ALVOPETRO ENERGY LTD.

CONSOLIDATED FINANCIAL STATEMENTS
As at and Years Ended December 31, 2022 and 2021

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of Alvopetro Energy Ltd.

Opinion

We have audited the consolidated financial statements of Alvopetro Energy Ltd. (the Entity), which comprise:

- the consolidated statements of financial position as at December 31, 2022 and 2021
- the consolidated statements of operations and comprehensive income for the years then ended
- the consolidated statements of changes in equity for the years then ended
- the consolidated statements of cash flows for the years then ended
- and notes to the consolidated financial statements, including a summary of significant accounting policies

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the consolidated financial position of the Entity as at December 31, 2022 and 2021, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "***Auditor's Responsibilities for the Audit of the Financial Statements***" section of our auditor's report.

We are independent of the Entity 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.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements for the year ended December 31, 2022. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

We have determined the matters described below to be the key audit matters to be communicated in our auditor's report.

Assessment of the impact of estimated proved and probable oil and gas reserves on the depletion of property, plant and equipment ("PP&E")

Description of the matter

We draw attention to Note 3 and Note 6 to the financial statements. The Entity depletes natural gas and oil assets, which are included within PP&E, using the unit-of-production method using the ratio of production in the period to the related proved and probable oil and gas reserves before royalties. The depletion base includes estimated forecasted future development costs to be incurred in developing proved and probable oil and gas reserves. Depletion and depreciation expense on PP&E was $5,961 thousand for the year ended December 31, 2022.

The estimate of proved and probable oil and gas reserves requires the expertise of independent third party reserve evaluators and includes significant assumptions related to:

- Forecasted natural gas and oil prices
- Forecasted production
- Forecasted operating costs
- Forecasted royalty costs
- Forecasted future development costs.

The Entity engages independent third party reserve evaluators to estimate the proved and probable oil and gas reserves.

Why the matter is a key audit matter

We identified the assessment of the impact of estimated proved and probable oil and gas reserves on the depletion of PP&E as a key audit matter. Significant auditor judgment was required to evaluate the results of our audit procedures regarding the estimate of proved and probable oil and gas reserves.

How the matter was addressed in the audit

The following are the primary procedures we performed to address this key audit matter:

We assessed the depletion expense calculation for compliance with International Financial Reporting Standards (IFRS).

With respect to the estimate of proved and probable oil and gas reserves:

- We evaluated the competence, capabilities and objectivity of the independent third party reserve evaluators engaged by the Entity
- We compared forecasted natural gas and oil prices to those published by other independent third party reserve evaluators
- We compared the 2022 actual production, operating costs, royalty costs and development costs of the Entity to those estimates used in the prior year's estimate of proved oil and gas reserves to assess the Entity's ability to accurately forecast

We evaluated the appropriateness of forecasted production and forecasted operating costs, royalty costs and future development costs assumptions by comparing to 2022 historical results. We took into account changes in conditions and events affecting the Entity to assess the adjustments or lack of adjustments made by the Entity in arriving at the assumptions.

Other Information

Management is responsible for the other information. Other information comprises the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at 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 the 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 International Financial Reporting Standards (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 Entity'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 Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity'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 generally accepted auditing standards 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 the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, 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 Entity'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 Entity'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 Entity 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.
- 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.
- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the group Entity 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.
- Determine, from the matters communicated with those charged with governance, those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor’s report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our auditor’s report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this auditor’s report is Shane Doig.

KPMG LLP

Chartered Professional Accountants

Calgary, Canada
March 21, 2023

ALVOPETRO ENERGY LTD.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Thousands of United States dollars)

	Note	December 31, 2022	December 31, 2021
ASSETS			
Current			
Cash and cash equivalents		**19,784**	11,469
Restricted cash		**296**	175
Trade and other receivables		**7,154**	4,203
Prepaid expenditures		**393**	1,341
Total current assets		**27,627**	17,188
Exploration and evaluation assets	5	**16,114**	3,713
Property, plant and equipment	6	**42,460**	39,780
Right-of-use assets	7	**8,701**	7,153
Deferred tax asset	14	**3,525**	5,305
Other assets	8	**-**	491
Total assets		**98,427**	73,630
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		**7,595**	5,480
Dividend payable	11	**4,357**	2,034
Lease liabilities	7	**855**	516
Decommissioning liabilities	9	**122**	61
Total current liabilities		**12,929**	8,091
Lease liabilities	7	**8,573**	7,463
Credit facility	10	**-**	6,545
Decommissioning liabilities	9	**517**	507
Total liabilities		**22,019**	22,606
Shareholders' equity			
Share capital	11	**42,933**	39,481
Contributed surplus		**51,361**	51,580
Retained earnings		**25,521**	6,486
Accumulated other comprehensive loss		**(43,407)**	(46,523)
Total shareholders' equity		**76,408**	51,024
Total liabilities and shareholders' equity		**98,427**	73,630

Commitments (Note 19)

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

Approved by:

"signed"

John D. Wright
Chairman of the Board of Directors

"signed"

Firoz Talakshi
Chairman of the Audit Committee

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

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

		Year ended December 31,	
	Note	**2022**	2021
Revenue			
Natural gas, oil and condensate sales	12	**63,508**	34,980
Royalties		**(4,486)**	(3,107)
Net natural gas, oil and condensate revenue		**59,022**	31,873
Other income	13	**923**	1,074
		59,945	32,947
Expenses			
Production	13	**3,550**	3,134
General and administrative	13	**4,984**	4,670
Depletion and depreciation	6,7	**7,003**	7,707
Impairment	5	**6,338**	-
Finance expenses	13	**2,378**	3,151
Share-based compensation	11	**861**	440
Risk management loss (gain)	16	**92**	(30)
Foreign exchange (gain) loss		**(2,706)**	1,977
Gain on disposition of assets		**-**	(123)
		22,500	20,926
Income before taxes		**37,445**	12,021
Income tax expense			
Current	14	**1,317**	507
Deferred		**4,396**	5,919
Total		**5,713**	6,426
Net income		**31,732**	5,595
Exchange gain on translation of foreign operations		**3,116**	2,505
Comprehensive income		**34,848**	8,100
Net income per share	11		
Basic		**0.92**	0.17
Diluted		**0.86**	0.16

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

ALVOPETRO ENERGY LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Thousands of United States dollars)

	Note	Common Shares	Contributed Surplus	Retained Earnings (Deficit)	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2021		**39,481**	**51,580**	**6,486**	**(46,523)**	**51,024**
Issue of common shares	11	**3,452**	**(921)**	**-**	**-**	**2,531**
Share-based compensation	11	**-**	**702**	**-**	**-**	**702**
Net income		**-**	**-**	**31,732**	**-**	**31,732**
Other comprehensive income		**-**	**-**	**-**	**3,116**	**3,116**
Dividends declared	11	**-**	**-**	**(12,697)**	**-**	**(12,697)**
Balance, December 31, 2022		**42,933**	**51,361**	**25,521**	**(43,407)**	**76,408**
Balance, December 31, 2020		156,755	2,821	(63,676)	(49,028)	46,872
Issue of common shares	11	1,086	(303)	-	-	783
Share issuance and restructuring costs		(61)	-	-	-	(61)
Share-based compensation	11	-	506	-	-	506
Net income		-	-	5,595	-	5,595
Other comprehensive income		-	-	-	2,505	2,505
Dividends declared	11	-	-	(4,057)	-	(4,057)
Share repurchases	11	(1,119)	-	-	-	(1,119)
Stated capital reduction	11	(117,180)	48,556	68,624	-	-
Balance, December 31, 2021		39,481	51,580	6,486	(46,523)	51,024

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Thousands of United States dollars)

	Note	Year ended December 31, 2022	2021
Operating Activities			
Net income		**31,732**	5,595
Adjustments:			
Depletion and depreciation	6,7	**7,003**	7,707
Impairment	5	**6,338**	-
Finance expenses	13	**2,378**	3,151
Share-based compensation	11	**861**	440
Gain on disposition of assets		**-**	(123)
Foreign exchange		**(2,823)**	1,966
Unrealized risk management (gain)		**-**	(12)
Deferred tax	14	**4,396**	5,919
Settlement of decommissioning liabilities	9	**(6)**	(6)
Funds flow from operations		**49,879**	24,637
Changes in non-cash working capital	17	**(2,345)**	(346)
		47,534	24,291
Financing Activities			
Credit Facility repayments	10	**(6,545)**	(9,000)
Interest on Credit Facility	10	**(306)**	(956)
Dividends paid	11	**(10,374)**	(2,023)
Issue of common shares	11	**2,531**	721
Shares repurchased	11	**-**	(1,119)
Lease liabilities payments	7	**(2,027)**	(1,856)
Changes in non-cash working capital	17	**175**	494
		(16,546)	(13,739)
Investing Activities			
Expenditures on exploration and evaluation assets	5	**(18,545)**	(1,528)
Expenditures on property, plant and equipment	6	**(6,250)**	(2,985)
Proceeds on dispositions		**5**	275
Change in restricted cash		**(110)**	(60)
Changes in non-cash working capital	17	**2,129**	322
		(22,771)	(3,976)
Change in cash and cash equivalents		**8,217**	6,576
Effect of foreign exchange on cash balances		**98**	(266)
Cash and cash equivalents, beginning of year		**11,469**	5,159
Cash and cash equivalents, end of year		**19,784**	11,469
Cash and cash equivalents consist of:			
Cash		**4,498**	7,869
Cash equivalents		**15,286**	3,600
Supplemental information:			
Cash income taxes paid		**1,029**	455
Cash interest income received		**324**	20

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 Brazil. Alvopetro is incorporated under the Business Corporations Act (Alberta) and is a publicly traded company listed on the TSX Venture Exchange (TSX: ALV.V) and is also traded on the OTCQX® Best Market in the United States (OTCQX: ALVOF).

The Company's head office and records are located at 1920, 215 9th Avenue S.W., Calgary, Alberta, Canada, T2P 1K3.

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 21, 2023.

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.

Current Environment and Estimation Uncertainty

Market uncertainty created by global events, including bank collapses, international conflicts, geopolitical factors and pandemics can have a significant impact on global commodity prices, even more so when such events involve a country that is a major exporter of oil or natural gas. Global markets have been experiencing a period of heightened economic uncertainty with more volatile commodity prices and currency exchange rates, as well as inflation concerns. It is difficult to reliably estimate the length or severity of the financial impact of these events in their entirety.

The growing demand for and global advancement of alternative energy sources can affect several assumptions used to determine the recoverable amount of the Company's exploration and evaluation assets and property, plant and equipment and the timing and settlement of decommissioning obligations. The time global energy markets will take to transition from carbon-based sources to alternative energy is unknown.

Emissions, carbon and other regulations impacting climate and climate related matters are constantly evolving. Furthermore, the increased focus on environmental, social and governance matters has a multitude of potential implications for the Company including, but not limited to, reduced access to capital markets and increased costs with respect to insurance and financial and human resources required to comply with new regulations.

Measurement Uncertainty

For Alvopetro, the most significant estimates, judgments and assumptions potentially affected by the situations above, are the valuation of Alvopetro's exploration and evaluation assets and property, plant and equipment. Amounts also recorded for depletion and depreciation, the decommissioning provision and deferred taxes, because they are based on several assumptions and estimates with respect to oil and natural gas proved plus probable reserves, are also impacted by the worldwide economic climate. The potential resulting direct and indirect impact to the Company of these uncertainties has been considered in management's estimates at the period end; however, there could be further material impact in future periods.

Judgments, estimates and assumptions made by management that have the most significant effect on the amounts recognized in the consolidated financial statements are discussed further in Note 3.

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, 2022 and 2021, the Company controls 100 percent of its subsidiaries (see Note 18).

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. 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.

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. Restricted cash held as collateral for letters of credit or other obligations expiring in less than one year is classified as current, with the remainder classified as non-current.

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.

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 also include equipment inventory which is primarily held 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.

The determination of technical feasibility and commercial viability and the impairment assessment requires significant judgment, estimates and assumptions with respect to future prospects, drilling success, well results from other activities including completions and stimulations, existing commitments and expiry of rights to explore, available funds, projected production rates, future market conditions and other significant changes (technological, economic, legal, regulatory).

Property, Plant and Equipment (“PP&E”)

PP&E consists primarily of natural gas and oil development and production assets and, to a lesser extent, operational equipment and corporate assets.

Natural gas and oil assets, which are included in property, plant and equipment, include all costs directly associated with the development of natural gas and oil 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.

Natural gas and oil assets are accumulated on a cash generating unit (“CGU”) basis. Costs accumulated within each CGU are depleted using the unit-of-production method using the ratio of production in the period to the related proved and probable oil and gas reserves before royalties as determined annually by third party reserve evaluators. The depletion base consists of capitalized costs and estimated future development 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 income as incurred. The carrying amount of any replaced or sold component is derecognized.

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.

The Company uses estimated proved and probable oil and gas reserves to deplete PP&E, to assess for indicators of impairment or impairment reversal on the Entity’s CGUs and if any such indicators exist, to perform an impairment test to estimate the recoverable amount of the CGU. The estimation of proved and probable oil and gas reserves, is an inherently complex process which involves professional judgment and geoscientific interpretation as well as determination of forecasted production, forecasted natural gas and oil prices and the timing and amount of forecasted operating costs, forecasted future development costs and forecasted royalties, all of which are subject to uncertainty. Key estimates used in determining future cash flows from proved and probable oil and gas reserves include:

Reserves – Assumptions that are valid at the time of reserve estimation may change significantly when new information becomes available. Changes in forecasted natural gas and oil prices, production costs, required development costs or recovery rates may change the economic status of reserves and may ultimately result in reserves being revised.

Natural gas and crude oil 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.

Impairment

E&E assets, which are comprised of the accumulated expenditures for each block for which technical feasibility and commercial viability has not yet been determined, 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 income.

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 income.

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 statements of operations and comprehensive income.

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.

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. Future cash outflows are based on current estimated abandonment and reclamation costs, adjusted for expected inflation. As all future abandonment and reclamation activities are expected to be funded in Brazilian Real ("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 income. 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.

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.

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.

Share-based Compensation

The Company accounts for share-based compensation using the Black-Scholes option-pricing model to determine the fair value of stock options and 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 instruments. The fair value of restricted share units ("RSUs") and deferred share units ("DSUs") is estimated based on the share price on the grant date.

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, DSUs 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.

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 income 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, adjusted for any available tax incentives or benefits which reduce current tax otherwise payable.

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 and incentives which may reduce the Company's income tax expense are 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.

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.

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, warrants, DSUs and RSUs 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. Alvopetro has chosen to present its consolidated financial statements in USD.

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. Despite the fact that the contracted price for natural gas under the Company's long-term natural gas sales agreement is derived from international benchmark prices in USD and the benchmark price for oil and condensate is set 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.

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 on the consolidated statement of operations and comprehensive income.

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 on the consolidated statements of operations and comprehensive income.

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 income 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 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 income from the date the Company determines such future settlement is likely to occur.

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.

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
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 did not designate its risk management contracts as effective accounting hedges and therefore did not apply hedge accounting. As a result, the Company's derivative instruments were 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 income 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.

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 income. 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, 2022 and 2021 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

The Company has not early adopted any standard, interpretation, or amendment that has been issued but is not yet effective.

The Company has reviewed the following new and revised accounting pronouncements that have been issued but are not yet effective and may have a potential impact on the consolidated financial statements of the Company:

Standard and Description	Date of Adoption	Expected Impact on Consolidated Financial Statements
IAS 1 *Presentation of Financial Statements* – amended to clarify certain requirements for the presentation of liabilities as current or non-current in the statements of financial position.	January 1, 2024	The Company is evaluating the expected impact on the financial statements.

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

NOTE 5 – EXPLORATION AND EVALUATION ASSETS

	As at	
	December 31, 2022	December 31, 2021
Balance, beginning of year	**3,713**	25,764
Capital expenditures	**18,545**	1,528
Capitalized share-based compensation	**66**	22
Change in decommissioning liabilities	**90**	2
Transfer to PP&E (Note 6)	**(155)**	(23,427)
Asset dispositions & other transfers	**(4)**	1
Impairment	**(6,338)**	-
Foreign currency translation	**197**	(177)
Balance, end of year	**16,114**	3,713

The majority of expenditures for the year ended December 31, 2022 relate to drilling and testing the 182-C1, 183-B1 and 182-C2 wells.

With respect to the 182-C1 well, no hydrocarbons were recovered during testing. The well was abandoned subsequent to December 31, 2022 and the carrying value was written down to $nil resulting in impairment of $6.3 million. With respect to the 183-B1 well and the 182-C2 well, the Company continues to evaluate the commercial viability and technical feasibility of these prospects and there are no indications of impairment as of December 31, 2022.

During the year ended December 31, 2021 the Company's $23.4 million carrying value of its Murucututu field (previously referred to as the Gomo natural gas asset), which includes the 183(1) and 197(1) wells, was transferred from E&E assets to PP&E (note 6).

General and administrative costs totaling $0.9 million (December 31, 2021 - $0.4 million) that were directly related to exploration and evaluation activities have been capitalized as exploration and evaluation assets.

Included in E&E assets is equipment inventory with a carrying value of $3.3 million (December 31, 2021 - $1.6 million) which has been predominantly used for exploration wells .

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NOTE 6 – PROPERTY, PLANT AND EQUIPMENT

	As at	
	December 31, 2022	December 31, 2021
Cost, beginning of year	**47,766**	25,174
Capital expenditures	**6,250**	2,985
Capitalized share-based compensation	**40**	44
Transfer from E&E assets (Note 5)	**155**	23,427
Other transfers	**(5)**	(255)
Change in decommissioning liabilities	**(106)**	(603)
Asset disposition	**-**	(56)
Foreign currency translation	**3,044**	(2,950)
Cost, end of year	**57,144**	47,766
Accumulated depletion, depreciation and impairment, beginning of year	**(7,986)**	(2,284)
Depletion and depreciation	**(5,961)**	(6,736)
Asset disposition	**-**	36
Foreign currency translation	**(737)**	998
Accumulated depletion, depreciation and impairment, end of year	**(14,684)**	(7,986)
Net book value, end of year	**42,460**	39,780

General and administrative costs totaling $0.6 million (December 31, 2021 - $0.5 million) that were directly related to property, plant, and equipment activities have been capitalized.

There were no indications of impairment or impairment reversal on any properties in 2022 or 2021.

NOTE 7 – RIGHT-OF-USE ("ROU") ASSETS AND LEASE LIABILITIES

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

	As at	
	December 31, 2022	December 31, 2021
Net book value, beginning of year	**7,153**	8,092
Additions	**1,930**	190
Depreciation	**(1,042)**	(971)
Foreign currency translation	**660**	(158)
Net book value, end of year	**8,701**	7,153
Net Book Value by Asset Class		
Natural gas facility	**8,477**	6,926
Office space	**138**	149
Surface land access	**86**	78
Total net book value	**8,701**	7,153

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

The Company's lease liabilities are as follows:

	As at	
	December 31, 2022	December 31, 2021
Lease liabilities, beginning of year	**7,979**	8,310
Additions	**1,930**	190
Finance expense	**1,525**	1,355
Lease payments	**(2,027)**	(1,856)
Foreign currency translation	**21**	(20)
Lease liabilities, end of year	**9,428**	7,979
Current	**855**	516
Non-current	**8,573**	7,463
Total	**9,428**	7,979

The majority of the right-of-use assets and the lease liabilities are related to the lease component contained in Alvopetro's 10-year contract (the "Gas Treatment Agreement") with Enerflex Ltd. ("Enerflex") expiring in July 2030. Under the Gas Treatment Agreement, Enerflex constructed, maintains, operates 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 additions in 2022 relate primarily to incremental monthly equipment costs associated with the expansion of the Facility and the total right-of-use asset is depreciated over 10 years.

The present value of future minimum lease payments were discounted using a rate of 16.9%. The right-of-use assets are depreciated over the lease term.

NOTE 8 – OTHER ASSETS

Other assets represents the unamortized portion of the Company's deferred financing costs associated with the Company's Credit Facility (Note 10) which was fully repaid and cancelled in 2022.

	As at	
	December 31, 2022	December 31, 2021
Balance, beginning of year	**491**	1,128
Amortization	**(496)**	(635)
Foreign currency translation	**5**	(2)
Balance, end of year	**-**	491

NOTE 9 – 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.

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

	As at	
	December 31, 2022	December 31, 2021
Balance, beginning of year	**568**	1,143
Liabilities incurred	**84**	19
Revisions to obligations	**(100)**	(620)
Obligations settled	**(6)**	(6)
Accretion	**51**	82
Foreign currency translation	**42**	(50)
Balance, end of year	**639**	568

Current	**122**	61
Non-current	**517**	507
Total	**639**	568

Total undiscounted cash flows, escalated at 3.1% (December 31, 2021 - 3.7%) for inflation, required to settle the Company's decommissioning liabilities are estimated to be $11.8 million (December 31, 2021 - $10.2 million). These estimated cash flows are discounted using an average risk-free rate of 8.1% (December 31, 2021 – 8.9%).

NOTE 10 – CREDIT FACILITY

The Credit Facility, which was repaid and cancelled in September 2022, was secured by all of Alvopetro's assets and subject to monthly interest payments at 9.5% per annum. The Company was in compliance with all financial and non-financial covenants during the term of the Facility.

	As at	
	December 31, 2022	December 31, 2021
Balance, beginning of year	**6,545**	15,423
Repayments	**(6,545)**	(9,000)
Accrued interest due upon repayment	**-**	122
Balance, end of year	**-**	6,545

NOTE 11 – SHARE CAPITAL

a) Authorized

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

b) Issued and Outstanding Common Shares

	Year Ended December 31,			
	2022		2021	
	Number of Shares	Amount ($000)	Number of Shares	Amount ($000)
Balance, beginning of year	33,903,629	39,481	33,153,800	156,755
Share buy-back	-	-	(421,699)	(1,119)
Exercise of stock options	326,334	217	1,046,528	861
Exercise of warrants	2,081,616	3,235	125,000	225
Stated capital reduction	-	-	-	(117,180)
Share issue costs and restructuring costs	-	-	-	(61)
Balance, end of year	36,311,579	42,933	33,903,629	39,481

In 2021, Alvopetro completed a share consolidation and split (the "Share Restructuring"). Prior to the Share Restructuring, there were a total of 99,828,295 common shares of Alvopetro outstanding and, as part of the Share Restructuring, 1,265,306 common shares were repurchased at a price of CAD$1.12 per common share, representing 1.3% of the total common shares outstanding prior to the Share Restructuring. The remaining common shares participated in the 2,100 to 1 share consolidation followed immediately by a 1 to 700 share split, for an effective 3:1 share consolidation. For the comparative periods, all common share, stock option, warrant, RSU and DSU quantities, as well as stock option and warrant exercise prices and diluted weighted average shares outstanding have been retrospectively adjusted to reflect the Share Restructuring.

A special resolution was approved by the Company's shareholders during 2021 to reduce the stated capital of the Company's common shares by an aggregate amount of up to CAD$150 million without any payments on the reduction. This stated capital reduction was subsequently approved by the Board of Directors on September 21, 2021. For accounting purposes, the stated capital reduction resulted in a reduction of $117.2 million and $68.6 million to the Company's share capital and deficit, respectively, and an increase of $48.6 million to contributed surplus.

Subsequent to December 31, 2022 the Company announced its share repurchase plans through a normal course issuer bid ("the NCIB") approved by the TSX Venture Exchange. The terms of the NCIB permit Alvopetro to repurchase up to 2,876,414 common shares, representing 7.9% of the common shares outstanding at December 31, 2022. The NCIB expires on the earlier of January 5, 2024, or when the NCIB is completed or terminated by Alvopetro. Any common shares purchased under the NCIB will be cancelled.

c) Warrants to Purchase Common Shares

The Company has previously issued warrants exercisable into an equal number of common shares. In 2022, all outstanding warrants were exercised.

	Number of Options	Weighted Average Exercise Price ($)
Balance as at December 31, 2020	2,810,956	1.80
Exercised	(125,000)	1.80
Balance as at December 31, 2021	2,685,956	1.80
Exercise of warrants for common shares	(2,081,616)	1.80
Adjustment for net settlement of warrants	(604,340)	1.80
Balance as at December 31, 2022	**-**	**-**

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

d) Options to Purchase Common Shares

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

	Number of Options	Weighted Average Exercise Price (CAD$)
Balance as at December 31, 2020	2,250,588	1.41
Granted	338,000	4.73
Exercise of options for common shares	(1,046,528)	0.93
Adjustment for net settlement of options	(94,552)	0.86
Adjustment for cash settlement of options	(2,400)	0.63
Balance as at December 31, 2021	1,445,108	2.58
Granted	**550,000**	**6.94**
Exercise of options for common shares	**(326,334)**	**1.91**
Adjustment for net settlement of options	**(103,778)**	**2.54**
Balance as at December 31, 2022	**1,564,996**	**4.25**
Percentage of common shares outstanding	**4.3%**	

	Options Outstanding at December 31, 2022			Options Exercisable at December 31, 2022		
Exercise Price	Number of Options	Weighted Average Exercise Price (CAD$)	Weighted Average Remaining Contractual Life (Years)	Number of Options	Weighted Average Exercise Price (CAD$)	Weighted Average Remaining Contractual Life (Years)
CAD$0.96	90,000	0.96	0.4	90,000	0.96	0.4
CAD$1.00 - $1.99	132,222	1.29	0.9	132,222	1.29	0.9
CAD$2.00 - $2.99	513,108	2.40	2.9	287,782	2.34	2.3
CAD$4.00 - $4.99	279,666	4.84	3.9	67,668	4.84	3.9
CAD$6.00 - $6.99	550,000	6.94	4.9	-	-	-
CAD$0.96 - $6.99	**1,564,996**	**4.25**	**3.5**	**577,672**	**2.18**	**1.9**

e) Restricted Share Units and Deferred Share Units

Alvopetro has a share-based compensation plan whereby the Company may grant RSUs, DSUs and performance share units ("PSUs") to purchase common shares of the Company.

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

	Number of RSUs & DSUs	Weighted Average Remaining Contractual Life (Years)
Balance as at December 31, 2020	300,000	3.9
Granted	263,165	4.8
Balance as at December 31, 2021	**563,165**	**3.3**
Granted	**166,123**	**4.9**
Balance at December 31, 2022	**729,288**	**3.5**
Percentage of common shares outstanding	**2.0%**	

f) Share-Based Compensation

The fair value of stock options is estimated on the grant date using the Black-Scholes option pricing model. The fair value of DSUs and RSUs is estimated based on the share price on the grant date. Weighted average assumptions and resultant fair values for stock options granted are as follows:

	Year ended December 31,	
	2022	2021
Risk free interest rate (%)	**3.9**	1.3
Expected term (years)	**4.0**	4.0
Expected volatility (%)	**45.0**	45.0
Dividend per share (%)	**9.3**	6.4
Forfeiture rate (%)	**5.0**	5.0
Weighted average fair value (CAD$)	**1.41**	1.08

Share-based compensation that was directly related to exploration and evaluation assets and property, plant and equipment has been capitalized with the remainder recognized as share-based compensation expense on the consolidated statements of operations and comprehensive income.

g) Net Income Per Share

Net income per share is calculated by dividing net income 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,	
	2022	2021
Weighted average basic	**34,642,260**	33,103,161
Dilutive securities		
Stock options	**517,677**	550,689
Warrants(1)	**1,183,195**	877,623
RSUs & DSUs	**575,940**	396,036
Weighted average diluted	**36,919,072**	34,927,509

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

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

h) **Dividends**

Dividends declared and paid were as follows:

		Year Ended December 31, 2022		
Period Declared	**Dividend per share ($)**	**Total Declared**	**Total Paid**	**Date Paid**
Three months ended December 31, 2021	0.06	**-**	**2,034**	January 14, 2022
Three months ended March 31, 2022	0.08	**2,716**	**2,716**	April 14, 2022
Three months ended June 30, 2022	0.08	**2,728**	**2,728**	July 15, 2022
Three months ended September 30, 2022	0.08	**2,896**	**2,896**	October 14, 2022
Three months ended December 31, 2022	0.12	**4,357**	**-**	January 13, 2023
Total		**12,697**	**10,374**	

		Year Ended December 31, 2021		
Period Declared	**Dividend per share ($)**	**Total Declared**	**Total Paid**	**Date Paid**
Three months ended September 30, 2021	0.06	2,023	2,023	October 15, 2021
Three months ended December 31, 2021	0.06	2,034	-	January 14, 2022
Total		4,057	2,023	

The declaration, timing, amount and payment of future dividends remain at the discretion of the Board of Directors and there is no certainty that dividends will be paid at the intended rate or at any rate in the future.

NOTE 12 – REVENUE FROM CONTRACTS WITH CUSTOMERS

	Year ended December 31,	
	2022	2021
Natural gas	**59,165**	32,078
Condensate	**4,167**	2,852
Oil	**176**	50
Total	**63,508**	34,980

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 and payments for condensate are often made in advance of shipment. For the year ended December 31, 2022 the natural gas sales revenue has been collected within the timing expected. There is no indication of potential collection issues with Bahiagás, the local distribution company in the state of Bahia in Brazil and sole customer of the Company's natural gas production. 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,	
	2022	2021
Natural gas	**6,935**	3,883
Condensate	**18**	-
Oil	**-**	-
Total	**6,953**	3,883

NOTE 13– NATURE OF OTHER INCOME AND EXPENSES

a) Other Income

	Year Ended December 31,	
	2022	2021
Tax recoveries from operations	**449**	629
Retroactive tax recoveries	**-**	390
Interest income	**367**	20
Water disposal income & other	**107**	35
Total other income	**923**	1,074

Upon the transition to a natural gas producing company, Alvopetro is entitled to certain tax credits which, starting in 2021, are recorded as other income. In the year ended December 31, 2021 the Company recorded a $0.4 million retroactive tax recovery resulting from a change in Brazilian tax legislation.

b) Production Expenses

	Year Ended December 31,	
	2022	2021
Personnel	**233**	286
Facility and pipeline	**1,719**	1,672
Other fixed	**1,319**	939
Variable	**279**	199
Workover	**-**	38
Total production expenses	**3,550**	3,134

c) General and Administrative ("G&A") Expenses

	Year Ended December 31,	
	2022	2021
Personnel	**3,799**	3,469
Travel	**152**	31
Office and IT costs	**224**	159
Professional fees	**722**	748
General corporate	**1,573**	1,168
Gross G&A expenses	**6,470**	5,575
Capitalized to E&E (Note 5)	**(876)**	(356)
Capitalized to PP&E (Note 6)	**(610)**	(549)
Net G&A expenses	**4,984**	4,670

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

General corporate expenses include public company costs, corporate insurance, directors' fees and other miscellaneous expenses. G&A expenses directly attributable to exploration and development projects, primarily being personnel costs, are capitalized.

d) Finance Expenses

	Year Ended December 31,	
	2022	2021
Lease interest (Note 7)	**1,525**	1,355
Accretion of decommissioning liabilities (Note 9)	**51**	82
Amortization of deferred financing costs (Note 8)	**496**	635
Interest on Credit Facility (Note 10)	**306**	1,079
Total finance expenses	**2,378**	3,151

NOTE 14 – TAXES

Alvopetro computes Brazil corporate income tax under the actual profit regime. Under this regime, the corporate tax rate on taxable income is 34%, comprised of corporate income tax of 15%, surtax of 10%, and a social contribution tax of 9%. 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.

In 2021, the Company received approval from tax authorities in Brazil for Supertintendência de Desenvolvimento do Nordeste ("SUDENE"), a regional tax incentive offered for Bahia State. Pursuant to the incentive, the Company may reduce its corporate tax and surtax liability by 75% for profits arising on qualifying natural gas projects, resulting in an effective tax rate of 15.25% where profits for SUDENE purposes align with taxable income under the actual profit regime. The SUDENE incentive applies to natural gas profits Alvopetro earns for a period of ten taxation years, commencing January 1, 2021 and ending December 31, 2030 (the "SUDENE period").

Deferred tax assets and liabilities are measured using substantively enacted tax rates that are expected to apply when temporary differences are expected to reverse. As the Company expects the majority of temporary differences to reverse in the SUDENE period, the Company has measured its deferred tax assets at the SUDENE tax rate of 15.25%.

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,	
	2022	2021
Income before taxes	**37,445**	12,021
Statutory income tax rate	**34%**	34%
Expected income tax expense	**12,731**	4,087
(Decrease) increase resulting from:		
Effect of tax incentives and lower local tax rates	**(9,039)**	(3,628)
Remeasurement of prior period deferred tax asset at lower future tax rate	**-**	4,095
Non-deductible amounts for tax purposes	**2,297**	1,638
Change in estimated tax pools	**(129)**	18
Share-based compensation	**293**	149
Change in unrecognized deferred tax asset	**(583)**	53
Impact of foreign exchange fluctuations and other	**143**	14
Income tax expense	**5,713**	6,426

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

The components of income tax expense are as follows:

	Year ended December 31,	
	2022	2021
Current tax expense	**1,317**	507
Deferred tax expense	**4,396**	5,919
Total income tax expense	**5,713**	6,426

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

	Year ended December 31,	
	2022	2021
Deferred tax asset, beginning of the year	**5,305**	7,789
Recognized in deferred income tax expense	**(4,396)**	(5,919)
Recognized in other comprehensive income – initial recognition	**2,172**	3,931
Impact of foreign exchange fluctuations and other	**444**	(496)
Deferred tax asset, end of year	**3,525**	5,305

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 tax pools	Unrecognized deferred tax asset	Total
As at December 31, 2020	(1,344)	389	8,954	1,560	(1,770)	7,789
Deferred tax recovery (expense)	625	(241)	(3,960)	(2,290)	(53)	(5,919)
Recognition in OCI	-	-	-	3,931	-	3,931
Foreign currency translation	46	(21)	(390)	(131)	-	(496)
As at December 31, 2021	(673)	127	4,604	3,070	(1,823)	5,305
Deferred tax (expense) recovery	(699)	(37)	(1,107)	(3,136)	583	(4,396)
Recognition in OCI	(57)	-	-	2,229	-	2,172
Foreign currency translation	12	8	203	221	-	444
As at December 31, 2022	**(1,417)**	**98**	**3,700**	**2,384**	**(1,240)**	**3,525**

A deferred tax asset of $1.2 million exists at December 31, 2022 (December 31, 2021 - $1.8 million) that has not been recognized, all of which relates to Canada. Total tax loss carry-forwards include $15.6 million attributable to Brazil, which carryforward indefinitely but are limited to annual utilization of up to 30% of taxable income in subsequent periods, and $8.1 million attributable to Canada which expire between 2032 and 2042.

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

NOTE 15 – CAPITAL MANAGEMENT

The Company's capital consists of the following:

	As at December 31,	
	2022	2021
Cash and cash equivalents	**19,784**	11,469
Working capital deficit, excluding cash and cash equivalents	**(5,086)**	(2,372)
Credit Facility	**-**	(6,545)
Working capital net of debt	**14,698**	2,552
Lease liabilities – non-current	**(8,573)**	(7,463)
Shareholders' equity	**76,408**	51,024

Alvopetro has the ability to adjust its capital structure by issuing new equity or debt and making adjustments to its capital and dividend programs to the extent the capital expenditures are not committed. There are no external restrictions on how the Company manages its capital.

NOTE 16 – 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, dividends payable, 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 are 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, comprehensive income, liquidity or the value of financial instruments. Market uncertainly associated with financial institution instability, international conflicts, geopolitical factors and pandemics is incorporated into management's risk assessments but given the lack of precedence, is difficult to accurately predict with confidence.

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 gas price, although benchmarked to USD, is set semi-annually in BRL (based on historical foreign exchange rates) and billed monthly in the set BRL price until the next price redetermination. The following table denotes the overall impact on natural gas revenues of a 5% and 10% appreciation and depreciation of the BRL relative to the USD:

	Year Ended December 31,	
	2022	2021
Increase (decrease) to natural gas revenues from:		
5% Appreciation of BRL to USD	**3,114**	1,688
10% Appreciation of BRL to USD	**6,574**	3,564
5% Depreciation of BRL to USD	**(2,817)**	(1,528)
10% Depreciation of BRL to USD	**(5,378)**	(2,916)

To reduce exposure to foreign exchange volatility with respect to the BRL, the Company entered into BRL/USD forward exchange rate contracts during 2022, all of which were settled, prior to December 31, 2022. The Company recognizes the fair value of these contracts in the statement of financial position, included with trade and other receivables or other liabilities, with changes in fair value recognized as an unrealized gain or loss included in earnings. Realized gains or losses are recognized in the period the contracts are settled. In the year ended December 31, 2022, the Company recognized risk management losses of $0.1 million (2021 – gain of $0.03 million)

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, 2022		December 31, 2021	
	CAD$ (000's)	**BRL (000's)**	CAD$ (000's)	BRL (000's)
Cash and cash equivalents	**386**	**27,582**	514	20,093
Restricted cash – current	**-**	**1,546**	-	977
Trade and other receivables	**45**	**36,921**	68	22,948
Accounts payable and accrued liabilities	**(1,695)**	**(31,333)**	(1,744)	(22,170)
Net exposure in foreign currency	**(1,264)**	**34,716**	(1,162)	21,848
Net exposure in USD ($000s)	**(933)**	**6,654**	(917)	3,915

Based on financial instruments held at December 31, 2022 and 2021, sensitivity to fluctuations in the exchange rates as indicated below would have the following estimated effect on net income and other comprehensive income:

	Year Ended December 31,	
	2022	2021
Effect of 5% appreciation in CAD and BRL to USD		
Decrease to net income	**(47)**	(42)
Increase to other comprehensive income	**350**	206
Effect of 5% depreciation in CAD and BRL to USD		
Increase to net income	**47**	42
Decrease to other comprehensive income	**(317)**	(186)

Commodity Price Risk

For the year ended December 31, 2022 approximately 93% (December 31, 2021 – 92%) of natural gas, oil and condensate sales was related to natural gas sales, mainly 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 and meet ongoing obligations. 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 12), 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, 2022 and 2021 but may consider such in the future to protect cash flows and manage this risk.

Interest Rate Risk

The Company is exposed to interest rate cash flow risk on cash and cash equivalents and restricted cash due to fluctuations in market interest rates applied to cash balances.

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 and trade and other receivables.

The Company is subject to credit risk as the Company has one customer for its natural gas production creating economic dependence on this one counterparty. At December 31, 2022, $6.9 million of accounts receivable (December 31, 2021 - $3.9 million) or 97% (2021 - 92%) is related to natural gas production sold to this counterparty (see Note 12), the full balance of which was received subsequent to December 31, 2022. 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 material expected credit losses recognized in 2022 or 2021. 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. All obligations in 2022 were satisfied with the Company's cash balances and cash flows from operating activities, including repaying the Credit Facility in full, thus reducing future financial obligations. The Company's current cash flow levels are anticipated to fund planned capital programs and ongoing operational requirements as well as dividends which are at the discretion of the Board of Directors.

Fair Value of Financial Instruments

Financial assets and liabilities measured at fair value are classified into levels reflecting the measurement method used. There were no transfers of any financial instruments between levels within the fair value hierarchy during the year ended December 31, 2022 or 2021.

The carrying values of the Company's financial assets and liabilities approximate their fair values.

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

NOTE 17 – CHANGES IN NON-CASH WORKING CAPITAL

	Year ended December 31,	
	2022	2021
Change in:		
Trade and other receivables	**(2,720)**	(1,269)
Prepaid expenditures	**1,025**	(1,131)
Accounts payable and accrued liabilities	**1,654**	2,870
	(41)	470
Changes relating to:		
Operating activities	**(2,345)**	(346)
Financing activities	**175**	494
Investing activities	**2,129**	322
	(41)	470

NOTE 18 – 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,	
	2022	2021
Short-term benefits	**1,862**	1,943
Share-based compensation	**590**	394
Total	**2,452**	2,337

The following table lists the Company's subsidiaries and their respective places of incorporation, each owned 100% directly and indirectly at December 31, 2022:

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

NOTE 19 – COMMITMENTS AND CONTINGENCIES

The following is a summary of contractual commitments as at December 31, 2022:

Commitments	**< 1 Year**	**1-3 Years**	**Thereafter**	**Total**
Minimum work commitments(1)				
Bom Lugar	67	-	-	67
Mãe-da-lua	-	-	67	67
Minimum work commitments	67	-	67	134
Gas Treatment Agreement	1,361	2,721	6,123	10,205
Total commitments	**1,428**	**2,721**	**6,190**	**10,339**

(1) Under the terms of the 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 National Agency of Petroleum, Natural Gas and Biofuels of Brazil (the "ANP") for all minimum work commitments in the table above. Alvopetro previously reported a minimum work commitment for Block 183. This commitment was satisfied with the completion of drilling of the 183-B1 well in July 2022, subject to the approval of the ANP.

Amounts presented above for the Gas Treatment Agreement represent the monthly service fees for operation and maintenance of the Facility and Alvopetro's 11-kilometre transfer pipeline. All costs associated with equipment rental, including equipment rental costs for the expansion completed in 2022, are treated as a capital lease obligation and reflected on the consolidated statements of financial position.

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

The Company currently has no contingent liabilities recorded; however, in the normal course of operations, 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.