



May 12, 2022

## HEADWATER EXPLORATION INC. ANNOUNCES FIRST QUARTER FINANCIAL RESULTS, OPERATIONS UPDATE AND INCREASED 2022 GUIDANCE

CALGARY, ALBERTA – Headwater Exploration Inc. (the "**Company**" or "**Headwater**") (**TSX:HWX**) is pleased to announce increased guidance and its operating and financial results for the three months ended March 31, 2022. Selected financial and operational information is outlined below and should be read in conjunction with the unaudited interim condensed financial statements and the related management's discussion and analysis ("**MD&A**"). These filings will be available at [www.sedar.com](http://www.sedar.com) and the Company's website at [www.headwaterexp.com](http://www.headwaterexp.com).

### Financial and Operating Highlights

	Three months ended March 31,		Percent Change
	2022	2021	
<b>Financial</b> (thousands of dollars except share data)			
Total sales, net of blending <sup>(1) (4)</sup>	110,022	23,122	376
Adjusted funds flow from operations <sup>(2)</sup>	70,023	14,479	384
Per share - basic	0.32	0.07	357
- diluted	0.30	0.07	329
Cash flows provided by operating activities	60,689	12,783	375
Per share - basic	0.27	0.07	286
- diluted	0.26	0.07	271
Net income (loss)	42,363	(12,793)	(431)
Per share - basic	0.19	(0.07)	(371)
- diluted	0.18	(0.07)	(357)
Capital expenditures <sup>(1)</sup>	81,957	37,272	120
Adjusted working capital <sup>(2)</sup>	80,072	58,367	37
Shareholders' equity	441,148	257,461	71
Weighted average shares (thousands)			
Basic	221,209	195,322	13
Diluted	234,265	195,322	20
Shares outstanding, end of period (thousands)			
Basic	223,727	195,574	14
Diluted <sup>(5)</sup>	241,688	240,456	1
<b>Operating</b> (6:1 boe conversion)			
Average daily production			
Heavy crude oil (bbls/d)	10,602	3,385	213
Natural gas (mmcf/d)	10.8	8.5	27
Natural gas liquids (bbls/d)	7	5	40
Barrels of oil equivalent <sup>(9)</sup> (boe/d)	12,414	4,805	158
Average daily sales <sup>(6)</sup> (boe/d)	12,398	4,768	160
Netbacks (\$/boe) <sup>(3) (7)</sup>			
Operating			
Sales, net of blending <sup>(4)</sup>	98.60	53.89	83
Royalties	(15.09)	(5.49)	175
Transportation	(4.90)	(6.04)	(19)
Production expenses	(5.77)	(5.62)	3
Operating netback <sup>(3)</sup>	72.84	36.74	98
Realized losses on financial derivatives	(3.54)	(1.28)	177
Operating netback, including financial derivatives <sup>(3)</sup>	69.30	35.46	95
General and administrative expense	(1.48)	(1.97)	(25)
Interest income and other expense <sup>(8)</sup>	0.14	0.26	(46)
Current tax expense	(5.21)	-	100
Adjusted funds flow netback <sup>(3)</sup>	62.75	33.75	86

(1) Non-GAAP measure. Refer to "Non-GAAP and Other Financial Measures" within this press release.

(2) Capital management measure. Refer to "Non-GAAP and Other Financial Measures" within this press release.

(3) Non-GAAP ratio. Refer to "Non-GAAP and Other Financial Measures" within this press release.

(4) 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 financial statements blending expense is recorded within blending and transportation expense.

- (5) *In-the-money dilutive instruments as at March 31, 2022 includes 9.4 million stock options with a weighted average exercise price of \$2.38 and 8.6 million warrants issued pursuant to the recapitalization transaction in March 2020 with an exercise price of \$0.92.*
- (6) *Includes sales of unblended heavy crude oil, natural gas and natural gas liquids. The Company's heavy crude oil sales volumes and production volumes differ due to changes in inventory.*
- (7) *Netbacks are calculated using average sales volumes. First quarter 2022 sales volumes comprised of 10,587 bbs/d of heavy oil, 10.8 mmcf/d of natural gas and 7 bbls/d of natural gas liquids. First quarter 2021 sales volumes comprised of 3,347 bbs/d of heavy oil, 8.5 mmcf/d of natural gas and 5 bbls/d of natural gas liquids.*
- (8) *Excludes unrealized foreign exchange gains/losses, accretion on decommissioning liabilities and interest on lease liability.*
- (9) *See "Barrels of Oil Equivalent."*

## FIRST QUARTER 2022 HIGHLIGHTS

- Production averaged 12,414 boe/d (consisting of 10,602 bbls/d of heavy oil, 10.8 mmcf/d of natural gas and 7 bbls/d of natural gas liquids) representing an increase of 158% from the first quarter of 2021.
- Added 98 net sections of unburdened lands in the Greater Peavine area of the Clearwater play establishing the Company's next exploration focus area.
- Realized record adjusted funds flow from operations <sup>(1)</sup> of \$70.0 million (\$0.32 per share basic).
- Achieved our highest net income in the Company's history of \$42.4 million (\$0.19 per share basic) representing \$37.96 per boe.
- Achieved record operating netback <sup>(2)</sup> of \$72.84/boe and an adjusted funds flow netback <sup>(2)</sup> of \$62.75/boe.
- Executed an \$82.0 million capital expenditure <sup>(3)</sup> program. The Company drilled 26 crude oil wells inclusive of 7 exploration and step-out wells in Marten Hills West at a 100% success rate.
- As at March 31, 2022, Headwater had adjusted working capital <sup>(1)</sup> of \$80.1 million, working capital of \$77.1 million, and no outstanding debt.

(1) Capital management measure. Refer to "Non-GAAP and Other Financial Measures" within this press release.

(2) Non-GAAP ratio that does not have any standardized meaning under IFRS and therefore may not be comparable with the calculation of similar measures of other entities. Refer to "Non-GAAP and Other Financial Measures" within this press release.

(3) Non-GAAP measure. Refer to "Non-GAAP and Other Financial Measures" within this press release.

## 2022 Guidance Update

Headwater's Board of Directors (the "**Board**") has approved an increase in the 2022 capital budget <sup>(1)</sup> from \$145 million to \$230 million. The increased expenditures include revised capital allocations as follows:

- Greater Peavine                      \$50 million
- Marten Hills West                      \$70 million
- Marten Hills                              \$110 million

The accelerated capital includes \$30 million of land expenditures, 20 incremental wells and \$30 million of incremental road and drilling pad construction. The incremental road and drilling pads constructed in the second half of 2022 will provide Headwater the ability to drill 150 incremental wells in 2023 and beyond with minimal construction expense. Incorporated within the budget increase is an additional 10% increase in drilling, completion and equipping costs to account for inflationary pressures in service costs.

With Headwater's substantial pre-planning, we continue to operate one drilling rig throughout break-up and will have two additional drilling rigs operational before the end of the second quarter. The extensive road and pad construction contemplated in the revised budget will begin in early July, allowing a fourth

drilling rig to be added to our program in October. All four of the rigs are expected to continue operations for Headwater throughout 2023.

The increased 2022 capital is expected to have a significant impact on 2023 production levels. Headwater's updated 2022 guidance is summarized below along with a comparison to previous guidance published as of March 10, 2022:

	Previous 2022 Guidance	Revised 2022 Guidance
2022 annual production (boe/d) <sup>(1)</sup>	12,500	13,000
2022 fourth quarter (boe/d) <sup>(2)</sup>	15,000	16,500
Capital expenditures <sup>(3)</sup>	\$145 million	\$230 million
Adjusted funds flow from operations <sup>(4)</sup>	\$259 million	\$305 million
Exit adjusted working capital <sup>(4)</sup>	\$207 million	\$170 million

(1) March 10, 2022, annual production guidance comprised of: 11,500 bbls/d of heavy oil and 6.2 mmcf/d of natural gas. May 12, 2022, annual production guidance comprised of: 11,900 bbls/d of heavy oil and 6.8 mmcf/d of natural gas.

(2) March 10, 2022, fourth quarter production guidance comprised of: 13,770 bbls/d of heavy oil and 7.4 mmcf/d of natural gas. May 12, 2022, fourth quarter production guidance comprised of: 15,200 bbls/d of heavy oil and 7.9 mmcf/d of natural gas.

(3) Non-GAAP measure. Refer to "Non-GAAP and Other Financial Measures" within this press release.

(4) Capital management measure. Refer to "Non-GAAP and Other Financial Measures" within this press release.

(5) For assumptions utilized in the above guidance see "Future Oriented Financial Information" within this press release.

## Greater Peavine Exploration Area

Headwater has continued to be active with our land expansion strategy. Since January 1, 2022, we have been successful at adding 98 net sections of unburdened exploration lands in the Greater Peavine area.

The team is extremely excited about the prospectivity of the new land base. Headwater has identified more than 10 distinct prospects on the acreage and are actively preparing to test the prospects with our fourth quarter drilling campaign.

The Company's revised guidance will see approximately \$50 million dedicated to this area in 2022. The revised guidance includes \$30 million of land expenditures and contemplates the drilling of up to 8 wells, testing 8 of the currently identified prospects. A significant portion of allocated capital expenditures to this area are for construction of area roads and drilling pads resulting in the ability to drill an additional 50 wells in the area with minimal civil construction.

With success, this new exploration focus area is expected to provide an additional material leg of long-term growth for Headwater.

## Marten Hills West Update

We have continued to experience exceptional success in both the Clearwater A and Clearwater B formations in the Marten Hills West area. As such, the Board has approved incremental expenditures to accelerate development. Headwater's revised guidance contemplates \$70 million of capital expenditures for the area in 2022. Year to date, Headwater has drilled 9 wells and anticipates drilling 22 further locations over the balance of the year. A significant amount of road and pad construction dollars are being spent in 2022 that provide us the ability to drill the next 100 wells in 2023 and beyond with minimal civil construction.

Recent wells results are as follows:

Well UWI	Zone	Initial Production ("IP") (Producing Days) <sup>(1)</sup>	Average Rate (bbls/d)
00/14-05-076-02W5	Clearwater A	IP-23	395
02/14-05-076-02W5	Clearwater A	IP-14	315
02/14-07-076-02W5	Clearwater A	IP-14	285
00/13-07-076-02W5	Clearwater A	IP-35	245
00/09-34-075-03W5	Clearwater B	IP-60	145
02/08-34-075-03W5	Clearwater A	IP-42	95

(1) IP rates indicate the days the well is on production post load recovery.

The success of the recent drilling campaign has resulted in area production growing from 70 bbls/d in September of 2021 to an average of 1,350 bbls/d in April of 2022.

### Marten Hills Update

Initial production rates from our latest area wells have been consistent with an average post load recovery 30-day production rate of approximately 300-400 bbls/d. Area production continues to grow, with current rates of approximately 10,500-11,000 boe/d.

Headwater's oil processing facility is now fully commissioned resulting in reduced oil transportation costs. Cost savings, partially realized in the first quarter, will be fully realized in the second quarter of 2022, resulting in annual corporate transportation expenses of approximately \$4.00 per boe.

Headwater's revised guidance will see approximately \$110 million dedicated to this area in 2022. This is approximately \$20 million greater than our initial guidance, providing incremental capital to accelerate implementation of secondary recovery.

Secondary recovery continues to ramp in the field with approximately 15% of the Marten Hills area now under waterflood. The accelerated capital allocation in 2022 will result in 25% of the field under secondary recovery by the third quarter of 2022 and 55% of the field being under secondary recovery by the end of the first quarter of 2023. Results from currently implemented secondary recovery continue to be very encouraging with decreasing gas oil ratios and stabilized oil rates.

### McCully Update

The Company's McCully asset performed strongly throughout the first quarter of 2022, contributing \$9.5 million in adjusted funds flow from operations <sup>(1)</sup>. Consistent with prior years and to optimize adjusted funds flow from operations <sup>(1)</sup>, Headwater shut-in production May 1, 2022, to await next winter's premium pricing season which is currently forecast at >Cdn\$30/mcf.

(1) Capital management measure. Refer to "Non-GAAP and Other Financial Measures" within this press release.

## Outlook

Our business continues to evolve with a very strong growth outlook for the foreseeable future. Our successful land expansion strategy will be tested with exploration drilling in the fourth quarter of 2022. When combined with the success we have already witnessed with our historical exploration and development strategy we anticipate a very strong and profitable future. The significant growth, land expansion and exploration continue to occur, while spending less than our cash flow in 2022.

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](http://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, 2022 revised guidance related to expected full-year and fourth quarter average daily production, capital expenditures and the breakdown thereof, adjusted funds flow from operations and adjusted working capital; the ability to drill 150 incremental wells in 2023 and beyond with minimal construction expense; the expectation that Headwater will operate one drilling rig through break-up and expect to have two drilling rigs operational by the middle of June; the expectation to have a fourth drilling added to the program in October and that all four rigs will continue operations for Headwater through to the end of the first quarter 2023; the expectation that 2022 capital will have significant impact on 2023 production levels; expected details of the 2022 capital expenditure program by area; the expectation that capital allocated to the Greater Peavine area for construction of roads and pads will result in the ability to drill the next 50 locations with minimal civil construction; the expectation the new exploration focus area is anticipated to provide an additional material leg of long-term growth for Headwater; the expectation to drill 22 wells over the remainder of 2022 in Marten Hills West; the expectation that civil expenditures in Marten Hills West contemplated in 2022 will provide the ability to drill the next 100 wells in 2023 and beyond with minimal civil construction; the expectation incremental capital will allow for the acceleration of secondary recovery; the expectation that transportation savings from the commissioning of the Company's oil processing facility will be fully realized in the second quarter of 2022 and will result in annual corporate transportation costs of \$4.00/boe; the expectation the accelerated capital allocation in 2022 will result in 25% of the field under secondary recovery by the third quarter of 2022 and 55% of the field under secondary recovery by the end of the first quarter of 2023; the expectation the land expansion strategy will be tested with exploration drilling in the fourth quarter of 2022; the expectation of future pricing realized in McCully; the expectation to have a very strong and profitable future and the expectation to generate significant free cash flow and the expectation that Headwater will spend less than cash flow in 2022. 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, prevailing commodity prices and certain other guidance assumptions as detailed below under the heading "Future Oriented Financial Information" in the MD&A available on SEDAR at [www.sedar.com](http://www.sedar.com). 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 Russian-Ukrainian war and the impact on the global economy and commodity prices; the impacts of inflation and supply chain issues and steps taken by central banks to curb inflation; 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, 2022, on SEDAR at [www.sedar.com](http://www.sedar.com), and the risk factors contained therein.

**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 2022 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 2022 guidance include: WTI US\$97.50/bbl, WCS Cdn\$107.30/bbl, AGT US\$15.90/mmbtu, foreign exchange rate of US\$/Cdn\$ of 0.78, blending expense of WCS less \$2.50, royalty rate of 20%, operating and transportation costs of \$10.00/boe, financial derivatives losses of \$1.10/boe, cash taxes of \$5.85/boe and G&A and interest income and other expense of \$1.40/boe. The AGT price is the volume weighted average price for the winter producing months in the McCully field which include January to April and November to December.

**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 IP 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. All IP rates presented herein represent the results from wells after all "load" fluids (used in well completion stimulation) have been recovered. While encouraging, readers are cautioned not to place reliance on such rates in calculating the aggregate production for the Company. Accordingly, the Company cautions that the test results should be considered to be preliminary.

#### **NON-GAAP AND OTHER FINANCIAL MEASURES**

In this press release, we refer to certain financial measures (such as total sales, net of blending, capital expenditures and free cash flow) which do not have any standardized meaning prescribed by IFRS. Our determinations of these measures may not be comparable with calculations of similar measures for other issuers. In addition, this press release contains the terms adjusted funds flow from operations and adjusted working capital, which are considered capital management measures. The term cash flow in this press release is equivalent to adjusted funds flow from operations.

#### Non-GAAP Financial Measures

##### *Total sales, net of blending*

Management utilizes total sales, net of blending expense to compare realized pricing to benchmark pricing. It is calculated by deducting the Company's blending expense from total sales. In the interim financial statements blending expense is recorded within blending and transportation expense.

	Three months ended March 31,	
	2022	2021
	<i>(thousands of dollars)</i>	
Total sales	119,262	25,492
Blending expense	(9,240)	(2,370)
Total sales, net of blending expense	110,022	23,122

#### *Capital expenditures*

Management utilizes capital expenditures and capital expenditures including acquisition to measure total cash capital expenditures incurred in the period. Capital expenditures represents capital expenditures – exploration and evaluation and capital expenditures – property, plant and equipment in the statement of cash flows in the Company's interim financial statements.

	Three months ended March 31,	
	2022	2021
	<i>(thousands of dollars)</i>	
Cash flows used in investing activities	80,374	8,260
Restricted cash	(5,000)	1,237
Change in non-cash working capital	6,583	27,775
Capital expenditures	81,957	37,272

#### Capital Management Measures

##### *Adjusted Funds Flow from Operations*

Management considers adjusted funds flow from operations to be a key measure to assess the Company's management of capital. In addition to being a capital management measure, adjusted funds flow from operations is used by management to assess the performance of the Company's oil and gas properties. Adjusted funds flow from operations is an indicator of operating performance as it varies in response to production levels and management of production and transportation costs. Management believes that by eliminating changes in non-cash working capital and deducting current income taxes, adjusted funds flow from operations is a useful measure of operating performance. While current income taxes will not be paid until 2023, management believes adjusting for current income taxes in the period incurred is a better indication of the funds generated by the Company.

	Three months ended March 31,	
	2022	2021
	<i>(thousands of dollars)</i>	
Cash flows provided by operating activities	60,689	12,783
Changes in non-cash working capital	15,150	1,696
Current income taxes	(5,816)	-
Adjusted funds flow from operations	70,023	14,479

##### *Adjusted Working Capital*

Adjusted working capital is a capital management measure which management uses to assess the Company's liquidity.

	March 31,	December 31,
	2022	2021
	<i>(thousands of dollars)</i>	
Working capital	77,122	89,775
Financial derivative receivable	(565)	(770)
Financial derivative liability	3,515	3,924
Adjusted working capital	80,072	92,929

## Non-GAAP Ratios

### *Adjusted funds flow netback, operating netback and operating netback, including financial derivatives*

Adjusted funds flow netback, operating netback and operating netback, including financial derivatives are non-GAAP ratios and are used by management to better analyze the Company's performance against prior periods on a more comparable basis. Adjusted funds flow netback is defined as adjusted funds flow from operations divided by sales volumes in the period.

Operating netback is defined as sales less royalties, transportation and blending costs and production expense divided by sales volumes in the period. The sales price, transportation and blending costs, and sales volumes exclude the impact of purchased condensate. Operating netback, including financial derivatives is defined as operating netback plus realized gains on financial derivatives.

### *Adjusted funds flow per share and net income per share*

Adjusted funds flow per share and adjusted net income per share are non-GAAP ratios and are used by management to better analyze the Company's performance against prior periods on a more comparable basis. Adjusted funds flow per share and net income per share are calculated as adjusted funds flow from operations or net income divided by weighted average shares outstanding on a basic or diluted basis.

### *Per boe numbers*

This press release represents various results on a per boe basis including Headwater average realized sales price, net of blending, financial derivatives gains (losses) per boe, royalty expense per boe, transportation expense per boe, production expense per boe, general and administrative expenses per boe, interest income and other expense per boe and current taxes per boe. These figures are calculated using sales volumes.