



May 11, 2023

HEADWATER EXPLORATION INC. ANNOUNCES FIRST QUARTER FINANCIAL RESULTS, OPERATIONS UPDATE AND DECLARES QUARTERLY DIVIDEND

CALGARY, ALBERTA – Headwater Exploration Inc. (the "**Company**" or "**Headwater**") (**TSX:HWX**) is pleased to announce its financial results for the three months ended March 31, 2023, operations update and quarterly dividend. Selected financial and operational information is outlined below and should be read in conjunction with the unaudited interim condensed financial statements and the related management's discussion and analysis ("**MD&A**"). These filings will be available at www.sedar.com and the Company's website at www.headwaterexp.com.

Financial and Operating Highlights

	Three months ended March 31,		Percent Change
	2023	2022	
Financial (thousands of dollars except share data)			
Total sales, net of blending ^{(1) (4)}	94,570	110,022	(14)
Adjusted funds flow from operations ⁽²⁾	59,157	70,023	(16)
Per share - basic	0.25	0.32	(22)
- diluted	0.25	0.30	(17)
Cash flows provided by operating activities	60,201	60,689	(1)
Per share - basic	0.26	0.27	(4)
- diluted	0.25	0.26	(4)
Net income	29,979	42,363	(29)
Per share - basic	0.13	0.19	(32)
- diluted	0.13	0.18	(28)
Capital expenditures ⁽¹⁾	69,494	81,957	(15)
Adjusted working capital ⁽²⁾	70,467	80,072	(12)
Shareholders' equity	551,160	441,148	25
Dividends declared	23,539	-	100
Weighted average shares (thousands)			
Basic	234,069	221,209	6
Diluted	236,279	234,265	1
Shares outstanding, end of period (thousands)			
Basic	235,386	223,727	5
Diluted ⁽⁵⁾	241,368	241,688	-
Operating (6:1 boe conversion)			
Average daily production			
Heavy crude oil (bbls/d)	14,777	10,602	39
Natural gas (mmcf/d)	12.8	10.8	19
Natural gas liquids (bbls/d)	91	7	1200
Barrels of oil equivalent ⁽⁹⁾ (boe/d)	17,004	12,414	37
Average daily sales ⁽⁶⁾ (boe/d)	16,968	12,398	37
Netbacks (\$/boe) ^{(3) (7)}			
Operating			
Sales, net of blending ⁽⁴⁾	61.93	98.60	(37)
Royalties	(10.04)	(15.09)	(33)
Transportation	(5.50)	(4.90)	12
Production expenses	(6.53)	(5.77)	13
Operating netback ⁽³⁾	39.86	72.84	(45)
Realized gains (losses) on financial derivatives	4.74	(3.54)	(234)
Operating netback, including financial derivatives ⁽³⁾	44.60	69.30	(36)
General and administrative expense	(1.35)	(1.48)	(9)
Interest income and other expense ⁽⁸⁾	1.11	0.14	693
Current tax expense	(5.61)	(5.21)	8
Adjusted funds flow netback ⁽³⁾	38.75	62.75	(38)

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

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

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

- (4) Heavy oil sales are netted with blending expense to compare the realized price to benchmark pricing while transportation expense is shown separately. In the interim financial statements blending expense is recorded within blending and transportation expense.
- (5) In-the-money dilutive instruments as at March 31, 2023 which include 4.1 million stock options with a weighted average exercise price of \$3.09 and 1.9 million PSUs. The number of outstanding PSUs has been adjusted for dividends. RSUs have been excluded as the Company intends to cash settle these awards.
- (6) Includes sales of unblended heavy crude oil, natural gas and natural gas liquids. The Company's heavy crude oil sales volumes and production volumes differ due to changes in inventory.
- (7) Netbacks are calculated using average sales volumes. First quarter 2023 sales volumes comprised of 14,741 bbls/d of heavy oil, 12.8 mmcf/d of natural gas and 91 bbls/d of natural gas liquids. First quarter 2022 sales volumes comprised of 10,587 bbls/d of heavy oil, 10.8 mmcf/d of natural gas and 7 bbls/d of natural gas liquids.
- (8) Excludes unrealized foreign exchange gains/losses, accretion on decommissioning liabilities and interest on lease liability.
- (9) See "Barrels of Oil Equivalent."

FIRST QUARTER 2023 HIGHLIGHTS

- Declared second cash dividend of \$0.10 per common share and returned \$23.5 million to shareholders in April 2023.
- Production averaged 17,004 boe/d (consisting of 14,777 bbls/d of heavy oil, 12.8 mmcf/d of natural gas and 91 bbls/d of natural gas liquids) representing an increase of 37% from the first quarter of 2022.
- Realized adjusted funds flow from operations ⁽¹⁾ of \$59.2 million (\$0.25 per share basic).
- Achieved an operating netback inclusive of financial derivatives ⁽²⁾ of \$44.60/boe and an adjusted funds flow netback ⁽²⁾ of \$38.75/boe.
- Achieved net income of \$30.0 million (\$0.13 per share basic).
- Executed a \$69.5 million capital expenditure ⁽³⁾ program inclusive of 31.5 net sections of land in the West Nipisi area and drilled 24 crude oil wells including 9 exploration wells in Greater Peavine and West Nipisi.
- As at March 31, 2023, Headwater had adjusted working capital ⁽¹⁾ of \$70.5 million, working capital of \$77.4 million, and no outstanding bank debt.

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

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

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

OPERATIONS UPDATE

Marten Hills West

Headwater has continued to experience exceptional success in the Marten Hills West area. Over the last 18 months, production has grown from less than 100 bbls/d to current levels of approximately 5,000 bbls/d. A total of 17 wells have been drilled into the Marten Hills West pool this year. To date, eight of these wells are on production at an average 30-day initial production ("IP") rate of 250 bbls/d. The remaining nine wells are currently in various stages of load recovery.

Key highlights of the drilling program are as follows: The 02/06-13-075-02W5 well has achieved an IP50 of 295 bbls/d. This well has validated our geotechnical interpretation of a continued southern extension of this pool. The 00/01-03-76-02W5 well has achieved an IP15 of 170 bbls/d proving an eastern extension of our pool boundaries. A third step out well at 00/14-16-075-02W5 came off load recovery May 3rd and is currently producing 400 bbls/d, validating a further western extension of our pool boundaries. The culmination of these tests continues to validate the scope of the Marten Hills West Clearwater A pool which is now interpreted to have the potential to be larger than our Marten Hills Core pool.

Testing of enhanced oil recovery is progressing on the Marten Hills West Clearwater A pool. Our first pilot injector has been on injection for 50 days with encouraging results. Our second injection well at 16-22-75-02W5 is currently being produced as an oil well and will commence injection early in the third quarter of 2023.

Our excitement around the Marten Hills West area continues to grow. The Headwater team has identified three additional prospective Clearwater zones that are currently untested. We are in the process of licensing locations to test these zones and anticipate having results prior to year-end.

West Nipisi

Subsequent to our last update on March 9th, Headwater has continued expanding the pool boundaries on this new Clearwater discovery. A 3-leg multi-lateral well drilled at 01-05-078-09W5 has achieved an IP45 of 110 bbls/d and extended the play to the southern edge of Headwater's lands. Current production from this area has exceeded 750 bbls/d.

Headwater has identified multiple Clearwater prospects on the recently acquired 31.5 sections of land and are currently preparing to license two tests that are expected to be drilled later this year.

Greater Peavine

Our first two Peavine exploration wells were shut-in for the majority of April due to spring break-up but have recently returned to production. Consistent with our expectations for the area, the wells are each producing at 75-100 bbls/d.

Our first exploration well at Seal, 13-06-083-15W5, has achieved an IP50 of 70 bbls/d of 13-degree API oil with a low water cut, which has confirmed economic hydrocarbons in the area.

Headwater remains extremely encouraged about the multi-zone potential of this area and has plans to return and test two additional Clearwater sands in the fourth quarter. Given the large oil resource throughout the area, Headwater has plans to test fishbone multi-lateral wells as a method to enhance productivity and improve recovery factor throughout this area.

Marten Hills Core

The core area continues to produce consistently at approximately 11,000 boe/d. The enhanced oil recovery implemented to date has resulted in approximately 2,800 bbls/d of stabilized oil production. As our implementation of waterflood continues throughout 2023, it is expected that the stabilized production within the core area will continue to grow.

McCully

McCully contributed \$12.1 million in free cash flow ⁽¹⁾ through the first quarter of 2023. Headwater's structured hedging program for its McCully asset has protected the asset's cash flow against the highly volatile gas pricing experienced this winter. Consistent with prior years and to optimize adjusted funds flow, Headwater shut-in production May 1, 2023, to await next winter's premium pricing season ⁽²⁾.

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

⁽²⁾ McCully's winter season is estimated to be November 2022 to April 2023.

SECOND QUARTER DIVIDEND

The Board of Directors of Headwater has declared a quarterly cash dividend to shareholders of \$0.10 per common share payable on July 17, 2023, to shareholders of record at the close of business on June 30, 2023. This dividend is an eligible dividend for the purposes of the Income Tax Act (Canada).

OUTLOOK

Although we continue to see extreme volatility in commodity prices, Headwater's positive working capital provides us the optionality to continue to execute on our focused business plan of shareholder returns through strong production growth and our stable dividend stream. For 2023, we remain committed to our previously guided capital budget of \$200 million to achieve average annual production of 18,000 boe/d.

Our success across our Clearwater asset base increases the depth of Headwater's drilling inventory providing the pathway for continued success in the future.

Headwater focuses on total shareholder returns through a combination of growth and return of capital through a consistent and growing dividend stream. Based on current strip pricing and our projected growth rate, we anticipate having the optionality to increase our quarterly dividend in 2024 and beyond.

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

ALBERTA WILDFIRES UPDATE

To date, Headwater's operations have not been impacted by the Alberta wildfires. We continue to closely monitor the wildfires in the region and are ready to take immediate action as necessary to ensure the safety of our personnel.

Headwater would like to thank our staff, industry partners, emergency responders and firefighters who are protecting our communities.

FOR FURTHER INFORMATION PLEASE CONTACT:

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FORWARD LOOKING STATEMENTS: This press release contains forward-looking statements. The use of any of the words "guidance", "initial", "anticipate", "scheduled", "can", "will", "prior to", "estimate", "believe", "potential", "should", "unaudited", "forecast", "future", "continue", "may", "expect", "project", and similar expressions are intended to identify forward-looking statements. The forward-looking statements contained herein, include, without limitation, the expected timing of testing of enhanced oil recovery at Marten Hills West and expected timing of the second injection well at 16-22-075-02W5 to commence injection early in the third quarter; expected timing of results in the Marten Hills West area; the expectation to license two tests in the West Nipisi area to be drilled later this year; the expectation to return to Greater Peavine and test two additional Clearwater sands in the fourth quarter; the expectation to test fishbone multi-laterals as a method to enhance productivity and improve recovery throughout Greater Peavine; expected timing and results of waterflood in the Marten Hills core area and the expectation that as waterflood continues throughout 2023, stabilized production within the core area will continue to grow; the expectation of future pricing realized in McCully; the expectation that Headwater's positive working capital provides the Company with the

optionality to continue to execute on a focused business plan of shareholder returns through strong production growth and a stable dividend stream; the expectation that Headwater's 2023 capital spending will be \$200 million and will achieve average annual production of 18,000 boe/d; the expectation that continued success across the Company's Clearwater asset base will continue to increase the depth of Headwater's drilling inventory; and the expectation that the Company will have the optionality to increase its quarterly dividend in 2024 and beyond. The forward-looking statements contained herein are based on certain key expectations and assumptions made by the Company, including but not limited to expectations and assumptions concerning the success of optimization and efficiency improvement projects, the availability of capital, current legislation, receipt of required regulatory approvals, the success of future drilling, development and waterflooding activities, the performance of existing wells, the performance of new wells, Headwater's growth strategy, general economic conditions, availability of required equipment and services, prevailing equipment and services costs, prevailing commodity prices. Although the Company believes that the expectations and assumptions on which the forward-looking statements are based are reasonable, undue reliance should not be placed on the forward-looking statements because the Company can give no assurance that they will prove to be correct. Since forward-looking statements address future events and conditions, by their very nature they involve inherent risks and uncertainties. Actual results could differ materially from those currently anticipated due to a number of factors and risks. These include, but are not limited to, risks associated with the oil and gas industry in general (e.g., operational risks in development, exploration and production; disruptions to the Canadian and global economy resulting from major public health events, the Russian-Ukrainian war and the impact on the global economy and commodity prices; the impacts of inflation and supply chain issues and steps taken by central banks to curb inflation; COVID-19 pandemic, war, terrorist events, political upheavals and other similar events; events impacting the supply and demand for oil and gas including the COVID-19 pandemic and actions taken by the OPEC + group; delays or changes in plans with respect to exploration or development projects or capital expenditures; the uncertainty of reserve estimates; the uncertainty of estimates and projections relating to production, costs and expenses, and health, safety and environmental risks), commodity price and exchange rate fluctuations, changes in legislation affecting the oil and gas industry and uncertainties resulting from potential delays or changes in plans with respect to exploration or development projects or capital expenditures and risks associated with the Alberta wildfires including safety of personnel, asset integrity and potential disruption of operations which could affect the Company's results, business, financial conditions or liquidity. Refer to Headwater's most recent Annual Information Form dated March 9, 2023, on SEDAR at www.sedar.com, and the risk factors contained therein.

FUTURE ORIENTED FINANCIAL INFORMATION: Any financial outlook or future oriented financial information in this press release, as defined by applicable securities legislation, has been approved by management of the Company as of the date hereof. Readers are cautioned that any such future-oriented financial information contained herein should not be used for purposes other than those for which it is disclosed herein. The Company and its management believe that the prospective financial information as to the anticipated results of its proposed business activities for 2023 has been prepared on a reasonable basis, reflecting management's best estimates and judgments, and represent, to the best of management's knowledge and opinion, the Company's expected course of action. However, because this information is highly subjective, it should not be relied on as necessarily indicative of future results.

DIVIDEND POLICY: The amount of future cash dividends paid by the Company, if any, will be subject to the discretion of the Board and may vary depending on a variety of factors and conditions existing from time to time, including, among other things, adjusted funds flow from operations, fluctuations in commodity prices, production levels, capital expenditure requirements, acquisitions, debt service requirements and debt levels, operating costs, royalty burdens, foreign exchange rates and the satisfaction of the liquidity and solvency tests imposed by applicable corporate law for the declaration and payment of dividends. Depending on these and various other factors, many of which will be beyond the control of the Company, the Board will adjust the Company's dividend policy from time to time and, as a result, future cash dividends could be reduced or suspended entirely.

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

INITIAL PRODUCTION RATES: References in this press release to IP rates, other short-term production rates or initial performance measures relating to new wells are useful in confirming the presence of hydrocarbons; however, such rates are not determinative of the rates at which such wells will commence production and decline thereafter and are not indicative of long-term performance or of ultimate recovery. All IP rates presented herein represent the results from wells after all "load" fluids (used in well completion stimulation) have been recovered. While encouraging, readers are cautioned not to place reliance on such rates in calculating the aggregate production for the Company. Accordingly, the Company cautions that the test results should be considered to be preliminary.

NON-GAAP AND OTHER FINANCIAL MEASURES

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

funds flow from operations and adjusted working capital, which are considered capital management measures. The term cash flow in this press release is equivalent to adjusted funds flow from operations.

Non-GAAP Financial Measures

Free cash flow

Management utilizes free cash flow to assess the amount of funds available for future capital allocation decisions. It is calculated as adjusted funds flow from operations net of capital expenditures.

	Three months ended March 31,	
	2023	2022
	<i>(thousands of dollars)</i>	
Adjusted funds flow from operations	59,157	70,023
Capital expenditures	(69,494)	(81,957)
Free cash flow	(10,337)	(11,934)

Total sales, net of blending

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

	Three months ended March 31,	
	2023	2022
	<i>(thousands of dollars)</i>	
Total sales	104,209	119,262
Blending expense	(9,639)	(9,240)
Total sales, net of blending expense	94,570	110,022

Capital expenditures

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

	Three months ended March 31,	
	2023	2022
	<i>(thousands of dollars)</i>	
Cash flows used in investing activities	57,957	80,374
Restricted cash	-	(5,000)
Change in non-cash working capital	11,537	6,583
Capital expenditures	69,494	81,957

Capital Management Measures

Adjusted Funds Flow from Operations

Management considers adjusted funds flow from operations to be a key measure to assess the Company's management of capital. In addition to being a capital management measure, adjusted funds flow from operations is used by management to assess the performance of the Company's oil and gas properties. Adjusted funds flow from operations is an indicator of operating performance as it varies in response to production levels and management of production and transportation costs. Management believes that by eliminating changes in non-cash working capital and adjusting for current income taxes in the period, adjusted funds flow from operations is a useful measure of operating performance.

Three months ended March 31,

	2023	2022
	<i>(thousands of dollars)</i>	
Cash flows provided by operating activities	60,201	60,689
Changes in non-cash working capital	(8,414)	15,150
Current income taxes	(8,572)	(5,816)
Current income taxes paid	15,942	-
Adjusted funds flow from operations	<u>59,157</u>	<u>70,023</u>

Adjusted Working Capital

Adjusted working capital is a capital management measure which management uses to assess the Company's liquidity. Financial derivative receivable/liability have been excluded as these contracts are subject to a high degree of volatility prior to settlement and relate to future production periods. Financial derivative receivable/liability are included in adjusted funds flow from operations when the contracts are ultimately realized. Management has included the effects of the contribution receivable and repayable contribution to provide a better indication of Headwater's net financing obligations.

	March 31, 2023	December 31, 2022
	<i>(thousands of dollars)</i>	
Working capital	77,415	109,433
Contribution receivable (long-term)	1,104	1,104
Repayable contribution	(6,837)	(6,720)
Financial derivative receivable	(1,215)	(419)
Financial derivative liability	-	1,520
Adjusted working capital	<u>70,467</u>	<u>104,918</u>

Non-GAAP Ratios

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

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

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

Adjusted funds flow per share and net income per share

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

Per boe numbers

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