Management’s Report

The management of Headwater Exploration Inc. has prepared the accompanying financial statements of Headwater Exploration Inc. in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. Financial and operating information presented throughout the regulatory filings is consistent with that shown in the financial statements.

Management is responsible for the integrity and objectivity of the financial information. Where necessary, the financial statements include estimates that are based on management’s informed judgments. Internal control systems are designed and maintained to provide reasonable assurance that assets are safeguarded, transactions are properly authorized and reliable accounting records are produced for financial purposes.

KPMG LLP, an independent firm of Chartered Professional Accountants was appointed by the Company’s shareholders to conduct an audit of the financial statements. Their examination included such tests and procedures as they considered necessary to provide reasonable assurance that the financial statements are presented fairly in accordance with International Financial Reporting Standards.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. It exercises its responsibilities primarily through the Audit Committee, which is comprised of three independent directors. The Committee meets regularly with management and with the independent auditors to satisfy itself that management’s responsibilities are properly discharged, to review the financial statements and to recommend that the financial statements be presented to the Board of Directors for approval.

The Audit Committee has reviewed the financial statements and recommended their approval to the Board of Directors. The Board has approved the financial statements for issuance to the Company’s shareholders.

(signed) "*Neil Roszell*"

Neil Roszell
Chief Executive Officer and Chairman

(signed) "*Ali Horvath”*

Ali Horvath, CPA, CA
Vice President Finance and Chief Financial Officer

March 9, 2023

KPMG LLP
205 5th Avenue SW
Suite 3100
Calgary AB T2P 4B9
Tel 403-691-8000
Fax 403-691-8008
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INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of Headwater Exploration Inc.

Opinion

We have audited the financial statements of Headwater Exploration Inc. (the Entity), which comprise:

- the statements of financial position as at December 31, 2022 and 2021
- the statements of income and comprehensive income for the years then ended
- the statements of changes in shareholders' equity for the years then ended
- the statements of cash flows for the years then ended
- and notes to the 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 financial position of the Entity as at December 31, 2022 and 2021, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

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 depletion expense for the Alberta cash-generating unit ("CGU")

Description of the matter

We draw attention to note 2, note 3, and note 6 to the financial statements. Depletion of oil and gas properties is calculated using the unit-of-production basis over the estimated proved and probable oil and gas reserves before royalties. Depletion is calculated at the cash generating unit ("CGU") level and takes into account expenditures incurred to date together with forecasted future development costs to develop the proved plus probable oil and gas reserves. The Entity recorded depletion expense related to its oil and gas properties of $78 million for the year ended December 31, 2022, of which a portion relates to the Alberta CGU.

The estimate of proved and probable oil and gas reserves for the Alberta CGU requires the expertise of an independent third party reserve evaluator and includes significant assumptions related to:

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

The Entity engages an independent third party reserve evaluator to estimate the proved and probable oil and gas reserves for the Alberta CGU.

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 depletion expense for the Alberta CGU as a key audit matter. Significant auditor judgement was required to evaluate the results of our audit procedures regarding the estimate of proved and probable oil and gas reserves for the Alberta CGU.

How the matter was addressed in the audit

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

We assessed the depletion expense calculation for compliance with IFRS as issued by the IASB.

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

- We evaluated the competence, capabilities and objectivity of the independent third party reserve evaluator engaged by the Entity
- We compared the forecasted oil and gas commodity 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 cost assumptions by comparing to 2022 actual 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) as issued by the International Accounting Standards Board (IASB), 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.
- 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 9, 2023

HEADWATER EXPLORATION INC.
Statements of Financial Position

(thousands)	December 31, 2022 $	December 31, 2021 $
ASSETS		
Current assets		
Cash and cash equivalents	175,447	114,703
Restricted cash (note 18)	350	350
Accounts receivable (note 16)	43,141	30,601
Financial derivative receivable (note 16)	419	770
Inventories	1,243	807
Prepaids and deposits	993	489
Total current assets	221,593	147,720
Contribution receivable (note 8)	1,104	-
Exploration and evaluation assets (note 5)	42,872	28,993
Property, plant and equipment (note 6)	468,042	310,290
Right-of-use assets	796	1,469
Other assets	335	335
Total assets	734,742	488,807
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (note 16)	71,404	52,970
Deferred share units liability (note 10)	825	196
Financial derivative liability (note 16)	1,520	3,924
Current portion of lease liability	626	855
Current income tax liability (note 11)	14,393	-
Dividends payable (note 9)	23,392	-
Total current liabilities	112,160	57,945
Lease liability	235	695
Decommissioning liability (note 7)	32,343	27,600
Repayable contribution (note 8)	6,720	-
Deferred income tax liability (note 11)	39,949	4,776
Total liabilities	191,407	91,016
Shareholders' Equity		
Capital stock (note 9)	479,157	469,521
Warrants (note 9)	2	5,437
Contributed surplus	17,312	14,686
Retained earnings (deficit)	46,864	(91,853)
Total shareholders' equity	543,335	397,791
Total liabilities and shareholders' equity	734,742	488,807

Commitments (note 18)
Subsequent events (note 19)

See accompanying notes to the financial statements

Approved on behalf of the Board of Directors:

(signed) "Chandra Henry"
Chandra Henry, CPA, CA, Director

(signed) "Neil Roszell"
Neil Roszell, Chairman

HEADWATER EXPLORATION INC.
Statements of Income and Comprehensive Income

	Year ended December 31, 2022	Year ended December 31, 2021
(thousands, except per share data)	$	$
REVENUE		
Sales (note 12)	458,379	190,940
Royalties	(85,162)	(25,938)
	373,217	165,002
Gains (losses) on financial derivatives (note 16)	2,221	(2,273)
	375,438	162,729
EXPENSES		
Blending and transportation	48,399	31,778
Production	27,814	12,513
General and administrative	6,475	3,981
Remeasurement loss on warrant liability	-	32,599
Stock-based compensation (note 10)	4,085	2,726
Depletion and depreciation (note 6)	79,407	44,388
Impairment reversal (note 6)	-	(16,293)
	166,180	111,692
Interest income and other expense (note 13)	2,417	(145)
Income before income taxes	211,675	50,892
Current income tax expense (note 11)	14,393	-
Deferred income tax expense (note 11)	35,173	5,064
Net income and comprehensive income	**162,109**	**45,828**
Net income per share (note 9)		
Basic	0.71	0.23
Diluted	0.70	0.21

See accompanying notes to the financial statements

HEADWATER EXPLORATION INC.
Statements of Cash Flows

	Year ended December 31, 2022	2021
(thousands)	$	$
OPERATING		
Net income	162,109	45,828
Items not involving cash:		
Unrealized (gains) losses on financial derivatives (note 16)	(2,184)	3,228
Remeasurement loss on warrant liability	-	32,599
Stock-based compensation	4,085	2,726
Depletion and depreciation	79,407	44,388
Impairment reversal	-	(16,293)
Non-cash finance charges	1,137	376
Income tax expense	49,566	5,064
Change in non-cash operating working capital (note 15)	(10,195)	(6,260)
Cash flows provided by operating activities	283,925	111,656
FINANCING		
Payment of lease liability	(918)	(340)
Proceeds from exercise of stock options & warrants (note 9)	1,843	18
Proceeds from repayable contribution (note 8)	7,950	35,724
Cash flows provided by financing activities	8,875	35,402
INVESTING		
Capital expenditures – exploration and evaluation (note 5)	(79,665)	(14,409)
Capital expenditures – property, plant and equipment (note 6)	(169,258)	(125,980)
Government grant (note 8)	1,988	-
Restricted cash	-	1,477
Change in non-cash investing working capital (note 15)	14,879	29,785
Cash flows used in investing activities	(232,056)	(109,127)
Change in cash and cash equivalents	60,744	37,931
Cash and cash equivalents, beginning of year	114,703	76,772
Cash and cash equivalents, end of year	175,447	114,703

See accompanying notes to the financial statements

HEADWATER EXPLORATION INC.
Statements of Changes in Shareholders' Equity

(thousands)	Notes	Capital stock $	Warrants $	Contributed surplus $	Retained earnings (deficit) $	Total Shareholders' equity $
Balance at January 1, 2021		**387,393**	**7,659**	**11,659**	**(137,681)**	**269,030**
Deferred income taxes on share issue costs	9	288	-	-	-	288
Exercise of warrants by Cenovus	9	72,904	-	-	-	72,904
Exercise of stock options	9	990	-	(972)	-	18
Exercise of warrants	9	7,946	(2,222)	-	-	5,724
Stock-based compensation	10	-	-	3,999	-	3,999
Net income		-	-	-	45,828	45,828
Balance at December 31, 2021		**469,521**	**5,437**	**14,686**	**(91,853)**	**397,791**
Balance at January 1, 2022		**469,521**	**5,437**	**14,686**	**(91,853)**	**397,791**
Exercise of stock options	9	3,280	-	(2,358)	-	922
Exercise of warrants	9	6,356	(5,435)	-	-	921
Stock-based compensation	10	-	-	4,984	-	4,984
Net income		-	-	-	162,109	162,109
Dividends declared		-	-	-	(23,392)	(23,392)
Balance at December 31, 2022		**479,157**	**2**	**17,312**	**46,864**	**543,335**

See accompanying notes to the financial statements

HEADWATER EXPLORATION INC.
Notes to the Financial Statements

As at and for the years ended December 31, 2022 and 2021

(All tabular amounts in thousands, unless otherwise stated)

1. NATURE OF OPERATIONS AND GENERAL INFORMATION

Headwater Exploration Inc. (“Headwater” or the “Company”) is a Canadian resource company engaged in the exploration for and development and production of petroleum and natural gas in Canada. Headwater is a public company existing under the Alberta Business Corporations Act with common shares listed on the Toronto Stock Exchange (“TSX”) under the symbol "HWX".

Headwater’s principal place of business is located at 1400, 215 – 9TH Avenue S.W., Calgary, Alberta, T2P 1K3 and its registered office is located at 2400, 525 - 8th Avenue S.W., Calgary, Alberta, T2P 1G1.

2. BASIS OF PREPARATION

Statement of compliance

These audited annual financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board. The accounting policies discussed in note 3 have been consistently applied for all periods presented in these financial statements.

These audited annual financial statements were approved and authorized for issue by the Company’s Board of Directors on March 9, 2023.

Basis of measurement, functional and presentation currency

These audited annual financial statements have been prepared on a historical cost basis except for certain financial instruments which are measured at fair value through profit or loss and inventories which are measured at the lower of cost and net realizable value.

The financial statements are presented in Canadian dollars, which is the Company’s functional currency.

Use of estimates and judgments

The preparation of the Company’s financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Such estimates and assumptions are evaluated at each reporting date and are based on management’s experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Estimates are more difficult to determine, and the range of potential outcomes can be wider, in periods of higher volatility and uncertainty. The impacts of the COVID-19 pandemic and the recovery therefrom coupled with several factors including higher levels of uncertainty due to the Russian invasion of Ukraine and its impact on energy markets, rising interest and inflation rates, and constrained supply chains have created a higher level of volatility and uncertainty. Management has, to the extent reasonable, incorporated known facts and circumstances into the estimates made, however, actual results could differ from those estimates and those differences could be material. The Company has identified the following areas requiring significant judgments, assumptions or estimates.

Climate change

The following provides certain disclosures as to the impact of climate change on the amounts recorded in the financial statements as at and for the year ended December 31, 2022. The below is not a comprehensive list or analysis of all climate change impacts and risks.

Emissions, carbon and other regulations impacting climate and climate related matters are constantly evolving. With respect to climate reporting, the International Sustainability Standards Board has issued an IFRS Sustainability Disclosure Standard with the aim to develop sustainability disclosure standards that are globally consistent, comparable and reliable. In addition, the Canadian Securities Administrators have issued a proposed national instrument 51-107 Disclosure of Climate-Related Matters. The cost to comply with these standards, and others that may be developed or evolve over time, has not yet been quantified.

The Company has considered the impact of the evolving worldwide demand for energy and global advancement of alternative sources of energy that are not sourced from fossil fuels in its assessment as a possible indication of impairment of its oil and gas properties. The Company completed the analysis of triggers for impairment as at December 31, 2022 and climate risk/climate change, in of itself, did not result in the Company completing an impairment test. The Company has considered the impact of the evolving worldwide demand for energy and global advancement of alternative sources of energy that are not sourced from fossil fuels in its assessment of depletion on its oil and gas properties. Depletion of the Company's oil and gas properties was based on proved and probable reserves, the life of which is generally less than 20 years. The ultimate period in which global energy markets can transition from carbon-based sources to alternative energy is highly uncertain, however, the majority of the Company's proved and probable reserves per the 2022 reserve report should be realized prior to the elimination of carbon-based energy. At this time, the Company has not capped its reserve life for purposes of calculating depletion expense, however, this estimate will be monitored as the energy evolution continues.

The Company engages a third-party external reserve engineer to prepare the reserve report. The reserve report includes anticipated impacts from emissions related taxes, most notably the reserve report includes estimated carbon tax related to the Company's operations consistent with Alberta's Emissions Management and Climate Resilience Act.

The evolving energy transition and general sentiment to the oil and gas industry may result in reduced access to capital markets. Management will continue to adjust the capital structure to the dynamic environment.

The Company's financial results for 2022 were not directly impacted from a climate event. In 2022, the Company did not incur material weather related damages to its property, plant and equipment. During 2022, management is not aware of a material disruption in its supply chain or the marketers of the Company's product related to climate events.

The Company maintains insurance coverage that provides a level of insurance for certain events that may arise due to climate change factors; however, the Company's insurance program is subject to limits and various restrictions. No claims were made under the Company's insurance policies in 2022 with respect to climate related matters.

a) Critical Judgments in Applying Accounting Policies

Business Combinations

Business combinations are accounted for using the acquisition method of accounting. The determination of fair value is estimated based on information available at the date of acquisition and requires management to make assumptions and estimates about future events. The assumptions and estimates with respect to determining the fair value of exploration and evaluation assets and property, plant and equipment acquired generally require the most judgment and include estimates of the cash flows associated with proved and probable reserves acquired which is impacted by assumptions related to forecasted production, forecasted operating and royalty costs, future development costs, future crude oil and natural gas commodity prices, foreign exchange rates, and discount rates. Assumptions are also required to determine the fair value of decommissioning liabilities associated with the properties. Changes in any of these assumptions or estimates used in determining the fair value of acquired assets and liabilities could impact the amounts assigned to assets, liabilities (including deferred income tax liabilities) in the acquisition equation. Future net income (loss) will be affected as the fair value on initial recognition impacts future depletion expense, as well as the risk of potential impairment in future periods.

Determination of cash-generating units (“CGU”) and impairment

The determination of what constitutes a CGU used to test the recoverability of the carrying values of the Company’s oil and gas properties is subject to management’s judgment. Judgments are made in regard to shared infrastructure, geographical proximity, petroleum type and similar exposure to market risks and materiality. The asset composition of a CGU can directly impact the recoverability of the assets included therein.

Judgments are required to assess when impairment or impairment reversal indicators exist and impairment testing is required.

The Company’s CGUs as at December 31, 2022 include its Alberta CGU comprised of its Marten Hills and Greater Peavine assets and its New Brunswick CGU consisting of its McCully assets.

Exploration and evaluation (“E&E”) assets

The application of the Company’s accounting policy for E&E assets requires management to make certain judgments as to whether economic quantities of reserves have been found. Judgment is also required to determine the level at which E&E is assessed for impairment; for Headwater, the recoverable amount of E&E assets is assessed at a CGU level.

b) Key Sources of Estimation Uncertainty

Recoverability of asset carrying value and the impact of reserves on depletion and the evaluation of the recoverable amount of a CGU

At each reporting date, the Company assesses its property, plant and equipment and exploration and evaluation assets to determine if there is any indication that the carrying amount of the assets may not be recoverable. An assessment is also made at each reporting date to determine whether there is any indication that previously recognized impairment losses no longer exist or have decreased. Determination as to whether and how much an asset is impaired, or no longer impaired, involves management’s estimates on highly uncertain matters. The key estimates used in the determination of cash flows from crude oil and natural gas reserves and the volume of proved and probable crude oil and natural gas reserves include the following:

i) Reserves and forecasted production – assumptions that are valid at the time of reserve estimation may change significantly when new information becomes available. Changes in future price estimates, production levels or results of future drilling may change the economic status of reserves and may ultimately result in reserve revisions.

ii) Forecasted crude oil and natural gas prices – commodity prices can fluctuate for a variety of reasons including supply and demand fundamentals, inventory levels, exchange rates, weather, and economic and geopolitical factors.

iii) Discount rate – the discount rate used to calculate the net present value of cash flows is based on estimates of an approximate industry peer group weighted average cost of capital. Changes in the general economic environment could result in significant changes to this estimate.

iv) Forecasted operating and royalty costs and future development costs – estimates concerning future drilling and infrastructure costs and production costs required to operate the assets are used in the cash flow model.

Changes in circumstances may impact these estimates which could have a material financial impact in future periods.

Reserves estimates also have a material financial impact on depletion expense, property, plant, and equipment acquired in business combinations and decommissioning liabilities, all of which could have a material impact on financial results. These reserve estimates are evaluated by third-party reserve evaluators at least annually, who work with information provided by the Company to establish reserve determinations in accordance with National Instrument (NI) 51-101, “Standards of Disclosure for Oil and Gas Activities”. Changes in circumstances may impact these estimates which could have a material financial impact in future periods.

Decommissioning liabilities

The decommissioning costs which will ultimately be incurred by the Company are uncertain and estimates can vary in response to many factors including changes to relevant legal requirements, the emergence of new restoration techniques or experience at other production sites. The expected timing can also change in response to changes in reserves or changes in laws and regulations. As a result, there could be significant adjustments to the provisions established which could materially affect future financial results. Judgments include the most appropriate discount rate to use, which management has determined to be a risk-free rate.

Valuation of financial instruments

The estimated fair values of the Company’s financial derivative commodity and foreign exchange contracts are subject to measurement uncertainty due to the estimation of future crude oil and natural gas commodity prices, foreign exchange rates and volatility.

Valuation of warrants and stock options

The estimated fair values of stock options issued under the Company’s stock option plans were based on the Black-Scholes pricing model incorporating assumptions on volatility, risk-free interest rate, forfeiture rate and the expected term.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared by management using the following IFRS accounting policies. The accounting policies have been applied consistently for all periods presented in these audited annual financial statements.

a) Joint interest

A portion of the Company’s exploration, development and production activities is conducted jointly with others through an unincorporated joint venture. These financial statements reflect only the Company’s proportionate interest of these jointly controlled assets and the proportionate share of the relevant revenue and related costs.

b) Foreign currency translation

Foreign currency transactions are translated using the exchange rate prevailing at the date of transaction. Monetary assets and liabilities that are denominated in foreign currencies are translated into Canadian dollars at each reporting date at the exchange rate prevailing on the Statement of Financial Position date. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation of monetary assets and liabilities on the Statement of Financial Position date are recognized in the Statement of Income and Comprehensive Income.

c) Business combinations

Business combinations are accounted for using the acquisition method. The identifiable net assets acquired are measured at their fair value at the date of acquisition.

Transaction costs associated with the acquisition are expensed when incurred.

d) Cash and cash equivalents and restricted cash

Cash and cash equivalents include cash held with Canadian chartered banks on deposit and/or in highly liquid investments.

Restricted cash consists of cash held for a standby letter of credit in respect to a transportation arrangement.

e) Financial instruments

Headwater's financial assets and liabilities are classified into two categories: amortized cost and at fair value though profit or loss ("FVTPL"). The classification of financial assets is determined by the characteristics of the contractual cash flows. Headwater does not classify any of its financial instruments as fair value through other comprehensive income.

Financial assets and liabilities are measured at fair value on initial recognition, which is typically the transaction price, unless a financial instrument contains a significant financing component.

i) Financial assets at amortized cost

Financial assets at amortized cost include cash and cash equivalents, restricted cash, accounts receivable, deposits and contribution receivable. Accounts receivable are financial assets held to collect contractual cash flows that represent payments of principal and interest only. The carrying values of these financial assets approximate fair values because of the short term to maturity.

The Company measures expected credit losses using a lifetime expected loss allowance for accounts receivable with expected lifetime losses recognized from initial recognition. Each period, Headwater assesses the expected credit losses on a forward-looking basis.

ii) Financial liabilities at amortized cost

Financial liabilities at amortized cost include accounts payable and accrued liabilities and dividends payable. The carrying values of these financial liabilities approximate fair values because of the short term to maturity. The repayable contribution is also recorded at amortized cost and its fair value approximates its carrying value.

iii) Fair value through profit or loss

The Company's financial derivative contracts are classified as fair value through profit or loss and are recognized at fair value based on quoted market prices at each reporting date. The Company does not apply hedge accounting to its derivative instruments.

f) Inventories

Inventories consist of crude oil products, diluent and materials and supplies. Inventory is valued at the lower of cost and net realizable value. The cost of crude oil is determined on a weighted average basis and the cost of diluent is based on the purchase price. Costs include the direct and indirect expenditures incurred in the normal course of business in bringing the item or product to its existing condition and location. Net realizable value is the estimated selling price less applicable selling expenses. If the carrying value exceeds the net realizable value, a write-down is recognized. The write-down may be reversed in a subsequent period if the inventory is still on hand and the circumstances which caused the write-down no longer exist.

g) Exploration and evaluation ("E&E") assets

Once the legal right to explore has been acquired, costs directly associated with an exploration activity are capitalized as E&E assets and grouped by licensed exploration area. Costs are capitalized until the technical feasibility and commercial viability of extracting a mineral resource are demonstrable and the presence of reserves has been established, after which capitalized costs are transferred to property, plant and equipment following an assessment for impairment.

The Company assesses E&E assets for impairment at a CGU level.

E&E assets are not depleted.

h) Property, plant and equipment ("PP&E")

Oil and gas properties

PP&E primarily consists of crude oil and natural gas development and production assets and is measured at cost less accumulated depletion and depreciation and accumulated impairment losses and reversals. These costs include property acquisitions, development drilling, completion and equipping costs, infrastructure costs, estimated decommissioning liabilities, directly attributable overhead and administration costs and transfers from E&E. In addition, borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use.

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of PP&E are recognized as oil and gas properties only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in net income as incurred.

Costs of planned major inspections, overhaul and turnaround activities that maintain PP&E and benefit future years of operations are capitalized and depreciated on a straight-line basis over the period to the next turnaround. Recurring planned maintenance activities performed on shorter intervals are expensed.

When an asset in PP&E is disposed of the carrying amount of the asset is derecognized with any gain or loss recorded in the Statement of Income and Comprehensive Income.

Depletion and depreciation

Depletion of oil and gas properties is calculated using the unit-of-production basis over the estimated proved plus probable oil and gas reserves before royalties, as determined, at least annually, by qualified independent reserves engineers. Depletion is calculated at the CGU level and takes into account expenditures incurred to date together with forecasted future development costs to develop the proved plus probable oil and gas reserves.

For office and other assets, depreciation is recognized in the Statement of Income and Comprehensive Income on a straight-line basis or declining balance basis over the estimated useful lives of each part of an item of PP&E.

i) Deferred taxes

Deferred income tax is recognized for the temporary differences between the tax basis and carrying value of assets and liabilities. Deferred income tax is measured using the enacted or substantively enacted tax rates expected to be in effect when the deferred income tax assets are estimated to be realized or the deferred income tax liabilities are estimated to be settled.

j) Current income taxes

Current income tax expense is the expected taxes payable on taxable income for the period, using tax rates enacted or substantively enacted at the reporting date.

k) Leases

The Company recognizes a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred, less any incentives received. The right-of-use asset is subsequently depreciated on a straight-line basis over the lease term. The carrying amount is reviewed for impairment at each reporting period.

The lease liability is initially measured at the present value of future lease payments, discounted using the interest rate implicit in the lease, if applicable, or the Company's incremental borrowing rate. The lease liability is subsequently measured at amortized cost using the effective interest method. It is remeasured if the Company changes its assessment of whether it will exercise a purchase, extension, or termination option with a corresponding adjustment to the carrying amount of the right-of-use asset.

Lease payments are allocated between the lease liability and finance charges. Cash outflows for repayment of the principal portion of the lease liability is classified under financing activities in the Statement of Cash Flows. The interest portion of the lease payments is classified under operating activities in the Statement of Cash Flows.

The Company does not recognize assets and lease liabilities for short-term leases with a term of twelve months or less, and leases of low value assets. The lease payments associated with these leases are recognized as an expense in the Statement of Income and Comprehensive Income over the lease term.

l) Provisions

Decommissioning liabilities

A decommissioning liability is recognized for the present value of the future cost of abandoning oil and gas wells or facilities and is calculated based on management's best estimate of the expenditure using a combination of publicly available industry benchmarks and internal site-specific information. A decommissioning liability is recognized only when a legal or constructive obligation exists. The liability is measured at each reporting date at the fair value of the estimated expenditures expected to settle the obligation using a risk-free interest rate. An equivalent amount is capitalized as part of E&E assets or PP&E and depleted along with the related asset.

Changes in the estimated timing of settlement or future cash flows are dealt with prospectively by recording an adjustment to the decommissioning liability and a corresponding adjustment to the related asset. The unwinding of the discount on the decommissioning liability is included as an expense item in interest income and other expense in the Statement of Income and Comprehensive Income. Actual expenditures are charged against the liability as incurred.

General

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the obligation can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation and are discounted to present value where the effect is material.

m) Capital stock

Common shares are classified as equity. Transaction costs directly attributable to the issuance of common shares are recognized as a reduction of shareholders' equity, net of any related income tax.

n) Revenue recognition

The Company generates revenue from the sale of commodities which include crude oil, natural gas and natural gas liquids ("NGLs"). Revenue is recorded when control is transferred to the buyer which is usually when legal title passes to the external party. The transaction price for variable priced contracts is based on the commodity price index, adjusted for quality, delivery location and other factors, whereby each component of the pricing formula can be either fixed or variable, depending on the contract terms. The amount of revenue recognized is based on the agreed upon transaction price, whereby any variability in revenue relates specifically to the Company's efforts to transfer production, and therefore the resulting revenue is allocated to the production delivered in the period during which the variability occurs. As a result, none of the variable consideration is considered constrained.

Headwater's crude oil, natural gas and NGLs revenue do not contain significant financing components and payments are typically due 25 days following the month of delivery.

Each contract is evaluated based on the nature of the performance obligations, including the Company's role as either principal or agent. Where the Company acts as principal, revenue is recognized on a gross basis. Where the Company acts as agent, revenue is recognized on a net basis.

Gathering, processing and transportation

In New Brunswick, the Company has collaborative arrangements with its joint venture partner to gather, process and transport natural gas production from the McCully field through Headwater's production facilities.

Gathering, processing and transportation fees are recognized when the gathering, processing and transportation services have been provided, which coincides with the month the natural gas is produced.

o) Transportation and blending

Transportation services procured by Headwater are recognized in blending and transportation expense.

Headwater is required to purchase commodity products from third parties to utilize in blending activities. Headwater subsequently sells the blended products to its customers. These transactions are presented in revenue with the related expense included in blending and transportation expense recognized in the Statement of Income and Comprehensive Income.

The costs associated with the transportation of crude oil, natural gas and NGLs, including the cost of diluent used in blending, are recognized when the product is sold.

p) Impairment of non-financial assets

At each reporting date, the Company assesses whether there is an indication that an asset or CGU may be impaired or that historical impairment may be reversed. A CGU includes a group of assets that generates cash flows that are largely independent of the cash inflows from other groups of assets. A CGU may also include certain aggregated E&E assets. If any indication of impairment exists, the Company estimates the asset's or CGU's recoverable amount. The recoverable amount is the higher of an asset's or CGU's fair value less costs of disposal ("FVLCD") and its value-in-use. When the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is written down to its recoverable amount with the impairment loss recognized in the Statement of Income and Comprehensive Income.

A previously recognized impairment loss is reversed if there has been a change in the assumptions used to determine the asset's or CGU's recoverable amount when the impairment loss was initially recognized. However, the amount of the impairment loss reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been recognized, net of depletion expense, had no impairment loss been recognized for the asset in prior years. Any reversal of previously recognized impairment losses is recognized in the Statement of Income and Comprehensive Income.

q) Stock-based compensation

The Company records stock-based compensation expense for stock options granted to directors, officers, employees and consultants using the fair value method. The fair value of each vesting installment of the stock options granted is determined using the Black-Scholes option pricing model. Stock-based compensation expense is calculated over the vesting period based on the number of stock options expected to vest. Forfeiture estimates are based on historical information and are reviewed at each reporting date, with any impact recognized immediately in the Statement of Income and Comprehensive Income. Stock-based compensation expense is recorded in the Statement of Income and Comprehensive Income with a corresponding increase to contributed surplus. The Company capitalizes a portion of stock-based compensation that is directly attributable to development activities. When stock options are exercised the consideration received and the amount previously recognized in contributed surplus are recorded as an increase to capital stock.

The Company records stock-based compensation expense for restricted share units ("RSUs") and performance share units ("PSUs") granted to officers, employees and consultants using the fair value method. The fair value is determined based on the volume weighted average trading price of the five days preceding the grant date. This fair value is recognized as stock-based compensation expense over the vesting period with a corresponding increase to contributed surplus. The Company capitalizes a portion of stock-based compensation that is directly attributable to development activities. For PSUs, the amount of stock-based compensation expense is adjusted to reflect the estimated outcome of the non-market related measures. The common shares underlying the PSUs are adjusted based on a payout multiplier ranging from 0 to 2 times, which is determined based on certain corporate performance measures, as determined by the Board of Directors. The amount of stock-based compensation expense is reduced by an estimated forfeiture rate determined at the date of the grant and updated each period. Upon vesting and settlement in common shares, the previously recognized value in contributed surplus will be recorded as an increase to capital stock.

The fair value of deferred share units paid to directors is calculated based on the weighted average share price of the Company's common shares over the five previous trading days. At each reporting period, the deferred share units outstanding are measured at the Company's five-day volume weighted average trading price. The fair value of the deferred share units granted and any changes in their fair value during the period are recognized in stock-based compensation expense in the Statement of Income and Comprehensive Income with a corresponding amount recorded in deferred share units liability in the Statement of Financial Position.

r) Government grants

Government grants are recognized when there is reasonable assurance that the grant will be received, and all conditions associated with the grant are met. Claims under government grant programs related to income are deducted in reporting the related expense and are recorded in the period in which the eligible expenses were incurred. Claims under government grant programs related to long-term assets are recorded as a reduction to the asset's carrying amount and are depreciated over the useful life of the asset.

s) Net income per share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the year. For the diluted net income per share calculation, the weighted average number of common shares outstanding is adjusted for the potential number of common shares which may have a dilutive effect on net income per share. The weighted average number of diluted shares is calculated in accordance with the treasury stock method. The treasury stock method assumes that the proceeds received from the exercise of all potentially dilutive instruments are used to repurchase common shares at the average market price.

4. SUMMARY OF NEW ACCOUNTING POLICIES AND DISCLOSURES

New accounting policies

On January 1, 2022, the Company adopted an amendment to IAS 16 "Property, Plant and Equipment" re: *proceeds before intended use*. The amendment prohibits a company from deducting from the cost of PP&E amounts received from selling items produced while the company is preparing the asset for its intended use. Instead, a company will recognize such sales proceeds and related costs in the Statement of Income and Comprehensive Income.

On January 1, 2022, the Company adopted an amendment to IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" re: *onerous contracts – cost of fulfilling a contract*. The amendment specifies which costs a company includes in determining the cost of fulfilling a contract for the purpose of assessing whether a contract is onerous.

These amendments did not have a material impact to the Company's financial statements for the year ended December 31, 2022.

Future accounting pronouncements

The IASB announced an amendment to IAS 1 "Presentation of financial statements" re: *classification of liabilities as current or non-current* which is effective for annual periods beginning on or after January 1, 2024. The amendment clarifies that the classification of liabilities as current or non-current should be based on rights that are in existence at the end of the reporting period.

On May 7, 2021, the IASB announced an amendment to IAS 12 "Income Taxes" re: *deferred tax assets and liabilities arising from a single transaction* which is effective for annual periods beginning on or after January 1, 2023. The amendment narrows the scope of the initial recognition exemption so that is does not apply to transactions that give rise to equal and offsetting temporary differences. As a result, companies will need to recognize a deferred tax asset and a deferred tax liability for temporary differences arising on initial recognition of a lease and of a decommissioning provision.

The new accounting pronouncement on income taxes is not expected to have a material impact to the Company's financial statements. The Company has not determined the impact of the revisions to IAS 1.

5. EXPLORATION AND EVALUATION ("E&E") ASSETS

E&E assets consist of the Company's undeveloped land and seismic for projects in which technical feasibility or commercial viability has yet to be determined.

The following table reconciles the movements of the Company's E&E assets for the year:

	December 31, 2022	December 31, 2021
	$	$
Balance, beginning of year	28,993	27,101
Additions	79,665	14,409
Transfers to PP&E	(65,786)	(12,517)
Balance, end of year	42,872	28,993

The Company concluded there are no indicators of impairment for its E&E assets as at December 31, 2022.

6. PROPERTY, PLANT AND EQUIPMENT (“PP&E”)

The Company’s PP&E includes oil and gas properties and corporate assets. Oil and gas properties include the Company’s interest in developed petroleum and natural gas properties, as well as interests in facilities and pipelines.

The following table reconciles the movements of the Company’s PP&E assets for the year:

	Oil and gas properties	Corporate	Total
Cost	$	$	$
Balance at December 31, 2020	448,721	2,739	451,460
Additions	127,345	13	127,358
Transfers from E&E	12,517	-	12,517
Changes in decommissioning liabilities	10,541	-	10,541
Balance at December 31, 2021	599,124	2,752	601,876
Additions	170,704	83	170,787
Transfers from E&E	65,786	-	65,786
Government grant (note 8)	(4,428)	-	(4,428)
Changes in decommissioning liabilities (note 7)	4,034	-	4,034
Balance at December 31, 2022	835,220	2,835	838,055
Accumulated depletion, depreciation and impairment			
Balance at December 31, 2020	261,645	2,151	263,796
Depletion or depreciation expense	44,007	76	44,083
Impairment reversal	(16,293)	-	(16,293)
Balance at December 31, 2021	289,359	2,227	291,586
Depletion or depreciation expense	78,358	69	78,427
Balance at December 31, 2022	367,717	2,296	370,013
Net book value at December 31, 2021	309,765	525	310,290
Net book value at December 31, 2022	467,503	539	468,042

Future development costs required to develop proved plus probable reserves in the amount of $159.4 million were included in the depletion calculation for the Company’s oil and gas properties for the year ended December 31, 2022 (December 31, 2021 – $94.3 million).

The Company capitalized $3.2 million of general and administrative costs for the year ended December 31, 2022 (December 31, 2021 – $3.1 million) and capitalized stock-based compensation expense of $1.5 million for the year ended December 31, 2022 (December 31, 2021 – $1.4 million).

Indicators of Impairment

The Company concluded there are no indicators of impairment for its Alberta or New Brunswick CGUs as at December 31, 2022.

Impairment Reversal – New Brunswick CGU – Q3 2021

In the third quarter of 2021, due to a significant increase in forecast natural gas pricing, the Company determined an indicator of impairment reversal was present for its New Brunswick CGU. As a result, the Company completed an impairment reversal test and recognized a reversal of previous impairment losses of $16.3 million; this amount represents the full amount available to be reversed.

The recoverable amount was estimated based on the fair value less costs of disposal (“FVLCD”) methodology which is calculated using the present value of the CGU’s estimated cash flows associated with proved and probable natural gas reserves. The cash flow information was derived from an internal reserve report on the Company’s McCully assets which was prepared by management as of September 30, 2021. The projected cash flows used in the FVLCD calculation reflect market assessments of key assumptions as at September 30, 2021, including long-term forecasts for natural gas commodity prices, inflation rates and foreign exchange rates (Level 3 fair value inputs). Cash flow forecasts are also based on the Company's reserves and individual well production profiles, operating and royalty costs and future development costs. Royalty rates used in the FVLCD calculation are consistent with the New Brunswick government's royalty regime in effect as of September 30, 2021.

The discount rate used in the impairment reversal calculation was 12% and was determined based on a peer group weighed average cost of capital factoring in risks specific to the types of reserves. The carrying value of the New Brunswick CGU at September 30, 2021 was $48.9 million prior to any impairment reversal.

Forecast natural gas commodity pricing used in the FVLCD calculation as at September 30, 2021 reflects the benchmark prices set forth in the table below. McCully natural gas prices were calculated by adjusting the Algonquin city-gates natural gas prices to reflect the expected premiums received at Headwater's delivery point, net of transportation costs, if applicable, and heat content.

	2021	2022	2023	2024	2025	2026 – 2030	Thereafter
Algonquin city-gates ($US/mmbtu)	10.50	7.25	5.44	4.37	4.46	4.55 – 4.92	+2%/year
McCully ($CDN/mcf) (1)	17.56	12.43	8.93	6.25	6.86	7.00 – 7.57	+2%/year
Exchange rate ($US/$CDN)	0.80	0.80	0.80	0.80	0.80	0.80	0.80

(1) Realized pricing reflects natural gas production through the winter producing months (January to April and November to December of the applicable year) in 2021 to 2023.

Changes in key assumptions, such as a downward revision in natural gas reserves, a decrease in forecast natural gas commodity prices, changes in foreign exchange rates, an increase in royalties, operating costs or future development costs would decrease the recoverable amount of the CGU and the amount of the impairment reversal with a corresponding decrease to the Company's net income for the period.

As at September 30, 2021, a 1% increase in the discount rate and/or a 5% decrease in forecast operating cash flows would result in the following reduction to the Company's impairment reversal for the period:

	Decrease to impairment reversal
	$
1% increase in discount rate	-
5% decrease in cash flows	(268)
1% increase in discount rate and 5% decrease in cash flows	(2,210)

7. DECOMMISSIONING LIABILITY

The following table reconciles the movements of the Company's decommissioning liability for the year:

	December 31, 2022	December 31, 2021
	$	$
Balance, beginning of year	27,600	16,718
Additions	14,267	10,772
Change in estimate (1)	(10,233)	(231)
Accretion	709	341
Balance, end of year	32,343	27,600

(1) Relates to changes in the risk-free rate, inflation rate, time to abandonment and cost estimates. Of this amount, an $8.8 million downward revision is a result of the increase in risk-free rate over the period from 1.7% at December 31, 2021 to 3.3% at December 31, 2022 and a $2.3 million upward revision is a result of the increase in inflation rate over the period from 1.8% at December 31, 2021 to 2.1% at December 31, 2022, with the remainder of the change attributed to changes in the time to abandonment and cost estimates.

The underlying cost estimates are derived from a combination of published industry benchmarks as well as site specific information. The Company has estimated the net present value of its total asset retirement obligations to be $32.3 million as at December 31, 2022 (December 31, 2021 - $27.6 million). The total future inflated and undiscounted amount of estimated cash flows required to settle these obligations is $73.3 million (December 31, 2021 - $40.7 million). Management estimates the settlement of these obligations will occur over the next 20 to 40 years. At December 31, 2022, a risk-free rate of 3.3% (December 31, 2021 – 1.7%) and an inflation rate of 2.1% (December 31, 2021 – 1.8%) were used to calculate the estimated fair value of the decommissioning liability.

Accretion of decommissioning liabilities is due to the passage of time and is presented within interest income and other expense in the Statement of Income and Comprehensive Income.

8. REPAYABLE CONTRIBUTION (NRCan ERF)

In the second and fourth quarters of 2022, the Company received approval of its first and second claims pursuant to a repayable contribution agreement with the Department of Natural Resources Canada ("NRCan"), under the Emissions Reduction Fund ("ERF") Onshore Program. The funds were received by the Company during the year ended December 31, 2022, with the exception of the holdback amount of $1.1 million which has been recorded as a long-term receivable.

NRCan has provided financial assistance by way of a partially repayable interest-free loan to the Company for its working interest in the joint Marten Hills natural gas processing plant and gathering system, as well as for gas conservation equipment associated with the Company's wholly owned oil processing facility in Marten Hills. Headwater will repay 80% of the financial assistance pursuant to the terms and conditions of the agreement, with the remaining 20% being non-repayable. The repayable portion of the funds received are to be repaid as follows: 10% on June 30, 2025, 33% on June 30, 2026, and 57% on June 30, 2027.

Headwater accounts for the non-repayable portion and benefit of the interest-free period of the financial assistance as a government grant. Government grants are recognized when there is reasonable assurance that the grant will be received, and all conditions associated with the grant are met. As this grant relates to the Company's PP&E, the grant is recorded as a reduction to the asset's carrying amount and is depreciated over the useful life of the asset. The Company recognized $4.4 million as an offset against PP&E for the year ended December 31, 2022.

The Company has recognized a repayable contribution of $8.8 million, undiscounted, and $6.7 million discounted as at December 31, 2022, with respect to claims submitted to the ERF and confirmed by NRCan. The Company discounts the repayable contribution at a weighted average interest rate of 7.3%.

	December 31, 2022
	$
Balance, beginning of period	-
Repayable contribution discounted at 7.3%	6,614
Interest	106
Balance, end of period	6,720

The Company is in compliance with all terms and conditions of the repayable contribution agreement.

9. CAPITAL STOCK

a) Authorized – unlimited common shares without nominal or par value.

b) Issued and outstanding

	December 31, 2022		December 31, 2021	
	Number of shares	Amount	Number of shares	Amount
		$		$
Balance, beginning of year	217,681	469,521	195,106	387,393
Deferred income taxes on share issue costs	-	-	-	288
Exercise of warrants by Cenovus	-	-	15,000	72,904
Exercise of stock options	2,706	3,280	1,299	990
Exercise of warrants	13,533	6,356	6,276	7,946
Balance, end of year	233,920	479,157	217,681	469,521

Stock Options

During the year ended December 31, 2022, 2.8 million stock options were exercised for 2.1 million common shares on a cashless basis, and 0.6 million stock options were exercised for 0.6 million common shares for total proceeds of $0.9 million. Contributed surplus related to the options exercised of $2.4 million was transferred to capital stock.

During the year ended December 31, 2021, 1.7 million stock options were exercised for 1.3 million common shares on a cashless basis, and 17 thousand stock options were exercised for 17 thousand common shares for total proceeds of $18 thousand. Contributed surplus related to the options exercised of $1.0 million was transferred to capital stock.

Warrants

During the year ended December 31, 2022, 14.4 million warrants were exercised for 12.5 million common shares on a cashless basis, and 1.0 million warrants were exercised for 1.0 million common shares for total proceeds of $0.9 million. The associated fair value of the warrants of $5.4 million, along with the proceeds received, were transferred to capital stock.

During the year ended December 31, 2021, 6.3 million warrants were exercised for 6.3 million common shares for total proceeds of $5.7 million. The associated fair value of the Warrants of $2.2 million, along with the proceeds received, were transferred to capital stock.

Cenovus Warrants

On December 23, 2021, Cenovus exercised 15 million warrants for 15 million common shares for total proceeds of $30 million. The total fair value of $42.9 million, along with the proceeds received, were credited to capital stock.

c) Warrants

	December 31, 2022		December 31, 2021	
	Number of Warrants	Amount	Number of Warrants	Amount
		$		$
Balance, beginning of year	15,387	5,437	21,677	7,659
Exercised	(15,381)	(5,435)	(6,290)	(2,222)
Balance, end of year	6	2	15,387	5,437

The remaining outstanding warrants have an exercise price of $0.92, expire in March 2024 and are fully vested. The fair value of the warrants is recorded in shareholders' equity. Subsequently, any consideration paid to the Company on the exercise of warrants along with the fair value of warrants will be credited to capital stock.

d) Per share amounts

Basic per share amounts are calculated using the weighted average number of shares outstanding. The Company uses the treasury stock method to determine the impact of dilutive securities. The reconciling items between the basic and diluted average common shares outstanding are stock options, warrants, RSUs, PSUs and accrued dividends on RSUs and PSUs.

	December 31, 2022	December 31, 2021
Weighted average shares outstanding		
Basic	227,299	199,802
Effect of stock options	3,316	4,077
Effect of warrants	5	11,982
Effect of RSUs and PSUs	135	-
Diluted	230,755	215,861

e) Dividends

On November 3, 2022, Headwater announced its inaugural quarterly cash dividend of $0.10 per common share ($0.40 per common share annualized). The first dividend was paid on January 16, 2023, to shareholders of record at the close of business on December 30, 2022.

10. STOCK-BASED COMPENSATION

a) Stock options

The Company has an old and new stock option plan (the "Option Plans") under which options to purchase common shares of the Company may be granted to directors, officers, employees and consultants of the Company. The exercise price of each option granted is based on the closing price of the common shares on the Toronto Stock Exchange ("TSX") on the trading day prior to the date the option was granted. Options granted generally vest as to one third of the number granted on each of the first, second and third anniversaries of the date of grant over a three-year period and expire four to five years after the grant date. The Company does not intend to grant any further options under the Option Plans.

The following table summarizes the changes in stock options outstanding during the year:

	December 31, 2022		December 31, 2021	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Options outstanding, beginning of year	9,505	$ 2.36	7,978	$ 1.32
Granted	-	-	3,430	$ 4.22
Forfeited or expired	-	-	(160)	$ 2.87
Exercised (1)	(3,419)	$ 1.70	(1,743)	$ 1.18
Options outstanding, end of year	6,086	$ 2.74	9,505	$ 2.36
Options exercisable, end of year	1,312	$ 2.93	1,083	$ 1.45

(1) The Company's weighted average share price, at the date of exercise, for stock options exercised during the year ended December 31, 2022, was $6.83 per common share (year ended December 31, 2021 - $4.56 per common share).

There were no options granted in 2022. The total fair value of each option granted during the year ended December 31, 2021, was estimated on the date of grant using the Black-Scholes pricing model with weighted average assumptions as follows:

	December 31, 2021
Weighted average fair value of options granted	$ 1.54
Risk-free interest rate	0.4%
Expected forfeiture rate	9.5%
Expected life (years)	2.5
Expected volatility (1)	60%

(1) During the year ended December 31, 2021, the expected volatility was estimated based on a peer group historical volatility.

The following table summarizes information regarding stock options outstanding as at December 31, 2022:

	Outstanding options			Exercisable options	
Exercise prices	Number of options outstanding	Weighted average remaining term (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
$ 1.01 - $ 2.00	2,283	1.2	$ 1.06	266	$ 1.06
$ 2.01 - $ 3.00	1,522	2.0	$ 2.50	582	$ 2.41
$ 3.01 - $ 5.23	2,281	2.3	$ 4.59	464	$ 4.66
Total	6,086	1.8	$ 2.74	1,312	$ 2.93

For the year ended December 31, 2022, with respect to stock options, the Company recorded net stock-based compensation expense of $2.0 million and capitalized stock-based compensation expense of $0.9 million with a corresponding increase to contributed surplus of $2.9 million (December 31, 2021 – net stock-based compensation expense of $2.6 million and capitalized stock-based compensation expense of $1.4 million with a corresponding increase to contributed surplus of $4.0 million).

b) Deferred share units

At the meeting of the Board of Directors held on March 10, 2022, the directors approved the adoption of a new DSU plan (the "DSU Plan"). The DSU Plan provides for grants of DSUs to non-management directors. Each DSU vests on the date of grant; however, settlement of the DSU occurs when the individual ceases to be a director of the Company. DSUs are to be settled in cash or by payment in common shares acquired through the facilities of the TSX. It is the intention of the Company to settle DSUs in cash.

The following table summarizes the changes in the outstanding DSUs for the periods:

	December 31, 2022		December 31, 2021	
	Number of DSUs	Amount	Number of DSUs	Amount
		$		$
DSUs, beginning of year	38	196	38	91
Granted	103	679	-	-
Fair value adjustment during the year	-	(50)	-	105
DSUs, end of year	141	825	38	196

The DSU liability as at December 31, 2022, of $825 thousand is based on a fair value of $5.86 per DSU, which is the Company's five-day volume weighted average trading price on December 31, 2022 (December 31, 2021 - $5.15 per DSU).

c) Share awards

At the meeting of the Board of Directors held on March 10, 2022, the directors approved a new incentive awards plan (“the Awards Plan”) providing for the grant of RSUs and PSUs (the “Awards”) to officers, employees and consultants of the Company. Under the Awards Plan, the aggregate number of common shares reserved for issuance may not exceed the lesser of: (i) 6.0% of the aggregate number of issued and outstanding common shares less the aggregate number of common shares reserved for issuance under the Company’s stock option plans; and (ii) 4.5% of the aggregate number of issued and outstanding common shares. Generally, one third of the RSUs will vest on each of the first, second and third anniversaries of the date of grant and all PSUs will vest on the third anniversary of the date of grant, unless otherwise determined by the Board of Directors. The common shares underlying PSUs are adjusted based on a payout multiplier ranging from 0 to 2 times, which is determined based on certain corporate performance measures, as determined by the Board of Directors. The Company received approval of the Awards Plan from the shareholders of the Company on May 12, 2022.

The Awards Plan allows a holder to receive common shares upon vesting. Headwater uses the fair value method for valuing Awards. The fair value of Awards is determined based on the volume weighted average trading price of the five days preceding the grant date. This fair value is recognized as stock-based compensation expense over the vesting period with a corresponding increase to contributed surplus. The Company capitalizes a portion of stock-based compensation that is directly attributable to development activities. For PSUs, the amount of stock-based compensation expense is adjusted to reflect the estimated outcome of the non-market related measures. The amount of stock-based compensation expense is reduced by an estimated forfeiture rate determined at the date of the grant and updated each period. Upon vesting of the Awards and settlement in common shares, the previously recognized value in contributed surplus will be recorded as an increase to capital stock.

The following table summarizes the changes in Awards for the year ended December 31, 2022:

	RSUs	PSUs
Outstanding, beginning of period	-	-
Granted	183	838
Forfeited	(4)	-
Outstanding, end of period	179	838

For the year ended December 31, 2022, with respect to the Awards outstanding, the Company recorded net stock-based compensation expense of $1.5 million and capitalized stock-based compensation expense of $0.6 million with a corresponding increase to contributed surplus of $2.1 million.

11. INCOME TAXES

The following table reconciles income taxes calculated at the weighted average Canadian statutory rate with the actual provision for deferred income taxes per the Statement of Income and Comprehensive Income:

	December 31, 2022	December 31, 2021
	$	$
Net income before income taxes	211,675	50,892
Blended Canadian statutory tax rate	23.3%	23.6%
Expected income tax expense	49,320	12,011
Increase (decrease) resulting from:		
Non-deductible expenses (1)	488	8,332
Change in unrecognized benefit	-	(15,353)
Change in tax rates	(86)	74
Other	(156)	-
Current income tax expense	14,393	-
Deferred income tax expense	35,173	5,064
Total income tax expense	49,566	5,064

(1) Non-deductible expenses primarily relate to stock-based compensation on the Company's outstanding stock options.

The Canadian statutory tax rate per the rate reconciliation above represents the weighted average combined federal and provincial corporate tax rate.

The deferred income tax liability is comprised of the following as at December 31, 2022:

Deferred income tax liability	December 31, 2021	Movement through Statement of Income and Comprehensive Income	December 31, 2022
	$	$	$
Current assets	(15)	63	48
Leases	20	(5)	15
E&E/PP&E/decommissioning liability	(13,560)	(27,407)	(40,967)
Net financial derivative liability	744	(487)	257
Non-capital losses and other	7,275	(7,672)	(397)
Share issue costs/transaction costs	760	(259)	501
Tax asset related to Awards	-	594	594
	(4,776)	(35,173)	(39,949)

The amount and timing of reversals of temporary differences will be dependent on a number of factors, including the nature and timing of future capital expenditures and the Company's future operating results.

12. SALES

The following table presents the Company's sales disaggregated by revenue source:

	December 31, 2022	December 31, 2021
	$	$
Heavy oil	423,211	178,434
Natural gas	31,876	11,416
Natural gas liquids ("NGLs")	1,891	62
Gathering, processing and transportation	1,401	1,028
	458,379	190,940

Primarily all of the Company's heavy oil, natural gas and NGL revenues for the years ended December 31, 2022, and December 31, 2021, are derived from variable priced contracts based on index prices.

Included in accounts receivable as at December 31, 2022 is $38.7 million (December 31, 2021 - $28.2 million) of accrued heavy oil, natural gas and NGLs sales related to December 2022 production.

13. INTEREST INCOME AND OTHER EXPENSE

Interest income and other expense consists of the following:

	December 31, 2022	December 31, 2021
	$	$
Interest income	3,844	663
Realized and unrealized foreign exchange losses	(538)	(432)
Accretion on decommissioning liability (note 7)	(709)	(341)
Interest on repayable contribution (note 8)	(106)	-
Interest	(74)	(35)
	2,417	(145)

14. EXPENSES BY NATURE

In the Company's Statement of Income and Comprehensive Income, items are primarily disclosed by nature except for employee compensation which is included in production expense, general and administrative expenses and stock-based compensation expense as follows:

	December 31, 2022	December 31, 2021
	$	$
Production	502	482
General and administrative	4,688	3,007
Stock-based compensation	4,085	2,726
	9,275	6,215

15. SUPPLEMENTAL CASH FLOW INFORMATION

	December 31, 2022	December 31, 2021
	$	$
Change in non-cash operating working capital:		
Accounts receivable	(12,662)	(25,126)
Inventories	(584)	(173)
Prepaids and deposits	(504)	(41)
Accounts payable and accrued liabilities	3,555	19,080
	(10,195)	(6,260)
Change in non-cash investing working capital:		
Accounts payable and accrued liabilities	14,879	29,785
	14,879	29,785
Interest received	$ 3,597	$ 811

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Financial instruments of the Company include cash and cash equivalents, restricted cash, accounts receivable, financial derivative receivable/liability, deposits, contribution receivable, accounts payable and accrued liabilities, dividends payable and repayable contribution. The Company is exposed to financial risks arising from its financial assets and liabilities that include credit risk and liquidity risk in addition to the market risks associated with commodity prices and foreign exchange rates.

a) Commodity price risk

Headwater enters into financial derivative commodity contracts to manage the risks associated with fluctuations in commodity prices. All such transactions are conducted in accordance with the Company's established risk management policies. The Company does not use derivative financial instruments for speculative purposes.

The Company had the following outstanding financial derivative commodity contracts as at December 31, 2022:

Commodity	Index	Type	Term	Daily Volume	Contract Price
Natural Gas	AGT (1)	Fixed	Jan 2023- Mar 2023	2,500 mmbtu	Cdn$17.91/mmbtu
Natural Gas	AGT	Fixed	Jan 2023- Feb 2023	2,500 mmbtu	Cdn$32.71/mmbtu
Natural Gas	AGT	Fixed	Mar 2023	2,500 mmbtu	Cdn$19.36/mmbtu
Natural Gas	AECO 5A	Fixed	Apr 2023- Oct 2023	2,000 GJ	Cdn$3.83/GJ

(1) AGT = Algonquin city-gates

The following financial derivatives gains (losses) are reflected in the Statement of Income and Comprehensive Income:

	December 31, 2022	December 31, 2021
	$	$
Financial derivatives gains (losses):		
- realized gains	37	955
- unrealized financial derivative gains (losses)	2,184	(3,228)
Financial derivatives gains (losses)	2,221	(2,273)

The following table summarizes the fair value of the Company's financial derivative contracts as at December 31, 2022 and the change in fair value for the year:

	Commodity contracts	Foreign exchange contracts	Total
	$	$	$
Net financial derivative receivable, December 31, 2020	74	-	74
Unrealized change in fair value	(3,459)	231	(3,228)
Net financial derivative liability, December 31, 2021	(3,385)	231	(3,154)
Unrealized change in fair value (1)	2,184	(131)	2,053
Net financial derivative liability, December 31, 2022	(1,201)	100	(1,101)

(1) Unrealized change in fair value related to the Company's foreign exchange contracts is included in interest income and other expense.

For the Company's commodity contracts, the fair value of the net financial derivative liability of $1.2 million as at December 31, 2022, is based on estimated future natural gas prices as of that date. The fair values of these financial derivative commodity contracts are sensitive to changes in the natural gas reference prices. Holding other assumptions constant, if AGT and AECO 5A prices increased (decreased) by 10%, the fair value of the financial derivative liability would increase (decrease) by $1.3 million.

Financial derivative receivables and liabilities are only offset if Headwater has the current legal right to offset and intends to settle on a net basis. The Company offsets when the counterparty, commodity, currency and timing of settlement are the same.

ii) Foreign currency risk

The Company is exposed to fluctuations of the Canadian to U.S. dollar exchange rate given realized pricing is directly influenced by U.S. dollar denominated benchmark pricing and from exposure to its U.S. dollar denominated heavy oil, natural gas and natural gas liquids marketing arrangements.

Headwater mitigates this risk by entering into commodity contracts in Canadian dollars and entering into foreign exchange contracts.

The Company had the following outstanding foreign exchange contract as at December 31, 2022:

Type	Buy Currency	Sell Currency	Rate	Notional Amount	Settlement Date
Forward contract	CAD	USD	WMR noon rate, December 2022 average (1)	US$28,000,000	January 26, 2023

(1) WM/Reuters Intraday Spot Rate as of Noon EST

The Company has the following financial instruments denominated in U.S. dollars:

(thousands of U.S. dollars)	December 31, 2022	December 31, 2021
	$	$
Cash	246	535
Accounts receivable	25,428	20,272
Financial instruments in U.S. dollars	25,674	20,807

All of the Company's accounts receivable denominated in U.S. dollars in the table above has been hedged at the December 2022 average noon rate through the Company's outstanding foreign exchange contract mitigating exposure to foreign currency fluctuations.

Fair Value Measurement

The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The Company maximizes the use of observable inputs when preparing calculations of fair value, where possible. The fair value hierarchy has the following levels:

- Level 1 – Values are used based on unadjusted quoted prices available in active markets for identical assets and liabilities as of the reporting date.
- Level 2 – Values are based on inputs, including forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace. Prices in Level 2 are either directly or indirectly observable as of the reporting date.
- Level 3 – Values are based on prices or valuation techniques that are not based on observable market data.

The fair value of cash and cash equivalents, restricted cash, accounts receivable, deposits, accounts payable and accrued liabilities and dividends payable approximate their carrying value due to the short term to maturity of these instruments. The repayable contribution has been discounted at an estimated market rate and therefore carrying value approximates fair value.

The Company's financial derivative receivable/liability is considered Level 2 in the fair value hierarchy.

iii) Credit risk

As at December 31, 2022, the carrying amount of cash, restricted cash, accounts receivable, contribution receivable, financial derivative receivable and deposits represent the Company's maximum credit exposure. The Company's cash and cash equivalents are held on deposit with Canadian chartered banks. The Company's contribution receivable is outstanding from the Government of Canada.

Headwater's receivables from its crude oil and natural gas sales are subject to normal credit risk. During the year ended December 31, 2022, the Company sold its crude oil and natural gas production to various counterparties with one counterparty accounting for 93% of sales (74% of sales for the year ended December 31, 2021). Headwater mitigates the risk of loss by ensuring its major counterparties are investment grade as ranked by reputable credit agencies and by periodically entering into parental guarantees. Headwater historically has not experienced any collection issues. Payment of revenues from both counterparties occurs on the 25th day following the month of sale. As a result, the Company's production revenues are current.

Headwater's receivables from its joint venture partner are also subject to normal credit risk. Headwater has one joint venture partner, which is investment grade, in connection with its New Brunswick assets.

At December 31, 2022, 100% of the Company's accounts receivables were outstanding for less than 30 days. The average expected credit loss on the Company's accounts receivable was $nil as at December 31, 2022 and December 31, 2021. Trade receivables generally have a 30-day term and have all been collected subsequent to year-end. As at December 31, 2022, the Company's receivables consisted of $38.7 million (December 31, 2021 - $28.2 million) from crude oil and natural gas marketers, $3.5 million (December 31, 2021 – $1.9 million) from commodity contract counterparties, $0.6 million (December 31, 2021 - $0.4 million) from its joint venture partner and $0.3 million (December 31, 2021 - $0.1 million) related to accrued interest and other.

iv) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company manages liquidity risk through its working capital and an actively managed operating and capital expenditure budgeting process. The Company also entered into a $100.0 million credit facility in the fourth quarter of 2022 to strengthen its liquidity. As at December 31, 2022, the Company was holding cash of $175.4 million.

The following table details the undiscounted contractual maturities of the Company's liabilities as at December 31, 2022:

	Within 1 year	1 to 5 years
	$	$
Accounts payable and accrued liabilities	71,404	-
DSU liability	825	-
Financial derivative liability	1,520	-
Current income tax liability	14,393	-
Dividends payable	23,392	-
Lease liability	658	314
Repayable contribution	-	8,834
Total	112,192	9,148

Credit Facility

During the fourth quarter of 2022, the Company entered into a senior secured revolving syndicated credit facility with the National Bank of Canada and the Bank of Montreal ("the Lenders"). The credit facility is comprised of extendible revolving credit facilities consisting of a $20.0 million operating facility and an $80.0 million syndicated facility.

As at December 31, 2022, Headwater had not drawn on the credit facility.

The credit facility has a revolving period of 364 days, extendible annually at the request of the Company, subject to approval of the Lenders. If not extended, the facilities will automatically convert to a term loan and all outstanding obligations will be repayable one year after the expiry of the revolving period. The borrowing base is subject to semi-annual redeterminations occurring by June 30th and by November 30th of each year. The credit facility is secured by a demand debenture in the amount of $250.0 million. Repayments of principal are not required until the maturity date, provided that the borrowings do not exceed the authorized borrowing base and the Company is in compliance with all covenants, representations and warranties.

The credit facility bears interest at a floating market rate with margins charged by the Lenders linked to the Company's senior debt to EBITDA ratio. EBITDA, for the purposes of calculating the senior debt to EBITDA ratio, is calculated as net income adjusted for non-cash items, interest expense and income taxes. Senior debt, for the purposes of calculating the senior debt to EBITDA ratio, is calculated as any debt of the Company excluding the financial derivative liability and repayable contribution.

The credit facility is not subject to any financial covenants. Additionally, distributions are permitted subject to compliance with a Board approved distributions policy.

b) Management of capital

The Company's objectives when managing capital are to i) deploy capital to provide an appropriate return on investment to its shareholders; ii) maintain financial flexibility in order to preserve the Company's ability to meet financial obligations; and iii) maintain a capital structure that provides financial flexibility to execute strategic acquisitions. To aid in managing the capital structure, the Company monitors adjusted working capital and adjusted funds flow from operations.

On November 3, 2022, Headwater announced its inaugural quarterly cash dividend of $0.10 per common share ($0.40 per common share annualized). The first dividend was paid on January 16, 2023, to shareholders of record at the close of business on December 30, 2022.

The Company's strategy is designed to maintain a flexible capital structure consistent with the objectives as stated above and to respond to changes in economic conditions and the risk characteristics of the underlying crude oil and natural gas assets. Key indicators of changing economic conditions include adjusted working capital and adjusted funds flow from operations. Headwater considers its capital structure to include shareholders' equity and working capital. In order to maintain or adjust its capital structure, the Company may from time to time issue new common shares, seek debt financing, change its future dividend policy and adjust its capital spending to manage working capital.

In order to facilitate the management of its capital expenditures and working capital, the Company prepares annual budgets which are updated quarterly depending upon varying factors including current and forecast crude oil and natural gas prices, capital expenditures and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

i) Adjusted working capital

Management considers adjusted working capital to be a key measure to assess the Company's liquidity and capital management.

	December 31, 2022	December 31, 2021
	$	$
Working capital	109,433	89,775
Contribution receivable (long-term)	1,104	-
Repayable contribution	(6,720)	-
Financial derivative receivable	(419)	(770)
Financial derivative liability	1,520	3,924
Adjusted working capital	104,918	92,929

ii) 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. Adjusted funds flow from operations is an indicator as to whether adjustments are necessary to the level of capital expenditures. For example, in periods where adjusted funds flow from operations is negatively impacted by reduced commodity pricing, capital expenditures may need to be reduced or curtailed to preserve the Company's capital and dividend policy. Management believes that by excluding the impact of changes in non-cash working capital and deducting current income taxes, adjusted funds flow from operations provides a useful measure of Headwater's ability to generate the funds necessary to manage the capital needs of the Company. 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.

	December 31, 2022	December 31, 2021
	$	$
Cash flows provided by operating activities	283,925	111,656
Changes in non-cash working capital	10,195	6,260
Current income taxes	(14,393)	-
Adjusted funds flow from operations	279,727	117,916

Adjusted working capital and adjusted funds flow from operations are not standardized measures and, therefore, may not be comparable with the calculation of similar measures of other entities.

17. RELATED PARTY TRANSACTIONS

The following table presents the remuneration accrued to key management personnel and the Board of Directors through the year:

	December 31, 2022	December 31, 2021
	$	$
Wages and benefits	3,067	2,798
Directors' compensation	187	-
Stock-based compensation	3,862	2,698
	7,116	5,496

Wages and benefits to key management personnel include salary, bonus and benefits accrued during the year. Directors' compensation includes cash compensation accrued during the year to directors who elected to receive their annual retainer in the form of cash compensation. Stock-based compensation includes non-cash expenses, including amounts capitalized to PP&E, accrued under the Company's Old Option Plan, New Option Plan, DSU Plan and Awards Plans for both key management personnel and directors of the Company.

18. COMMITMENTS

a) Commitments

As at December 31, 2022, the Company is committed to future payments under the following agreements:

	Total	2023	2024	2025	2026	2027	Thereafter
	$	$	$	$	$	$	$
Transportation (1)	110,397	11,808	13,362	13,628	14,775	15,906	40,918
Waste disposal (2)	1,917	1,917	-	-	-	-	-
Lease (3)	765	357	375	33	-	-	-
Government grant (4)	8,834	-	-	883	2,942	5,009	-

(1) At December 31, 2022, Headwater has the following transportation commitments:
   a. 8- year take-or-pay transportation agreement with a minimum volume commitment of 10,000 boe/d.
   b. 8- year financial commitment at $1.9 million per year adjusted for inflation.
   c. 8- year take-or-pay transportation agreement with a current minimum volume commitment of 4,750 boe/d increasing to 9,750 boe/d in year 4 and to 12,500 boe/d in year 6.

(2) Relates to a commitment to deliver a certain amount of drilling waste to a third-party landfill.
(3) Relates to variable operating costs, which are a non-lease component of the Company's head office lease.
(4) Relates to scheduled undiscounted re-payments of federal government funding under the terms of the repayable contribution agreement with NRCan. See note 8.
(5) Excludes leases accounted for under IFRS 16.

b) Letter of credit

As at December 31, 2022, the Company had a standby letter of credit issued by a Canadian chartered bank in the amount of $0.4 million relating to a transportation arrangement. The standby letter of credit is supported by cash and is recorded in restricted cash in the Statement of Financial Position.

19. SUBSEQUENT EVENTS

a) Dividend

Subsequent to December 31, 2022, the Company declared a cash dividend of $0.10 per common share. The dividend will be payable on April 17, 2023, to shareholders of record at the close of business on March 31, 2023.

b) Financial derivative commodity contract and foreign exchange contracts

Subsequent to December 31, 2022, Headwater entered into the following commodity contract:

Commodity	Index	Type	Term	Daily Volume	Contract Price
Natural Gas	AECO 5A	Fixed	Apr 2023 - Oct 2023	1,000 GJ	Cdn$2.93/GJ

Subsequent to December 31, 2022, Headwater entered into the following foreign exchange contracts:

Type	Buy Currency	Sell Currency	Rate	Notional Amount	Settlement Date
Forward contract	CAD	USD	WMR noon rate, January 2023 average	US$23,800,000	February 28, 2023
Forward contract	CAD	USD	WMR noon rate, February 2023 average	US$24,600,000	March 28, 2023
Forward contract	CAD	USD	WMR noon rate, March 2023 average	US$26,000,000	April 26, 2023