22**	23
Options exercised		**(233)**	(5)
Balance, end of year		**2,821**	2,790
Deficit			
Balance, beginning of year		**(76,878)**	(71,847)
IFRS 16 opening adjustment	4	**-**	(20)
Net income (loss)		**5,706**	(5,011)
Balance, end of year		**(71,172)**	(76,878)
Accumulated other comprehensive loss			
Balance, beginning of year		**(26,393)**	(25,125)
IFRS 16 opening adjustment	4	**-**	1
Other comprehensive loss		**(8,901)**	(1,269)
Balance, end of year		**(35,294)**	(26,393)

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)

	Note	Year ended December 31, 2020	2019
Operating Activities			
Net income (loss)		**5,706**	(5,011)
Adjustments for non-cash items:			
Depletion and depreciation	7,8	**2,070**	234
Impairment	15	**1,455**	1,645
Finance expenses	15	**2,337**	259
Share-based compensation	13	**242**	141
Gain on disposition of assets	5	**-**	(38)
Foreign exchange		**(1,856)**	9
Unrealized risk management losses		**12**	-
Deferred tax	16	**(3,745)**	-
Settlement of decommissioning liabilities	10	**(5)**	(67)
Funds flow from operations		**6,216**	(2,828)
Changes in non-cash working capital	19	**(3,155)**	319
		3,061	(2,509)
Financing Activities			
Advances under Credit Facility	12	**10,000**	5,000
Interest on Credit Facility	12	**(849)**	(34)
Unearned revenue	11	**42**	-
Credit Facility transaction costs	12	**-**	(1,109)
Issue of common shares, net of share issuance costs	13	**226**	620
Lease liabilities payments	8	**(1,014)**	(234)
Repayment of Other Liabilities	11	**(4,231)**	-
Changes in non-cash working capital	19	**59**	(82)
		4,233	4,161
Investing Activities			
Expenditures on exploration and evaluation assets	6	**(992)**	(3,276)
Expenditures on property, plant and equipment	7	**(2,425)**	(6,151)
Proceeds on dispositions	5	**158**	179
Change in restricted cash		**120**	(143)
Changes in non-cash working capital	19	**(92)**	1,834
		(3,231)	(7,557)
Change in cash and cash equivalents		**4,063**	(5,905)
Effect of foreign exchange on cash balances		**(119)**	50
Cash and cash equivalents, beginning of year		**1,215**	7,070
Cash and cash equivalents, end of year		**5,159**	1,215
Cash and cash equivalents consist of:			
Cash		**2,474**	805
Cash equivalents		**2,685**	410
Supplemental information:			
Cash income taxes paid		**-**	-
Cash interest income received		**19**	127

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

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 24, 2021.

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

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. These estimates and associated assumptions are based on historical experience and other factors that are considered relevant. 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.

Impact of the COVID-19 Pandemic

The market uncertainty created by the COVID-19 pandemic has significantly impacted global commercial activity. The worldwide disruption to business operations has caused heightened economic uncertainty resulting in more volatile commodity prices and currency exchange rates. Even as economies re-open it is still difficult to reliably estimate the length or severity of the financial impact of this event. For Alvopetro, the most significant estimates, judgments and assumptions potentially affected by COVID-19 are the valuation of Alvopetro's exploration and evaluation assets and property, plant and equipment. Amounts recorded for depletion and depreciation, the decommissioning provision and deferred taxes are also based on several assumptions and estimates with respect to oil and natural gas reserves, the accuracy of which is impacted by the worldwide economic climate. The potential resulting direct and indirect impact to the Company of this situation has been considered in management's estimates at the period end; however, there could be further material impact in future periods.

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 and 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).

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 proximity and 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.

Oil & gas properties are reviewed for impairment at a CGU level quarterly or when indicators of impairment exist. When indicators of impairment exist, the carrying value of each CGU is compared to its recoverable amount which is defined as the higher of its fair value less cost of disposal ("FVLCD") or its value in use ("VIU"). VIU is estimated as the present value of the future cash flows expected to arise from the continuing use of a CGU or an asset. FVLCD is the amount that would be realized from the disposition of an asset or CGU in an arm's length transaction between knowledgeable and willing parties. FVLCD is based on the discounted after-tax cash flows of reserves using forward prices and costs, consistent with Company's independent qualified reserves evaluators and may consider an evaluation of comparable asset transactions.

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. Key estimates used in determining future cash flows include:

> *Reserves* - Assumptions that are valid at the time of reserve estimation may change significantly when new information becomes available. Changes in forward price estimates, production costs, required capital expenditures or recovery rates may change the economic status of reserves and may ultimately result in reserves being restated.
>
> *Crude oil and natural gas prices* – Forward price estimates are used in the discounted cash flow model. These prices are adjusted for quality differentials, heat content and other factors. Commodity prices can fluctuate for a variety of reasons including supply and demand fundamentals, inventory levels, exchange rates, weather, economic and geopolitical factors.
>
> *Discount rate* – The discount rate used to calculate the net present value of cash flows is based on estimates of an industry peer group weighted average cost of capital as appropriate for each CGU being tested. Changes in the general economic environment could result in significant changes to this estimate.

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 and condensate is set in USD and the contracted price for natural gas under the Company's long-term natural gas sales agreement is derived from international benchmark prices in USD, due to the business environment as well as foreign exchange and banking 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 sales is Brazil.

The determination of the timing and quantum of any anticipated settlement of amounts receivable from foreign operations and the resulting treatment of any foreign exchange gains or losses on such intercompany amounts is subject to judgment based on management estimates and assumptions of future profitability and capital and other activities, all of which are subject to additional uncertainties.

Deferred Tax Assets

As at December 31, 2020 the Company has recognized a deferred tax asset that was unrecognized in previous years. The determination of deferred taxes requires interpretation of complex laws and regulations involving multiple jurisdictions. The measurement of income tax expense and deferred tax assets and liabilities is based on judgment in applying tax law and estimates on the applicable tax rates, available tax incentives, and the timing, likelihood and reversal of temporary differences between the accounting and tax bases of assets and liabilities as well as the expected recoverability of deferred tax assets. The extent to which deferred tax assets are recognized are based on estimates of future profitability which are based on estimated future commodity prices and estimates of reserves, all of which are subject to management estimates, judgments and assumptions. Tax interpretation, regulations, and legislation in both Canada and Brazil are subject to change and interpretation which can affect the timing of the reversal of temporary tax differences, the tax rates in effect when such differences reverse and the Company's ability to utilize tax losses and other tax pools in the future. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. If any of these judgments and estimates prove to be inaccurate, actual results may differ significantly from that estimated and recorded by management and future earnings may be impacted.

Lease Obligations and Right-of-Use Assets

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

Joint Arrangement

The determination of a joint arrangement requires management's judgment and interpretation of IFRS. The classification of a joint arrangement between joint operations and joint venture, which requires further judgment and interpretation, will affect how the financial position and results of the joint arrangement are accounted for.

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, 2020 and 2019, 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, revenues, 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.

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 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.

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 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. The depletion base consists of 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 the consolidated statements of operations and comprehensive loss as incurred.

Corporate assets included within PP&E consist primarily of computer equipment, leasehold improvements and office furniture and equipment. Operational equipment and corporate assets are depreciated over the estimated useful lives of the related assets, ranging from five to ten years, on straight-line basis.

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 CGU's recoverable amount is the greater of its fair value less costs of disposal and its value-in-use. Fair value less costs of disposal incorporates management's judgment, determined using discounted future cash flows of reserves at 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.

Leases

A contractual arrangement where a party has the right to control the use of an identified asset in exchange for consideration is or contains a lease. The Company recognises a right-of-use asset and a corresponding lease liability with respect to all lease arrangements in which it is the lessee, except for short-term leases (defined as leases with a lease term of 12 months or less) and leases of low value assets. For these leases, the Company recognises the lease payments as an operating expense on a straight-line basis over the term of the lease unless another systematic basis is more representative of the time pattern in which economic benefits from the leased assets are consumed.

At commencement, determined to be when the leased asset is available for use, the lease liability is recognized, measured at the present value of the lease payments that are not paid at the commencement date and discounted using the implicit lease rate or Alvopetro's incremental borrowing rate when the implicit rate is not readily determinable. A corresponding right-of-use ("ROU") asset is recognized. The ROU asset is based on the initial measurement of the corresponding lease liability, lease payments made at or before the commencement day, less any lease incentives received and any initial direct costs. ROU assets are subsequently measured at cost less accumulated depreciation and impairment losses.

The ROU asset is depreciated over the shorter of: 1) the asset's useful life; and 2) the lease term on a straight-line basis. Adjustments to the ROU asset are made if the contractual arrangement includes costs to dismantle the asset.

The lease liability is remeasured when there is a change in future lease payments arising from a change in rate, a change to the Company's expected residual value guarantee payable, or changes in the assessment for exercising a purchase, termination or extension option. Lease payments are allocated between repayment of the lease liability and finance expense which is charged to the consolidated statement of operations and comprehensive loss.

Decommissioning Liabilities

The Company recognizes the present value of the estimated 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, facilities and pipelines 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 future abandonment and reclamation activities are expected to be funded in BRL, in determining the risk-free rate the Company uses a Brazil government bond rate for maturities coinciding as closely as possible 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 included in finance 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

The Company's revenues are primarily derived from the production of natural gas and to a lesser extent condensate and oil production. Revenue is recognized when the performance obligations are satisfied and revenue can be reliably measured. The performance obligations are satisfied upon delivery, when control of the product has transferred to the customer, being when the product has been physically transferred to the contracted delivery point. Revenue is measured at the consideration specified in the contract and represents amounts receivable for the hydrocarbons sold, net of discounts and sales taxes.

The Company recognizes take-or-pay pre-payments for natural gas as unearned revenue until the performance obligations are met at which point the volumes delivered are recorded as natural gas revenue.

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, restricted share units ("RSUs") and certain 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, RSUs 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.

Finance Expense

Finance expense is comprised of lease interest, accretion of decommissioning liabilities, interest charged on the Company's credit facility (including cash interest, interest accrued and due upon repayment of advances and commitment fees), and the amortization of deferred financing costs associated with the Company's credit facility. The portion of the interest charged on the Company's credit facility and the amortization of deferred financing costs that is directly attributable to the development of qualifying PP&E and E&E assets is capitalized directly to those assets.

Income Taxes

Income tax expense is comprised of current and deferred income taxes. Income tax expense is recognized in the consolidated statements of operations and comprehensive 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. The impact of tax benefits which may reduce the Company's income tax expense are only recognized as the benefit is utilized consistent with the provision of tax regulations. Such tax benefits are not considered in determining the expected future rates.

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.

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 assuming that any proceeds received by the Company upon the exercise of in-the-money stock options 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 on 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. Any exchange gains or losses are included in the determination of net income (loss) on the consolidated statement of operations and comprehensive loss.

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 income (loss) on the consolidated statements of operations and comprehensive loss.

Amounts receivable from a foreign operation are considered part of the reporting entity's net investment when settlement is neither forecasted nor likely to occur in the foreseeable future. Foreign exchange gain or losses related to such items are recognized in other comprehensive income and presented in accumulated other comprehensive loss in equity. Such amounts are retained in accumulated other comprehensive income and released to earnings where the Company has disposed of its entire interest in the foreign operation or loses control, joint control or significant influence over a foreign operation. If the Company disposes of a portion of its interest in the foreign operation, a proportionate amount of the related foreign currency gains or losses accumulated in other comprehensive income or loss would be reallocated between controlling and non-controlling interests. Where any amounts receivable from a foreign operation are expected to be settled in the foreseeable future, foreign exchange gains or losses related to such items are recognized in the consolidated statements of income and comprehensive loss from the date the Company determines future settlement is likely to occur in the foreseeable future.

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 statement of financial position with subsequent measurement at amortized cost, fair value through other comprehensive income ("FVOCI"), or fair value through profit or loss ("FVTPL").

The measurement category for each class of the Company's financial assets and liabilities is as follows:

Financial Instrument	Classification
Cash and cash equivalents	Amortized cost
Restricted cash - current	Amortized cost
Trade and other receivables	Amortized cost
Accounts payable and accrued liabilities	Amortized cost
Risk management contracts (classified as Other Liabilities)	FVTPL
Credit facility	Amortized cost

Financial instruments subsequently revalued at fair value are further categorized using a three-level hierarchy which reflects the inputs available for measurement:

Level 1 – values based on quoted prices in active markets for identical assets or liabilities;

Level 2 – values based on quoted market prices for similar instruments in markets that are not active or model inputs that are observable either directly or indirectly; and

Level 3 – values based on inputs that are unobservable for the asset or liability.

Transfers of financial assets or liabilities between levels only occur if the business model for managing those financial instruments changes.

Derivative Instruments

The Company may at times use derivative instruments to manage its exposure to fluctuations in commodity prices, foreign currency exchange rates or interest rates. Alvopetro does not use financial derivatives for trading or speculative purposes.

The Company has not designated its risk management contracts as effective accounting hedges and therefore has not applied hedge accounting. As a result, the Company's derivative instruments are classified as FVTPL and are recorded at fair value based on quoted market prices, recognizing changes in the fair value of the instruments as unrealized gains or losses in the consolidated statements of operations and comprehensive loss in the respective period.

As the delivery and receipt of a non-financial item is the underlying premise of the Company's long-term gas sales agreement ("GSA") it is accounted for as an executory contract. As such, it is not considered to be a financial asset or liability and settlements on the physical deliveries are recognized as natural gas revenue in the period the product is delivered to the sales point.

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

Impairment of Financial Assets

At each reporting date the Company assesses any objective evidence that a financial asset carried at amortized cost is impaired. Management uses judgment in making these assumptions, taking into consideration past loss history, existing market conditions and forward-looking estimates at the end of each reporting period. Any impairment is recorded in the consolidated statements of operations and comprehensive loss. Impairment losses can be reversed in subsequent periods.

Segmented Operations

All natural gas, oil and condensate sales revenue is derived from Brazilian operations. All exploration and evaluation assets and all material property, plant and equipment are located in Brazil. Cash and cash equivalents are held in both Canada and Brazil and all of the restricted cash at December 31, 2020 and 2019 is held in Brazil. The Company does not have any revenue in Canada other than interest earned on cash balances.

NOTE 4 – CHANGES IN ACCOUNTING STANDARDS

New and Revised Accounting Standards

On January 1, 2020 the Company adopted amendments to the following standards:
- IFRS 3 *Business Combinations;*
- IAS 1 *Presentation of Financial Statements*; and
- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors.*

The amendments did not have a material impact on the financial statements as at and for the year ended December 31, 2020.

NOTE 5 – ASSETS HELD FOR SALE

	As at	
	December 31, 2020	December 31, 2019
Balance, beginning of year	**332**	202
Transfer from E&E assets (Note 6)	**-**	351
Impairment	**(4)**	(37)
Disposition	**(158)**	(171)
Foreign currency translation	**(42)**	(13)
Balance, end of year	**128**	332

Land	**128**	170
Equipment inventory	**-**	162
Total	**128**	332

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

During 2020, the Company entered into an agreement to dispose of its land held for sale and the carrying value was reduced to the fair value less costs to sell, resulting in a nominal impairment loss.

During 2019, the Company sold equipment inventory classified as held for sale for total proceeds of $0.2 million and recorded a nominal gain. The impairment loss in 2019 reflects management's revised estimate of the anticipated net proceeds on both the land and equipment inventory held for sale at December 31, 2019.

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

NOTE 6 – EXPLORATION AND EVALUATION ASSETS

	As at	
	December 31, 2020	December 31, 2019
Balance, beginning of year	**35,971**	35,340
Capital expenditures	**992**	3,276
Capital expenditures – non-cash	**3**	-
Capitalized share-based compensation	**10**	8
Change in decommissioning liabilities	**-**	48
Transfer from (to) PP&E (Note 7)	**99**	(14)
Other transfers (Note 5)	**(1)**	(351)
Impairment	**21**	(1,608)
Foreign currency translation	**(4,833)**	(728)
Balance, end of year	**32,262**	35,971

The majority of the Company's carrying value of its E&E assets relates to the Gomo natural gas project, including the 183(1) and 197(1) wells. Proved plus probable reserves have been assigned to Alvopetro's Gomo gas asset since December 31, 2018 and the Company has continued to evaluate the technical feasibility and commercial viability of the property since that time. In 2019 Alvopetro commenced a stimulation and production test, which was completed in the first quarter of 2020. However, because of operational challenges during this stimulation, in late 2020, the Company installed a plunger lift system to remove remaining fluids and, subsequent to December 31, 2020, another production test was completed on this well. The Company expects to declare commerciality in advance of the development phase expiry of May 2021. At that time the carrying costs of the asset, less any impairment will be transferred to PP&E assets. Given the results of the stimulation and production testing, reserves assigned to date and additional prospects on this project, there is no indication of impairment of this E&E asset as at December 31, 2020.

General and administrative costs totaling $0.2 million (December 31, 2019 - $0.3 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 been predominantly used for exploration wells and accordingly, the carrying value of the equipment inventory is included in E&E assets. In 2019, the Company transferred $0.4 million of materials inventory to assets held for sale.

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

	Year ended December 31,	
	2020	2019
Block 57	**-**	(1,572)
Equipment inventory	**(1)**	(36)
Other	**22**	-
Net E&E impairment reversal (loss)	**21**	(1,608)

The impairment reversal in 2020 relates to amounts accrued for capitalized letter of credit fees ("LCs", see Note 17) accrued for blocks no longer held by the Company and impaired in prior years. During 2019, the Company relinquished Block 57 and recorded an impairment loss of $1.6 million to bring the carrying value of the block to $nil at December 31, 2019.

The Company is continually assessing the value of its equipment inventory and provides for impairment on any items which are considered to have a book value in excess of its recoverable amount. At the time of the transfer of $0.4 million of equipment inventory to assets held for sale in 2019 (Note 5), a $0.04 million impairment loss was recognized. As at December 31, 2020, the Company held $1.1 million (December 31, 2019 - $1.5 million) of equipment inventory to be utilized in 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

	As at	
	December 31, 2020	December 31, 2019
Cost, beginning of year	**34,354**	25,631
Capital expenditures – cash	**2,425**	6,151
Capital expenditures – non-cash	**394**	3,244
Capitalized share-based compensation	**12**	15
Transfer (to) from E&E assets (Note 6)	**(99)**	14
Transfer to ROU assets (Note 8)	**-**	(30)
Change in decommissioning liabilities	**-**	196
Foreign currency translation	**(5,897)**	(867)
Cost, end of year	**31,189**	34,354
Accumulated depletion, depreciation and impairment, beginning of year	**(3,370)**	(3,620)
Depletion and depreciation for the period	**(1,496)**	(67)
Impairment	**(1,381)**	-
Foreign currency translation	**901**	317
Accumulated depletion, depreciation and impairment, end of year	**(5,346)**	(3,370)
Net book value, end of year	**25,843**	30,984

Capital expenditures in 2020 and 2019 primarily related to development of the Company's Caburé natural gas field, including joint upstream development at the Caburé unit and midstream infrastructure construction of the Caburé transfer pipeline and site construction and other costs for the gas treatment facility.

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

The Company determined that indications of impairment existed as at March 31, 2020 due to the significant decline in global crude oil prices and the uncertainty surrounding the economic impact of the COVID–19 global pandemic. A test for impairment was performed at the CGU level by comparing the estimated recoverable amount to the carrying values of the assets. The estimated recoverable amount was determined based on fair value less costs of disposal, based on discounted cash flows from management's best estimate of recoverable reserves, discounted using a pre-tax rate of 15%. The Company utilized forecasted commodity prices from its external reserves evaluator. A resultant impairment charge of $1.4 million was recognized in the three months ended March 31, 2020 related to the Bom Lugar field, reducing the carrying value of the field to $1.3 million net of asset retirement obligations as at March 31, 2020. In determining the estimated recoverable amount of the Bom Lugar field as of March 31, 2020, the Company utilized the following forecasted commodity prices:

Brent forecasted utilized at March 31, 2020 ($/bbl)										
2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	Thereafter
34.00	45.50	52.50	57.50	62.50	62.95	64.13	65.33	66.56	67.81	Escalated at 2%

As of December 31, 2020 although there were improvements in commodity prices from March 31, 2020, given the prevailing uncertainty related to the pandemic the Company reassessed the net recoverable amount remaining for the Bom Lugar field and determined that no further impairment was required. In determining the estimated recoverable amount at December 31, 2020, the Company utilized future cash flows from the Company's recoverable proved reserves as evaluated by the Company's independent reserves evaluator. The probable estimated future cash flows from a development location on this field were excluded. The Company utilized proved reserves in the determination of the estimated recoverable amount as of December 31,

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2020. In evaluating the estimated recoverable amount based on proved reserves, the Company utilized a pre-tax discount rate of 5% as proved reserves are inherently subject to less uncertainty. Based on these assumptions, the estimated recoverable amount of this CGU was determined to be within the range of estimated recoverable amounts determined at March 31, 2020 and as such no further impairment charge or reversal was required at December 31, 2020. In determining the estimated recoverable amounts, the Company utilized the following forecasted commodity prices as of December 31, 2020:

Brent forecasted utilized at December 31, 2020 ($/bbl)										
2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	Thereafter
50.75	55.00	58.50	61.79	62.95	64.13	65.33	66.56	67.81	69.17	Escalated at 2%

Future changes to forecasted commodity prices could result in future impairment losses or impairment reversals. A 5% increase in Brent would result in a $0.3 million increase in the recoverable amount while a 5% decrease in Brent would result in additional impairment of $0.3 million. An increase or decrease in the discount rate by 1% would result in changes to the estimated recoverable amount of $0.06 million. 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.

NOTE 8 – RIGHT-OF-USE ASSETS AND LEASE LIABILITIES

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

	As at	
	December 31, 2020	December 31, 2019
Net book value, beginning of year	**219**	-
ROU Assets upon adoption of IFRS 16 – formerly operating leases	**-**	226
ROU Assets upon adoption of IFRS 16 – transferred from PP&E (Note 7)	**-**	30
Additions	**8,494**	133
Depreciation of ROU assets	**(574)**	(167)
Foreign currency translation	**(47)**	(3)
Net book value, end of year	**8,092**	219
Net Book Value by Asset Class		
Natural gas facility	**7,890**	-
Office space	**105**	70
Surface land access	**97**	149
Total Net Book Value	**8,092**	219

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

The Company's lease liabilities at December 31, 2020 are as follows:

	As at	
	December 31, 2020	December 31, 2019
Lease liabilities, beginning of period	**163**	-
Lease liabilities upon adoption of IFRS 16	**-**	244
Additions	**8,494**	133
Finance expense	**706**	14
Lease payments	**(1,014)**	(234)
Foreign currency translation	**(39)**	6
Lease liabilities, end of period	**8,310**	163
Current	**483**	101
Non-current	**7,827**	62
Total	**8,310**	163

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

The Company's weighted average rate used to discount all lease liabilities was 16.7% (December 31, 2019 – 7.0%). During the year ended December 31, 2020 the Company incurred a nominal amount in payments related to leases for which the low-value expedient is applied in application of the relevant accounting standard.

NOTE 9 – OTHER ASSETS

Other assets represent the unamortized portion of the Company's deferred financing costs associated with the Company's Credit Facility arrangement entered into in 2019 (Note 12). The deferred financing costs are comprised of cash transactions costs as well as the fair value of the warrants issued to advisors and lenders. These costs are being amortized over the term of the Credit Facility as follows:

	As at	
	December 31, 2020	December 31, 2019
Balance, beginning of year	**1,790**	-
Additions (Note 12)	**-**	1,927
Amortization of deferred financing costs	**(650)**	(137)
Foreign currency translation	**(12)**	-
Balance, end of year	**1,128**	1,790

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

NOTE 10 – DECOMMISSIONING LIABILITIES

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

	As at	
	December 31, 2020	December 31, 2019
Balance, beginning of year	**1,380**	1,231
Liabilities incurred	**-**	962
Revisions to obligations	**-**	(718)
Obligations settled	**(5)**	(67)
Accretion	**80**	52
Foreign currency translation	**(312)**	(80)
Balance, end of year	**1,143**	1,380

Current	**63**	80
Non-current	**1,080**	1,300
Total	**1,143**	1,380

Total undiscounted cash flows, escalated at 5.5% (December 31, 2019 - 5.5%) for inflation, required to settle the Company's decommissioning liabilities are estimated to be $5.8 million (December 31, 2019 - $5.8 million). These estimated cash flows are discounted using an average risk-free rate of 6.9% (December 31, 2019 – 6.7%).

For the year ended December 31, 2019, the calculation of the asset retirement obligations was transitioned from a U.S. Treasury bill rate to a Brazil government bond rate to align the rate more closely with the source of the funds. This was based on the expectation that the cash flows from the Caburé asset would be sufficient to support exploration and development activities, including decommissioning. This change, along with abandonment timing revisions to maintain consistency with the 2019 independent reserve report, resulted in a reduction in the estimated obligations of $0.7 million.

NOTE 11 – OTHER LIABILITIES

	As at	
	December 31, 2020	December 31, 2019
Balance, beginning of year	**5,728**	2,348
Unit development capital additions (including effective interest)	**190**	3,244
Net unearned revenue	**42**	-
Changes in risk management liabilities (Note 18)	**12**	-
Payments of amounts owing for unit capital	**(4,231)**	-
Foreign currency translation	**(1,729)**	136
Balance, end of year	**12**	5,728

Amount owing to unit development partner	**-**	5,728
Unearned revenue	**-**	-
Risk management contracts	**12**	-
Total	**12**	5,728

As at December 31, 2019 the Company had an amount owing related to Alvopetro's share, net of cash calls paid and inventory and equipment transfers, of the costs incurred to date with respect to joint development of the Caburé natural gas field in which the Company has a 49.1% working interest. Pursuant to the Unit Operating Agreement, the majority of the 2018 and 2019 field development was initially funded by the Company's partner and Alvopetro reimbursed the operating partner in full, including the contracted adjustments for inflation during the six months ended June 30, 2020.

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

Under the terms of the Company's GSA, Alvopetro is entitled to take-or-pay pre-payments to the extent Bahiagás is unable to accept natural gas deliveries. The take-or-pay payments are based on a fixed percentage of the firm volumes specified in the contract, with equivalent volumes to be subsequently recovered by Bahiagás. In the second quarter of 2020, Alvopetro received $1.2 million of take-or-pay payments, the corresponding volumes for which were all delivered in the second half of 2020, with the revenue being recognized upon delivery and resulting in a net liability of $nil at December 31, 2020. As the take-or-pay amounts received were denominated in BRL Alvopetro realized a foreign exchange benefit of $0.04 million resulting from the USD difference of the amount repaid compared to the initial advances.

NOTE 12 – CREDIT FACILITY

On September 20, 2019 the Company entered into a $15 million Credit and Guarantee Agreement (the "Credit Facility") and all funding conditions were met on October 8, 2019 (the "Funding Date"). The Credit Facility is secured by all of Alvopetro's assets and matures on October 8, 2022. The net proceeds drawn on the Credit Facility were used to fund the development of the Company's Caburé natural gas field, Gomo development costs, payments for the well drilled on Block 57 in the third quarter of 2019, and for ongoing general operational and corporate requirements. The Credit Facility contains certain customary financial and non-financial covenants, standard representations and warranties, and events of default. Financial covenants include a minimum debt service ratio of 1.30:1 and a maximum leverage ratio of 2.25:1. As at December 31, 2020 the Company was in compliance with all covenants.

Amounts drawn under the Credit Facility are repayable at maturity however after the first anniversary of the Credit Facility, amounts drawn may be repaid in part or full at Alvopetro's option without penalty. Interest on the Credit Facility includes monthly payments at 9.5% per annum and an additional 3.0% per annum upon repayment of any amounts drawn. Until October 8, 2020, the Credit Facility was subject to a 1.0% per annum commitment fee on the unused available balance.

	As at	
	December 31, 2020	December 31, 2019
Balance at beginning of year	**5,027**	-
Draws on Facility	**10,000**	5,000
Accrued interest due upon repayment	**396**	27
Balance at end of year	**15,423**	5,027

In addition to cash transaction costs of $1.1 million incurred to secure this Facility, Alvopetro issued 8,057,868 share purchase warrants to the lenders ("Lender Warrants") and 375,000 share purchase warrants to the Company's financial advisors ("Advisor Warrants")(see Note 13). The Lender Warrants issued in connection with the Credit Facility are considered an equity instrument, valued using the residual value method and reflected as a deferred financing cost incurred for the ability to access the Credit Facility. The cash transaction costs are also reflected as a deferred financing cost. As the fair value of the services with respect to the Advisor Warrants could not be reliably measured, the value was derived from the valuation of the Lender Warrants and recorded as a deferred financing cost. Financing costs related to this transaction are as follows, and included with Other Assets on the Consolidated Statement of Financial Position and amortized to finance expense over the term of the Credit Facility (Note 9).

	As at	
	December 31, 2020	December 31, 2019
Cash transaction costs	**-**	1,109
Fair value of Lender Warrants	**-**	782
Fair value of Advisor Warrants	**-**	36
Total transaction costs incurred	**-**	1,927

NOTE 13 – 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

	Year Ended December 31,			
	2020		**2019**	
	Number of Shares	**Amount ($000)**	Number of Shares	Amount ($000)
Balance, beginning of year	**97,849,788**	**156,355**	96,670,871	155,731
Shares issued – exercise of warrants	**-**	**-**	1,249,000	621
Shares issued – exercise of options	**1,611,612**	**403**	7,296	4
Cancellation of shares	**-**	**-**	(77,379)	-
Share issue costs	**-**	**(3)**	-	(1)
Balance, end of year	**99,461,400**	**156,755**	97,849,788	156,355

c) Warrants to Purchase Common Shares

Warrants outstanding at December 31, 2020 are as follows:

	Number of Warrants			
	Exercise Price			
	USD $0.50	**USD $0.60**	**CAD $0.64**	**Total**
Balance as at December 31, 2018	3,300,000	-	376,000	3,676,000
Granted	-	8,432,868	-	8,432,868
Exercised	(1,009,000)	-	(240,000)	(1,249,000)
Expired	(1,491,000)	-	(136,000)	(1,627,000)
Balance as at December 31, 2019	800,000	8,432,868	-	9,232,868
Expired	(800,000)	-	-	(800,000)
Balance as at December 31, 2020	**-**	**8,432,868**	**-**	**8,432,868**
Weighted Average Remaining Contractual Life (years)	**-**	**1.72**	**-**	**1.72**

The 2019 warrants granted relate to the Lender Warrants and Advisor Warrants issued in connection with the Credit Facility (Note 12). Each warrant entitles the holder to purchase one common share of Alvopetro, at an exercise price of $0.60 per common share at any time prior to September 20, 2022.

d) 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 when combined with Alvopetro's incentive share plan. 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, 2020 are as follows:

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

	Number of Options	Weighted Average Exercise Price (CAD$)
Balance as at December 31, 2018	7,180,750	0.34
Granted	970,000	0.75
Expired	(72,000)	1.10
Exercised	(40,000)	0.57
Balance as at December 31, 2019	8,038,750	0.38
Granted	1,308,000	0.81
Expired	-	-
Adjustment for options net settled	(859,711)	0.40
Adjustment for options cash settled	(123,677)	0.40
Exercise of options for common shares	(1,611,612)	0.29
Balance as at December 31, 2020	**6,751,750**	**0.47**
Percentage of common shares outstanding	**6.7%**	

	Options Outstanding at December 31, 2020			**Options Exercisable at December 31, 2020**		
Exercise Price (CAD$)	Number of Options	Weighted Average Exercise Price (CAD$)	Weighted Average Remaining Contractual Life (years)	Number of Options	Weighted Average Exercise Price (CAD$)	Weighted Average Remaining Contractual Life (years)
0.18 - 0.39	3,173,750	0.26	1.4	3,173,750	0.26	1.4
0.40 - 0.75	2,270,000	0.57	3.3	1,190,004	0.52	3.1
0.76 - 1.00	1,308,000	0.81	5.2	-	-	-
0.18 - 1.00	**6,751,750**	**0.47**	**2.8**	**4,363,754**	**0.33**	**1.9**

e) Restricted Share Units

During the three months ended September 30, 2020 the Company granted RSUs to officers and employees to purchase 900,000 common shares under Alvopetro's Incentive Share Plan, of which 660,000 were granted to officers. These RSUs vest evenly over three years and expire on August 17, 2025. The Incentive Share Plan allows for the issuance of up to 1,700,000 common shares of the Company.

f) Share-Based Compensation

The fair value of the stock options and RSUs granted under the Alvopetro's share based compensation plans for the years ended December 31, 2020 and 2019 has been estimated on the grant date using the Black-Scholes option pricing model. Weighted average assumptions and resultant fair values for stock options and RSUs granted are as follows:

	Year ended December 31,	
	2020	2019
Risk free interest rate (%)	**0.32**	1.46
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)	**0.47**	0.28

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

Total share-based compensation of $0.3 million was computed for the year ended December 31, 2020 (2019 - $0.2 million) related to the Alvopetro stock option plan. Of this amount, approximately $0.02 million (2019 - $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.

g) **Net Income (Loss) Per Share**

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

	Year ended December 31,	
	2020	2019
Weighted average basic	**98,615,766**	96,708,918
Dilutive securities		
Stock options	**5,546,939**	-
Warrants(1)	**631,694**	-
RSUs	**334,426**	-
Weighted average diluted	**105,128,825**	96,708,918

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

In determination of the weighted average number of diluted common shares outstanding for the year ended December 31, 2019, all stock options and warrants were excluded because the effect would be anti-dilutive.

NOTE 14 – REVENUE FROM CONTRACTS WITH CUSTOMERS

	Year ended December 31,	
	2020	2019
Natural gas	**10,495**	-
Condensate	**752**	86
Oil	**61**	154
Total	**11,308**	240

Alvopetro commenced natural gas sales on July 5, 2020 with 100% of natural gas production sold under the GSA. The Company's natural gas price is set semi-annually (in February and August) using a trailing weighted average basket of USD benchmark prices, with a floor and a ceiling price adjusted based on United States inflation. The natural gas price is then translated to BRL based on the average BRL relative to USD and fixed in BRL until the next price re-set date. As all invoices are issued in BRL, actual receipts and revenue recognized in equivalent USD will be subject to exchange rate variations.

The Company's oil and condensate sales revenues are derived under contracts with customers based on floating prices, specifically the Brent benchmark oil price adjusted for contracted discounts at a fixed percentage of Brent in the case of oil sales and at fixed premiums to Brent in the case of condensate sales.

Payment terms are on or before the 25th day of the month following satisfaction of the performance obligation. For the year ended December 31, 2020 the natural gas sales revenue has been collected within the timing expected. There is no indication of potential collection issues with the Bahiagás, the local distribution company in the state of Bahia in Brazil and sole customer of the Company's natural gas production. There were no adjustments to any revenues recorded in the years ended December 31, 2020 or 2019. Amounts receivable from contracts with customers by commodity are as follows:

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

	As at December 31,	
	2020	2019
Natural gas	**2,539**	**-**
Condensate	**32**	-
Oil	**-**	16
Total	**2,571**	16

NOTE 15 – NATURE OF EXPENSES

Production expenses by nature were as follows:

	Year Ended December 31,	
	2020	2019
Personnel	**193**	102
Facility and pipeline	**573**	-
Other fixed	**519**	150
Variable	**51**	24
Total production expenses	**1,336**	276

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

	Year Ended December 31,	
	2020	2019
Personnel	**2,595**	2,524
Travel	**17**	117
Office and IT costs	**115**	145
Professional fees	**419**	371
General corporate	**652**	621
Gross G&A expenses	**3,798**	3,778
Capitalized to PP&E (Note 7)	**(491)**	(642)
Capitalized to E&E (Note 6)	**(237)**	(343)
Net G&A expenses	**3,070**	2,793

General corporate expenses include public company costs, corporate insurance, directors' fees and other miscellaneous expenses. G&A expenses directly attributable to exploration and development projects, primarily being personnel costs, are capitalized. Personnel expenses in the year ended December 31, 2020 were impacted by severance costs as well as bonuses following completion of the Caburé development.

Finance expenses by nature are as follows:

	Year Ended December 31,	
	2020	2019
Lease interest (Note 8)	**706**	14
Accretion of decommissioning liabilities (Note 10)	**80**	52
Amortization of deferred financing costs (Note 9)	**650**	137
Interest on Credit Facility (Note 12)	**1,638**	132
Gross finance expenses	**3,074**	335
Capitalized to PP&E	**(623)**	(76)
Capitalized to E&E	**(114)**	-
Net finance expenses	**2,337**	259

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

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

A summary of impairment by nature is as follows:

	Year Ended December 31,	
	2020	2019
Impairment loss on Assets Held for Sale (Note 5)	**4**	37
Impairment (reversal) loss on E&E assets (Note 6)	**(21)**	1,608
Impairment loss on PP&E assets (Note 7)	**1,381**	-
Other	**91**	-
Total Impairment	**1,455**	1,645

Other impairment in the year ended December 31, 2020 relates to consideration expected upon the disposition of assets as agreed to in a previous year.

NOTE 16 – 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.

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,	
	2020	2019
Income (loss) before taxes	**1,961**	(5,011)
Statutory income tax rate	**34%**	34%
Expected income tax expense (recovery)	**667**	(1,704)
Decrease (increase) resulting from:		
Change in unrecognized deferred tax asset	**(3,810)**	312
Change in estimated tax pools	**55**	134
Share-based compensation	**90**	143
Non-deductible amounts for tax purposes	**615**	-
Impact of foreign exchange fluctuations and other	**(1,362)**	1,115
Income tax (recovery) expense	**(3,745)**	-

In 2020, upon the commencement of natural gas deliveries and cash flows from the Caburé natural gas field, the Company recognized a previously unrecognized deferred tax asset. As of December 31, 2020, the deferred tax asset is $4.6 million (December 31, 2019 - $nil). 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. The tax benefit is considered to be a special deduction and will only be recognized as it is utilized to reduced current income tax expense.

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

The change in the Company's deferred tax balance is as follows:

	Year ended December 31, 2020	2019
Deferred tax liability (asset), beginning of the year	**-**	-
Recognized in deferred income tax expense (recovery)	**(3,745)**	-
Recognized in other comprehensive income – initial recognition	**(457)**	-
Impact of foreign exchange fluctuations and other	**(374)**	-
Deferred tax liability (asset), end of year	**(4,576)**	-

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, E&E and ROU assets	Decommissioning liabilities	Tax loss carryforwards	Other Brazil tax pools	Unrealized taxable foreign exchange gains	Unrecognized deferred tax asset	Total
As at December 31, 2018	1,611	(188)	(5,695)	(1,062)	66	5,268	-
Deferred tax expense (recovery)	193	(22)	(473)	41	(51)	312	-
Foreign currency translation	-	-	-	-	-	-	-
As at December 31, 2019	1,804	(210)	(6,168)	(1,021)	15	5,580	-
Deferred tax expense (recovery)	2,348	(148)	(1,699)	(605)	169	(3,810)	(3,745)
Recognition in OCI	-	-	(457)	-	-	-	(457)
Foreign currency translation	405	(31)	(630)	(139)	21	-	(374)
As at December 31, 2020	**4,557**	**(389)**	**(8,954)**	**(1,765)**	**205**	**1,770**	**(4,576)**

A deferred tax asset of $1.8 million exists at December 31, 2020 (December 31, 2019 - $5.6 million) that has not been recognized. Of the full balance of the unrecognized deferred tax asset, $nil relates to Brazil (December 31, 2019 - $4.2 million) and $1.8 million relates to Canada (December 31, 2019 - $1.4 million). Total tax loss carry-forwards include $24.4 million attributable to Brazil, which carryforward indefinitely but are limited to annual utilization of up to 30% of taxable income in subsequent periods, and $7.7 million attributable to Canada which expire between 2032 and 2039.

NOTE 17 – CAPITAL MANAGEMENT

The Company's capital consists of the following:

	As at December 31, 2020	2019
Cash and cash equivalents	**5,159**	1,215
Non-cash working capital surplus (deficit)	**380**	(7,916)
Credit Facility	**(15,423)**	(5,027)
Net debt	**(9,884)**	(11,728)
Lease liabilities – non-current	**(7,827)**	(62)
Shareholders' equity	**53,110**	55,874

As of December 31, 2020, a total of $15 million was drawn under the Credit Facility which represents the full available balance. Alvopetro may adjust its capital structure by issuing new equity or debt and adjusting its capital expenditure program, as allowed pursuant to contracted work commitments.

The Company has a credit support facility with a Canadian bank which allows for the issuance of LCs and letters of guarantee in support of financial guarantees required by the National Agency of Petroleum, Natural Gas and Biofuels of Brazil ("ANP") for

Alvopetro's work commitments under the terms of its concession contracts as discussed further in Note 21. 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, 2020, the total amount of LCs issued was $0.6 million (December 31, 2019 - $4.9 million), the full balance of which was supported by EDC on behalf of Alvopetro.

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

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

NOTE 18 – FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

Overview

The Company's financial instruments, classified as financial assets and liabilities, consist of cash and cash equivalents, restricted cash, trade and other receivables, accounts payable and accrued liabilities, other liabilities, risk management contracts and the Credit Facility.

Financial Risk

The Company is exposed to risks arising from the volatility of commodity prices, foreign exchange rates and interest rates, resulting in market risks, credit risk and liquidity risk. Risk management strategies are employed to ensure that any exposures are within risk tolerance levels compatible with the Company's business objectives. Alvopetro's Board of Directors has overall responsibility for establishment and oversight of the Company's risk management policies and activities.

Market Risk

Market risk is the risk that changes in market factors will affect the Company's cash flows, net income (loss), comprehensive loss, liquidity or the value of financial instruments. Market uncertainly associated with the COVID-19 pandemic is incorporated into management's risk assessments but given the lack of precedence, is difficult to accurately predict.

Commodity Price Risk

For the year ended December 31, 2020 approximately 93% of natural gas, oil and condensate sales was related to natural gas sales from the Company's Caburé field. Fluctuations in natural gas prices may have a significant impact on the carrying value of this property as well as cash flows and the Company's resultant ability to execute planned capital expenditures, meet ongoing obligations and repay amounts drawn under the Credit Facility. Changes in commodity prices can also affect the Company's ability to obtain future financings and the terms of those future financings. Alvopetro's natural gas volumes are sold pursuant to its GSA at a natural gas price, set semi-annually, based on average historical international USD benchmark commodity prices. The GSA includes both a USD floor and ceiling price, based on three benchmark price indices (see Note 14), limiting the Company's exposure to commodity price risk.

The Company did not have any forward commodity price contracts in place as at or during the years ended December 31, 2020 and 2019 but may consider such in the future to protect cash flows and manage this risk.

Foreign Currency Risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign currency exchange rates. The Company's natural gas, oil and condensate sales are denominated in BRL based on USD benchmark prices, unused tax pools in Brazil are in BRL and all operational, administrative and capital activities related to the Brazil properties are transacted primarily in BRL. Alvopetro's GSA is exposed to fluctuations in the USD to the BRL as the natural price, although benchmarked to USD, is set semi-annually in BRL (based on historical foreign exchange rates) and billed monthly in the set BRL price until the next price redetermination. The following table denotes the overall impact on natural gas revenues of a 5% and 10% appreciation and depreciation of the BRL relative to the USD:

	Year Ended December 31, 2020	2019
Increase (decrease) to natural gas revenues from:		
5% Appreciation of BRL to USD	**525**	-
10% Appreciation of BRL to USD	**1,050**	-
5% Depreciation of BRL to USD	**(500)**	-
10% Depreciation of BRL to USD	**(954)**	-

To manage exposure to foreign exchange volatility with respect to the BRL, the Company has entered into BRL/USD forward exchange rate contracts. As of December 31, 2020, the Company has entered into a total of BRL 3,000,000 forward exchange contracts with settlements based on fixed rates between 5.10 and 5.42 and settlement dates spanning from February to July 2021. The Company recognizes the fair value of these contracts in the statement of financial position with changes in fair value recognized as an unrealized gain or loss included in net income (loss). Realized gains or losses are recognized in the period the contracts are settled. Total losses with respect to these contracts for the year ended December 31, 2020 were $0.01 million (2019 - $nil), all unrealized. In addition, management closely monitors foreign exchange rates and will determine the currency and location of cash held based on funding needs and opportunities to optimize on foreign currency and local interest rates.

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

	As at December 31, 2020		2019	
	CAD (000's)	**BRL (000's)**	CAD (000's)	BRL (000's)
Cash and cash equivalents	**64**	**4,282**	91	1,656
Restricted cash – current	**-**	**651**	-	1,089
Trade and other receivables	**40**	**14,156**	28	891
Accounts payable and accrued liabilities	**(415)**	**(10,371)**	(315)	(11,001)
Other liabilities	**-**	**(65)**	-	(23,088)
Net exposure in foreign currency	**(311)**	**8,653**	(196)	(30,453)
Net exposure in USD ($000s)	**(244)**	**1,665**	(151)	(7,555)

Based on financial instruments held at December 31, 2020 and 2019, sensitivity to fluctuations in the exchange rates as indicated below would have the following estimated effect on net income (loss) and other comprehensive loss:

	Year Ended December 31, 2020	2019
Effect of 5% appreciation in CAD and BRL to USD		
Decrease to net income	**(12)**	(11)
Decrease (increase) to accumulated other comprehensive loss	**75**	(414)
Effect of 5% depreciation in CAD and BRL to USD		
Increase to net income	**12**	11
(Increase) decrease to accumulated other comprehensive loss	**(67)**	375

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 Company also incurs interest on its Credit Facility, with no effect from market conditions however given the interest rate is fixed.

Credit Risk

Credit risk is the risk of financial loss to the Company if counterparties do not fulfill their contractual obligations. This exposure for Alvopetro potentially affects restricted cash, trade and other receivables and risk management contracts. This risk is considered low based on Alvopetro's policies to balance the amount of credit outstanding with management's assessment of the counterparty's financial strength.

Alvopetro is subject to increased credit risk as a result of concentration with one counterparty. At December 31, 2020, $2.5 million of accounts receivable (December 31, 2019 - $nil) or 91% (2019 - $nil, 0%) is related to natural gas production sold to one counterparty (see Note 14), the full balance of which was received subsequent to December 31, 2020. Alvopetro is paid for its production monthly and has assessed the risk of nonpayment from this customer, the distribution company for the state of Bahia, as very low. To date there have been no issues with respect to recoverability of the accounts receivable from Alvopetro's natural gas customer nor any significant issues recovering amounts from oil or condensate customers. As such, the risk of non-collection from this counterparty and any of Alvopetro's counterparties is not expected to have a material impact on the financial statements.

The Company closely monitors other trade receivables, recognizing a provision when collection is in doubt. There were no expected credit losses recognized in 2020 or 2019 with the exception of the $0.1 million loss referred to in Note 15. The maximum exposure to credit risk is equal to the carrying value of the financial assets.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations when due. The Company manages this risk by forecasting cash flows for a minimum period of twelve months which involves preparation of capital expenditure, operating and general and administrative budgets, all of which are monitored and updated as considered necessary. Obligations were satisfied throughout 2020 with the Company's access to cash balances, cash flows from operating activities and drawings on the Credit Facility (see Note 12). The Company's current cash flow levels are anticipated to fund planned capital programs and ongoing operational requirements as well as debt repayments.

LCs for work commitments supported by EDC are reviewed annually and to the extent the EDC coverage is terminated or 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. This risk is steadily declining in magnitude given that at December 31, 2020, the Company had $0.6 million compared to $4.9 million in 2019 of LCs supported by EDC.

Fair Value of Financial Instruments

Financial assets and liabilities measured at fair value are classified into levels reflecting the measurement method used. The risk management contracts are considered level 1 instruments. There were no transfers of any financial instruments between levels within the fair value hierarchy during the year ended December 30, 2020 or 2019.

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

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

NOTE 19 – CHANGES IN NON-CASH WORKING CAPITAL

	Year ended December 31,	
Change in:	**2020**	2019
Trade and other receivables	**(2,864)**	(2)
Prepaid expenditures	**161**	(30)
Accounts payable and accrued liabilities	**(485)**	2,103
	(3,188)	2,071
Changes relating to:		
Operating activities	**(3,155)**	319
Financing activities	**59**	(82)
Investing activities	**(92)**	1,834
	(3,188)	2,071

NOTE 20 – 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,	
	2020	2019
Short-term benefits	**1,056**	477
Share-based compensation	**198**	110
Total	**1,254**	587

The following table lists the Company's subsidiaries and their respective places of incorporation, each owned 100% directly and indirectly at December 31, 2020:

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

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

NOTE 21 – COMMITMENTS AND CONTINGENCIES

The following is a summary of contractual commitments as at December 31, 2020:

Commitments	< 1 Year	1-3 Years	Thereafter	Total
Minimum work commitments[(1)]				
Block 183	-	642	-	642
Bom Lugar	-	-	67	67
Mãe-da-lua	-	-	67	67
Minimum work commitments	**-**	**642**	**134**	**776**
Gas Treatment Agreement	**1,136**	**2,272**	**7,385**	**10,793**
Total commitments	**1,136**	**2,914**	**7,519**	**11,569**

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.

In addition to gas treatment equipment rental (Note 8), the Company's Gas Treatment Agreement with Enerflex provides for monthly service fees for operation and maintenance of the Facility as well as Alvopetro's 11-kilometre transfer pipeline. The committed payments for service fees are included in the table above. The Gas Treatment Agreement includes early termination penalty provisions which vary depending on timing of the termination. While the agreement also includes strict availability requirements and downtime credits, such credits may not fully offset costs incurred by Alvopetro due to ship or pay obligations under the GSA as discussed below to the extent processing in the Facility is limited due to unplanned or longer than scheduled maintenance or repair.

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

As is customary in the oil and gas industry, the Company may at times have work plans in place to reserve or earn certain acreage positions or wells. If such work plans are not completed in a timely manner, the acreage positions or wells may be lost, or penalties may be applied.

The Company currently has no contingent liabilities recorded; however, in the normal course of operations, may have disputes with industry participants for which the outcomes are not determinable. The Company has a policy to record contingent liabilities as they become determinable and the probability of loss is more likely than not.