

August 5, 2021

HEADWATER EXPLORATION INC. ANNOUNCES SECOND QUARTER OPERATING AND FINANCIAL RESULTS, OPERATIONS UPDATE AND INCREASED 2021 GUIDANCE

CALGARY, ALBERTA – Headwater Exploration Inc. (the "**Company**" or "**Headwater**") (**TSX:HWX**) is pleased to announce its operating and financial results for the three and six months ended June 30, 2021. Selected financial and operational information is outlined below and should be read in conjunction with the unaudited condensed interim financial statements and the related management's discussion and analysis ("MD&A"). These filings will be available at www.sedar.com and the Company's website at www.headwaterexp.com.

Financial and Operating Highlights

	Three months ended June 30,		Six months ended June 30,	
	2021	2020	2021	2020
Financial (thousands of dollars except share data)				
Sales, net of blending ⁽¹⁾	37,429	565	60,552	2,873
Cash flow provided by operating activities	23,232	863	36,015	2,045
Per share - basic	0.12	0.01	0.18	0.02
- diluted ⁽³⁾	0.10	0.01	0.16	0.02
Adjusted funds flow (used in) from operations ⁽²⁾	23,182	(610)	37,661	4,803
Per share - basic	0.12	-	0.19	0.04
- diluted ⁽³⁾	0.10	-	0.17	0.04
Net income (loss)	4,588	(1,679)	(8,205)	(8,489)
Per share - basic	0.02	(0.01)	(0.04)	(0.07)
- diluted	0.02	(0.01)	(0.04)	(0.07)
Adjusted net income (loss) ⁽²⁾	10,561	(1,679)	16,963	(8,489)
Per share - basic	0.05	(0.01)	0.09	(0.07)
- diluted ⁽³⁾	0.05	(0.01)	0.08	(0.07)
Development capital expenditures	16,781	398	54,053	468
Adjusted working capital ⁽²⁾			69,697	113,569
Shareholders' equity			268,191	156,386
Weighted average shares (thousands)				
Basic	197,445	144,749	196,389	125,401
Diluted	213,905	144,749	196,389	125,401
Shares outstanding, end of period (thousands)				
Basic			202,286	145,044
Diluted ⁽⁴⁾			240,257	151,381
Operating (6:1 boe conversion)				
Average daily production				
Heavy crude oil (bbls/d)	6,185	-	4,793	-
Natural gas (mmcf/d)	2.3	2.4	5.4	5.6
Natural gas liquids (bbl/d)	5	-	5	3
Barrels of oil equivalent ⁽⁵⁾ (boe/d)	6,565	396	5,690	942
Average daily sales ⁽⁶⁾ (boe/d)	6,653	396	5,715	942
Netbacks (\$/boe) ⁽⁷⁾				
Operating				
Sales, net of blending ⁽¹⁾	61.83	15.67	58.53	16.76
Royalties	(8.84)	(0.39)	(7.45)	(0.42)
Transportation ⁽¹⁾	(8.21)	-	(7.31)	-
Production expenses	(4.89)	(14.79)	(5.19)	(6.89)
Field netback ⁽²⁾	39.89	0.49	38.58	9.45
Realized gains on financial derivatives	0.24	-	(0.39)	22.97
Operating netback ⁽²⁾	40.13	0.49	38.19	32.42
General and administrative expense	(1.60)	(23.33)	(1.76)	(8.90)
Interest income and other ⁽⁸⁾	(0.23)	6.00	(0.03)	4.50
Adjusted funds flow netback ⁽²⁾	38.30	(16.84)	36.40	28.02

(1) Heavy oil sales are netted with blending expense to compare the realized price to benchmark pricing while transportation expense is shown separately. In the interim condensed financial statements blending is recorded within blending and transportation expense.

(2) See "Non-IFRS" measures.

(3) Total weighted average shares, calculated using the treasury stock method, for the diluted per share number for cash flow provided by operating activities, adjusted funds flow (used in) from operations and adjusted net income (loss) is 221,966,942 and 219,449,573, respectively, for the three and six months ended June 30, 2021.

(4) Includes in-the-money dilutive instruments as at June 30, 2021 which include 7.4 million stock options with a weighted average exercise price of \$1.57, 15.6 million warrants issued pursuant to the recapitalization transaction with an exercise price of \$0.92 and 15 million warrants with an exercise price of \$2.00.
(5) See "Barrels of Oil Equivalent."
(6) Includes sales of unblended heavy crude oil, natural gas and natural gas liquids. The Company's heavy crude oil sales and production volumes differ due to changes in inventory.
(7) Netbacks are calculated using average sales volumes.
(8) Excludes accretion on decommissioning liabilities and interest on lease liability.

SECOND QUARTER 2021 HIGHLIGHTS

- Generated average production of 6,565 boe/d representing an increase of 37% over the first quarter of 2021.
- Achieved adjusted funds flow from operations of \$23.2 million (\$0.12 per share basic), representing an increase of 60% over the first quarter of 2021.
- Achieved an operating netback of \$40.13/boe and an adjusted funds flow netback of \$38.30/boe.
- Achieved adjusted net income of \$10.6 million (\$0.05 per share basic).
- As at June 30, 2021, Headwater had adjusted working capital of \$69.7 million and no outstanding debt.

OPERATIONS UPDATE

Marten Hills Core Area Development

The 12 producing 8-leg horizontal wells drilled in the first quarter have achieved:

- 30-day average rates of 38 bbls/d per lateral (304 bbls/d per well)
- 60-day average rates of 36 bbls/d per lateral (288 bbls/d per well)
- 90-day average rates of 35 bbls/d per lateral (280 bbls/d per well)

In early June, Headwater commenced the remainder of its 2021 drilling program. The learnings from the Company's inaugural program in the first quarter have been applied to this ongoing drilling program with encouraging incremental results to date.

Since spring break-up, the Company has successfully rig released 13, 6-leg producing wells of which 7 of these wells have been placed on production and have recovered 100% of load fluid.

The first 2 wells drilled in this program achieved load recovery in early July with extremely positive initial results. The first well achieved a 30-day average rate post load recovery of 390 bbls/d (65 bbls/d per lateral) and the second well achieved a 20-day average rate post load recovery of 426 bbls/d (71 bbls/d per lateral). These wells are performing approximately 36% ahead of management's expectations and are in the top decile of all wells drilled in Marten Hills to date.

In addition to the first 2 wells drilled in this program, 5 wells achieved first production, beyond load recovery, in late July or early August. The producing performance of these wells during the load recovery process is comparable to the first 2 wells drilled, confirming the improvements in capital efficiency that were expected during the Company's second half program have occurred.

For the first 13 wells drilled with Headwater's optimized drilling strategy, the Company is pleased to report that current drilling costs with oil-based muds are tracking 10% lower than the average water-based mud drilling costs from the first quarter of 2021. The optimized strategy allows superior oil-based mud systems to be cost competitive with water-based mud systems, delivering repeatable top decile production results and stronger capital efficiencies.

Enhanced Oil Recovery

Headwater commenced water injection into the 4-leg horizontal injector, 02/16-35-74-25W4, on April 15, 2021, and has injected approximately 56,000 bbls of water to date. The pilot waterflood results are extremely encouraging with the gas oil ratio in the supported producer having dropped from 875 scf/bbl that was seen prior to injection to a current gas oil ratio of 400 scf/bbl. The oil rate during this time has continued to climb with the rate increasing from 240 bbls/d prior to injection to its current rate of 275 bbls/d. The combined positive results validate Headwater's plan to implement a full scale waterflood program over the next 18 months.

The 4 injection wells drilled in the first quarter of 2021 will be converted to injection in late August providing further validation of the merits and value of enhanced oil recovery.

Exploration Update

Headwater has licensed 7 exploration wells covering three distinct Clearwater prospects in the greater Marten Hills area. The current budget contemplates drilling 2 of these tests in the third quarter of 2021, with an additional 2 to 4 wells drilled in the fourth quarter of 2021.

Multiple additional exploration prospects in the Clearwater and other formations have been identified throughout the Company's land base. The current plan contemplates drilling 3 to 5 additional exploration prospects by the end of the first quarter of 2022.

Oil Processing Facility Construction

Civil work on the 100% owned Headwater oil processing facility is currently in progress with mechanical construction expected to start by early September. The team has been successful in procuring all long lead items for construction and now expects to complete and commission the facility in late December 2021 which is approximately 3 months ahead of schedule.

ESG Update

The Company's joint gas processing facility is expected to be commissioned in late August 2021, resulting in first sales gas and an approximate 50% reduction in Headwater's CO₂e emissions intensity.

Fresh water usage intensity has decreased by greater than 50% and placed the Company in the top decile of its peer group, due to changes in drilling strategy using primarily oil-based mud systems.

Guidance Increase

Headwater's Board of Directors has approved an increase to Headwater's capital budget from \$110 million to \$130 million, allowing for the acceleration of the oil processing facility. Accelerating \$20 million from the first quarter of 2022 to the fourth quarter of 2021 is expected to result in operating and transportation costs savings of approximately \$4 million in the first quarter of 2022.

With the oil processing facility commissioned, operating and transportation costs are expected to be reduced from \$13.25 per boe in 2021 to \$9.00 per boe in 2022.

The performance of the Company's second half drilling program to date has provided the confidence to increase Headwater's production and capital outlook as follows:

	Previous	Revised
Annual average daily production (boe/d)	7,000 - 7,250	7,250
Fourth quarter 2021 daily production (boe/d)	9,000 - 9,500	10,250
Capital expenditures (\$millions)	105 - 110	130
Exit adjusted working capital (\$millions)	60	65

Outlook

Headwater continues to build momentum in the development of its marquee Clearwater assets. Based on Headwater's increased guidance, production per share growth of greater than 200% is expected to be achieved in 2021 while having reduced the Company's CO2e emissions intensity by approximately 50%. This is all expected to be completed while maintaining an estimated positive working capital position of \$65 million, allowing for future capital acceleration and or acquisition opportunities.

Headwater's guiding principles of shareholder value creation, sustainability, asset development with an emphasis on environmental, social, and governance goals, and maintaining a pristine balance sheet continue to be unwavering.

Additional corporate information can be found in the Company's corporate presentation and on Headwater's website at www.headwaterexp.com

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FORWARD LOOKING STATEMENTS: This press release contains forward-looking statements. The use of any of the words "guidance", "initial", "anticipate", "scheduled", "can", "will", "prior to", "estimate", "believe", "potential", "should", "unaudited", "forecast", "future", "continue", "may", "expect", "project", and similar expressions are intended to identify forward-looking statements. The forward-looking statements contained herein, include, without limitation, the revised 2021 guidance including expected 2021 annual average daily production, fourth quarter 2021 daily production, expected 2021 capital expenditures and estimated exit adjusted working capital; the expectation that the producing performance of the wells drilled post spring break-up indicate improvements in capital efficiency have occurred; the expectation that current waterflood results including gas oil ratios and oil rates are indicative of future results; the expectation to implement a full scale waterflood program over the next 18 months; the expectation that the gas processing facility will be commissioned in late August 2021 and result in an approximate 50% reduction in Headwater's CO2e emissions intensity; the expectation that the remaining 4 injection wells drilled in the first quarter of 2021 will be placed on injection in late August providing further validation for the merits and value of enhanced oil recovery; the expectation to drill 2 exploration tests in the third quarter of 2021 with an additional 2 to 4 tests in the fourth quarter of 2021 and to complete an additional 3 to 5 tests by the end of the first quarter of 2022; the expectation to complete and commission the oil processing facility in December 2021; the expectation that shifting \$20 million of capital, for Headwater's oil processing facility, to the fourth quarter of 2021 will result in operating and transportation costs savings of \$4 million in the first quarter of 2022; the expectation that with the oil processing facility commissioned, operating and transportation costs are expected to be reduced from \$13.25 per boe in 2021 to \$9.00 per boe in 2022; and the expectation to achieve production per share growth of greater than 200% while reducing CO2e emissions intensity by approximately 50% in 2021 and maintaining an estimated positive working capital position of \$65 million with Headwater's increased guidance. The forward-looking statements contained herein are based on certain key expectations and assumptions made by the Company, including but not limited to expectations and assumptions concerning the success of optimization and efficiency improvement projects, the availability of capital, current legislation, receipt of required regulatory approval, the success of future drilling, development and waterflooding activities, the

performance of existing wells, the performance of new wells, Headwater's growth strategy, general economic conditions, availability of required equipment and services, prevailing equipment and services costs and prevailing commodity prices. Although the Company believes that the expectations and assumptions on which the forward-looking statements are based are reasonable, undue reliance should not be placed on the forward-looking statements because the Company can give no assurance that they will prove to be correct. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to a number of factors and risks. These include, but are not limited to, risks associated with the oil and gas industry in general (e.g., operational risks in development, exploration and production; disruptions to the Canadian and global economy resulting from major public health events, including the COVID-19 pandemic, war, terrorist events, political upheavals and other similar events; events impacting the supply and demand for oil and gas including the COVID-19 pandemic and actions taken by the OPEC + group; delays or changes in plans with respect to exploration or development projects or capital expenditures; the uncertainty of reserve estimates; the uncertainty of estimates and projections relating to production, costs and expenses, and health, safety and environmental risks), commodity price and exchange rate fluctuations, changes in legislation affecting the oil and gas industry and uncertainties resulting from potential delays or changes in plans with respect to exploration or development projects or capital expenditures. Refer to Headwater's most recent Annual Information Form dated March 10, 2021, on SEDAR at www.sedar.com, and the risk factors contained therein.

The forward-looking statements contained in this press release are made as of the date hereof and the Company undertakes no obligation to update publicly or revise any forward-looking statements or information, whether as a result of new information, future events or otherwise, unless so required by applicable securities laws.

FUTURE ORIENTED FINANCIAL INFORMATION: Any financial outlook or future oriented financial information in this press release, as defined by applicable securities legislation, has been approved by management of the Company as of the date hereof. Readers are cautioned that any such future-oriented financial information contained herein should not be used for purposes other than those for which it is disclosed herein. The Company and its management believe that the prospective financial information as to the anticipated results of its proposed business activities for 2021 has been prepared on a reasonable basis, reflecting management's best estimates and judgments, and represent, to the best of management's knowledge and opinion, the Company's expected course of action. However, because this information is highly subjective, it should not be relied on as necessarily indicative of future results. The assumptions used in the revised 2021 guidance include: WTI US\$66.00/bbl, WCS Cdn\$67.00/bbl, AGT US\$5.00/mmbtu and a foreign exchange rate of US\$/Cdn\$ of 0.80.

NON-IFRS MEASURES: This document contains the terms "adjusted funds flow from operations", "adjusted net income", "adjusted working capital", "operating cash flow", "field netback", "operating netback", and "adjusted funds flow netback", which do not have standardized meanings prescribed by International Financial Reporting Standards ("IFRS") and therefore may not be comparable with the calculation of similar measures by other companies. Management uses adjusted funds flow from operations to analyze operating performance and leverage. Adjusted funds flow from operations is calculated as cash flow provided by (used in) operating activities before changes in non-cash working capital and adding back transaction costs. Management uses adjusted net income to assess financial performance that is more comparable between periods and is calculated as net income or loss before the remeasurement loss of the warrant liability. Adjusted working capital is used by the Company to measure liquidity. Adjusted working capital is defined as working capital excluding the effects of the Company's financial derivatives and warrant liability. Management uses operating cash flow as a measure of the company's efficiency and its ability to fund future capital expenditures and is calculated as sales received after royalties, production, blending and transportation costs and realized gains (losses) on financial derivatives. Management believes "field netback", "operating netback" and "adjusted funds flow netback" are useful supplemental measures to consider the profitability of the Company's operations on a per unit basis using unblended sales volumes and have been calculated in respect of field netback by taking the amount of sales received after royalties and production and blending and transportation costs, in respect of operating netback by taking the amount of sales received after royalties, production, blending and transportation costs and realized gains (losses) on financial derivatives, and in respect of adjusted funds flow netback by taking the amount of sales received after royalties, production, blending and transportation costs, realized gains (losses) on financial derivatives, general and administrative costs, interest income and other (excluding accretion on decommissioning liabilities) and decommissioning liabilities settled. Additional information relating to certain of these non-IFRS measures, including the reconciliation of cash flow from operating activities to adjusted funds from operations, net income or loss to adjusted net income or loss, working capital to adjusted working capital, and sales to operating cash flow can be found in the MD&A.

BARRELS OF OIL AND CUBIC FEET OF NATURAL GAS EQUIVALENT: The term "boe" (or barrels of oil equivalent) and "Mcf" (or thousand cubic feet of natural gas equivalent) may be misleading, particularly if used in isolation. A boe and Mcf conversion ratio of six thousand cubic feet of natural gas to one barrel of oil equivalent (6 Mcf: 1 bbl) is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Additionally, given that the value ratio based on the current price of crude oil, as compared to natural gas, is significantly different from the energy equivalency of 6:1; utilizing a conversion ratio of 6:1 may be misleading as an indication of value.

INITIAL PRODUCTION RATES: References in this press release to initial production rates, other short-term production rates or initial performance measures relating to new wells are useful in confirming the presence of hydrocarbons; however, such rates are not determinative of the rates at which such wells will commence production and decline thereafter and are not indicative of long-term performance or of ultimate recovery. Additionally, such rates may also include recovered "load oil" fluids used in well completion stimulation. While encouraging, readers are cautioned not to place reliance on such rates in calculating the aggregate

production for the Company. A pressure transient analysis or well-test interpretation has not been carried out in respect of all wells. Accordingly, the Company cautions that the test results should be considered to be preliminary.