

Case Study: Alvopetro Energy

Long-Distance Gas Development Prepared For A Crisis

One of CGEF's Directors recently sat down (virtually) with Corey Ruttan, CEO of CGEF Member Company Alvopetro Energy Ltd. The company's vision is to become a leading independent upstream and midstream operator in Brazil. Its strategy is to unlock the onshore natural gas potential in the state of Bahia in Brazil, building off the development of the Caburé and Gomo natural gas projects and the construction of strategic infrastructure assets.

CGEF: Hi Corey. Thanks for taking the time. We hope you and your teams are safe and healthy. How is Alvopetro adjusting to the COVID-19 pandemic that is impacting all of us? How were you prepared for it, and what adjustments have you had to make as a result? As a company with international operations, are you impacted by travel bans and movement restrictions that have been put in place, or the health risks that COVID-19 poses?

Corey Ruttan: Well I don't think anyone was fully prepared for exactly what is happening right now, and nor do we know exactly how the situation will evolve. But the nature of our business forced us to be relatively prepared for things like remote working. From our headquarters in Calgary, it takes a full day to travel to our offices and operations in Brazil, so when our Canadian staff does fly to Brazil it is typically for longer durations but we have always been setup to work remotely from anywhere. We have built teams that can do most of their jobs from anywhere with an internet connection, and systems that allow us to be very cost-effective doing so. We were early adopters of video conferencing with our prior company more than a decade ago. We have built strong local relationships and have an exceptional local operating team that allows us to be highly effective even in circumstances that dictate no physical in-person contact.

Operating anywhere in South America requires additional health, safety, and environmental considerations. Although the gas projects we're currently developing are in a developed industrial area of northern Brazil, which is great for gas demand, our team has experience operating in some of the remotest areas of Latin America. Operating with a lot of thought dedicated to health and safety is not new to us, and so our staff was ready when we needed to put additional precautions in place to address COVID-19 risks.

I think we're seeing across the international oil and gas industry, the companies that have operated in more challenging environments have a lot of very stringent health, safety and environmental protocols and cultures that are helping them adapt to the additional COVID-19 related requirements.

CGEF: Thank you. What about the collapse in energy demand and oil prices that we've seen? How does that impact Alvopetro?



**Corey Ruttan,
CEO of Alvopetro
Energy Ltd.**

Corey Ruttan: That is impacting us to an extent. We are certainly looking at deferring oil focused development projects. Again, the nature of our business and our long experience working in Latin America allowed us to be relatively well prepared. We've had to persist and survive through some long regulatory timelines and business negotiations as we've developed our business in Brazil, during what we thought was a relatively capital constrained low oil price environment since 2014. So we're used to being thrifty in order to survive on very limited cash flows. We've always understood we need emergency funds in case of delays and other unexpected events.

And going forward, we're lucky that despite large offshore oil discoveries in Brazil, the country is still reliant on gas imports and has seen growing gas demand. This has allowed us to secure favorable terms in our gas sales agreement, including pricing terms. The agreement we negotiated has take-or-pay provisions and ties the pricing we will receive to a cocktail of global benchmark oil and natural gas prices. But it also has both a floor and a ceiling price to provide our customer and us with greater cost certainty. The floor price is over US\$5/mmbtu and escalates with inflation, so even though we were hoping to get a dollar or two more than that, and we still hope to achieve higher prices in the long run, we're happy to be expecting more than twice what gas producers are able to typically achieve in Canada or the U.S. And our costs are low enough that we'll be able to achieve good netbacks when we start selling gas in the very near future, regardless of any demand destruction that may occur. We're adjusting to reduced commodity prices by implementing cost saving measures including staff reductions and discretionary spending reductions. However, we're relatively fortunate with our gas sales agreement and that our cornerstone project, Caburé, is already developed and we expect to be able to maintain a very stable base of natural gas production with very little maintenance capital. This positions us very well relative to most of our competition.

CGEF: Great. Your company is about to start up production from what you refer to as a precedent setting new gas development at your Caburé field in the state of Bahia. Why do you call it precedent setting? And can you share some of your company's history and lessons learned from operating in Brazil and the region?

Corey Ruttan: Sure. There aren't a lot of companies that have developed gas onshore Brazil in recent years, despite the country's long history of developing oil and gas. That's because historically most of the upstream industry has been managed by the state oil company Petrobras.

The state monopoly on oil and gas exploration and production ended in the late 1990s, but Petrobras retained all the major producing fields at that time and has never divested any significant producing onshore fields, until recently.

We actually discovered our Caburé field back in 2014, so it will be roughly six years from discovery when we bring on our share of production over coming weeks. The discovery extended onto neighboring blocks, and so we had to negotiate a unitization (pooling) agreement, as a result of which we are now partnered with a Brazilian company that led the initial development of the field and started production of its share of reserves in 2018. We chose to sell our gas by different means and were able to negotiate a gas sales agreement with Bahiagas, the gas distribution company in the State of Bahia. To our knowledge that was a first for any independent company. To meet the conditions of our sales agreement, we had to commit to building what is the only non-Petrobras gas plant in the state of Bahia capable of delivering gas to Brazilian sales specifications, so we're building both upstream and midstream operations.

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We have been assisted in that process by Canadian company Enerflex Ltd., which we awarded a 10-year contract to build, own, operate and maintain a Natural Gas Treatment Facility. This facility gives us control of our own sales and enables us to test gas production from another gas discovery that we own 100%.

So there are a number of firsts that we have achieved in Brazil, and we're hopeful we will be able to build on that success and strategic investment for years to come.

Exhibit 1: The Caburé Gas Treatment Facility during construction.



Photo: Alvopetro

CGEF: It doesn't sound like building your business was easy or straightforward. Can you provide some more background on your company to explain how you got to where you are now, and maybe highlight some of the lessons you've learned in the process? CGEF's GO Program is in part designed to encourage those Canadian oil and gas companies without international operations to consider investing internationally, not because Canadian companies don't have attractive resource development opportunities at home, but because international developments could help to diversify our economy, and could export some of our human resources, expertise, and technologies. What advice do you have for any oil and gas executives with international aspirations?

Corey: Definitely, and thanks for the opportunity to tell a little of our story.

We weren't new to operating in Latin America when we started Alvopetro. I was previously the CFO and then CEO of a company called Petrominerales. We were one of the first Canadian companies to acquire lands in Colombia when that country opened up in the early 2000s, and we were able to grow production there to over 40,000 BOE/d. We were starting to expand into Peru and Brazil when the company was acquired for about C\$1.8 billion in 2013, and Alvopetro was spun out of that acquisition to continue operating the Brazilian assets, which were really just exploration blocks without meaningful reserves at the time. Prior to that experience with Petrominerales, numerous members of our team had worked with previous companies that had started and grown businesses in Latin America, and I think it was that experience that helped us do a few things right along the way.

Fortunately, we've always looked after our balance sheet. We started with just over \$100 million in cash and no debt, and because we had virtually no production and cash flow to start with, we set ourselves up to be very lean, and really kept G&A to a minimum. That was particularly fortunate because it has taken us longer to build our business in Brazil than we might have hoped. But based on our experience in other Latin American countries, we were prepared for that eventuality, and I think we have shown a lot more persistence than most would be willing to endure. And it is only thanks to that persistence that we are now about to achieve a precedent-setting development of gas sales in Brazil. I hope that once our project comes onstream this quarter that our shareholders will agree that the patience and persistence were all worth-while as we have a really exciting project that I think can be a shining light at a difficult time in the broader energy market.

I think even that brief story I gave of our company's history tells you that we needed a lot of experienced people and perseverance to get to where we are now. And the companies we were successful with in the past needed the same ingredients. From also having followed a number of our competitors over the years I think it's clear that the team really has to be the foundation. I haven't seen any of our peers and competitors build successful international companies without a management team that already had significant international experience. So companies without that experience should hire it, acquire it, or partner with the right people.

Recognize there is no such thing as an overnight success in international oil and gas. Occasionally you see companies build and sell businesses within a year or two, but in most cases when that happens there's a much longer back-story. We're in a relatively good position now because we've been building our business for almost a decade, and it was built with a team with a lot more than a decade of experience in the region.

In Brazil, we have persisted where others might not have, and we have adjusted our strategy when necessary. For the first couple of years of our operations in Brazil, our initial oil-focused exploration and development programs weren't as successful as we had hoped. But having invested to build a business in Brazil, we didn't just give up. When we made our natural gas discoveries we recognized that it was going to be a longer process to reach commerciality but also saw it as a huge opportunity. Certainly having Western Canadian roots was a benefit when pioneering a natural gas business on-shore Brazil. Now because we made that investment when no-one else did, we feel we have a huge head start on anyone else that might want to emulate what we're doing. So don't expect it to be easy, but we've done this multiple times now, and we've generally found it rewarding in the long run to go further afield than most would dare.

CGEF: You mentioned the long distance from your headquarters in Canada to your main operations in Brazil, which maybe isn't ideal. But are there advantages to being in Canada or Calgary specifically?

Corey Ruttan: Definitely. With regards to Canada, we have to build our own reputation and relationships wherever we go, but I have also always felt that it doesn't hurt to introduce yourself as a Canadian person or company when you're traveling and working internationally. And we've always appreciated the unquestionable professionalism of the embassy and trade commission staff that are tasked with helping Canadian companies work internationally. Given our years of working in Brazil they're less relevant to us now, but for anyone that is new to working in a region, I would suggest connecting with those people before investing is a very good idea. During our early years at AlvoPetro and in all our predecessor companies we have obtained great support from Export Development Canada (EDC). At AlvoPetro, EDC provided us with a Performance Security Guarantee (PSG) account, which is

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helpful for smaller companies that need to qualify or put up financial guarantees in order to be able to acquire blocks with work commitments and operate internationally.

With regards to Alberta and Calgary, I've always thought Calgary has possibly the most concentrated pool of highly qualified oil and gas professionals anywhere in the world. A lot of them have a lot of international experience, whether just studying and working on projects in far flung places while sitting at a desk in Calgary, having moved to Calgary as an immigrant, or being a Canadian that has lived and worked abroad. Consider that the Western Canadian Sedimentary Basin typically sees thousands of wells drilled each year so this is a highly competitive landscape. Canada is the fourth largest oil producer in the World and the fifth largest natural gas producer. Canada has always been a leader with best in class operating and environmental practices and is a breeding ground for the development and application of new leading-edge technologies. This experience exports to international operations extremely well. Because of what has happened in Alberta and the Canadian exchange rate, hiring and housing human expertise here in Calgary is now extremely cost-competitive. I have concerns that our standard of living in Canada in general and Calgary in particular might suffer as a result of both COVID-19 and an unprecedented reduction in oil prices, but I can definitely still recommend Calgary as a great place for individuals and families to choose to live, and I expect our country and city will continue to be a fairly easy sell in attracting top talent. That means it's a great place to employ people with the appropriate business and technical expertise to manage our business.

We try to hire local contractors as much as possible when operating in Brazil, but Calgary is also a good place to find well qualified contractors and suppliers. For example, while most of the interactions we had with Enerflex were with people based outside Calgary, it certainly didn't hurt in the process of building our relationship with a key supplier and partner that their head office is also in Calgary. Nor does it hurt that we have a range of law firms and investment banks with decades of experience working in international oil and gas. Some of those firms are struggling to maintain all the service levels we were able to expect when oil prices were much higher, but we're also seeing new service models pop up globally and in Canada. Cito Energy Law introduced a low overhead/cost model and we were able to draw on their experience when we were working to complete the Unitization of our Caburé field. We have also raised capital both inside and outside of Canada in recent years supported by the team at Tory's LLP. I wouldn't recommend any management team invest internationally if they have zero international experience, but with some of the advisors and consultants that are available, I don't think you need to have a full team where everyone has international experience. During this pandemic, more than ever, you realize the benefits of all the technology that has been developed to help improve multi-location collaboration and communication. I encourage anyone looking to operate internationally to really leverage these tools.

CGEF: Thanks Corey. It's a difficult time in general, but also an exciting time with your gas project currently in the commissioning phase. Best of luck with that and continuing to build your business.

