HEADWATER EXPLORATION INC.
Interim Condensed Statements of Financial Position
(unaudited)

(Cdn$ thousands)	March 31 2023 $	December 31 2022 $
ASSETS		
Current assets		
Cash and cash equivalents	154,845	175,447
Restricted cash	350	350
Accounts receivable (note 12)	37,217	43,141
Financial derivative receivable (note 12)	1,215	419
Inventories	535	1,243
Prepaids and deposits	1,261	993
Total current assets	195,423	221,593
Contribution receivable (note 6)	1,104	1,104
Exploration and evaluation assets (note 3)	39,352	42,872
Property, plant and equipment (note 4)	515,415	468,042
Right-of-use assets	614	796
Other assets	335	335
Total assets	752,243	734,742
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (note 12)	85,380	71,404
Stock-based compensation payable (note 8)	1,607	825
Financial derivative liability (note 12)	-	1,520
Current portion of lease liability	459	626
Current income tax liability	7,023	14,393
Dividend payable	23,539	23,392
Total current liabilities	118,008	112,160
Stock-based compensation payable (note 8)	365	-
Lease liability	215	235
Decommissioning liability (note 5)	35,094	32,343
Repayable contribution (note 6)	6,837	6,720
Deferred income tax liability	40,564	39,949
Total liabilities	201,083	191,407
Shareholders' Equity		
Capital stock (note 7)	481,518	479,157
Warrants (note 7)	-	2
Contributed surplus	16,338	17,312
Retained earnings	53,304	46,864
Total shareholders' equity	551,160	543,335
Total liabilities and shareholders' equity	752,243	734,742

Subsequent events (note 13)

See accompanying notes to the interim condensed financial statements

Approved on behalf of the Board of Directors:

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

(signed) "Neil Roszell"
Neil Roszell, Chairman

HEADWATER EXPLORATION INC.
Interim Condensed Statements of Income and Comprehensive Income
(unaudited)

	Three months ended March 31,	
	2023	2022
(Cdn$ thousands, except per share data)	$	$
REVENUE		
Sales (note 9)	104,209	119,262
Royalties	(15,332)	(16,838)
Revenue, net of royalties	88,877	102,424
Gains (losses) on financial derivatives (note 12)	9,243	(4,075)
	98,120	98,349
EXPENSES		
Blending and transportation	18,036	14,711
Production	9,979	6,436
General and administrative	2,063	1,650
Stock-based compensation	1,615	699
Depletion and depreciation	28,657	19,038
	60,350	42,534
Interest income and other expense (note 10)	1,396	(265)
Income before income taxes	39,166	55,550
Income taxes		
Current income tax expense	8,572	5,816
Deferred income tax expense	615	7,371
Net income and comprehensive income	**29,979**	**42,363**
Net income per share (note 7)		
Basic	0.13	0.19
Diluted	0.13	0.18

See accompanying notes to the interim condensed financial statements

HEADWATER EXPLORATION INC.
Interim Condensed Statements of Cash Flows
(unaudited)

Cash flow related to the following activities:	Three months ended March 31, 2023	2022
(Cdn$ thousands)	$	$
OPERATING		
Net income	29,979	42,363
Items not involving cash:		
Unrealized (gains) losses on financial derivatives (note 12)	(2,003)	130
Stock-based compensation	1,615	699
Depletion and depreciation	28,657	19,038
Income tax expense	9,187	13,187
Non-cash finance charges	294	422
Income taxes paid	(15,942)	-
Change in non-cash operating working capital (note 11)	8,414	(15,150)
Cash flows provided by operating activities	60,201	60,689
FINANCING		
Payment of lease liability	(197)	(232)
Proceeds from exercise of stock options & warrants (note 7)	743	17
Dividends paid	(23,392)	-
Cash flows used in financing activities	(22,846)	(215)
INVESTING		
Capital expenditures – property, plant and equipment (note 4)	(53,735)	(43,693)
Capital expenditures – exploration and evaluation (note 3)	(15,759)	(38,264)
Change in restricted cash	-	(5,000)
Change in non-cash investing working capital (note 11)	11,537	6,583
Cash flows used in investing activities	(57,957)	(80,374)
Change in cash and cash equivalents	(20,602)	(19,900)
Cash and cash equivalents, beginning of period	175,447	114,703
Cash and cash equivalents, end of period	154,845	94,803

See accompanying notes to the interim condensed financial statements

HEADWATER EXPLORATION INC.
Interim Condensed Statements of Changes in Shareholders' Equity
(unaudited)

(Cdn$ thousands)	Notes	Capital stock $	Warrants $	Contributed surplus $	Retained earnings/ (Deficit) $	Total Shareholders' equity $
Balance at January 1, 2022		**469,521**	**5,437**	**14,686**	**(91,853)**	**397,791**
Exercise of stock options	7	86	-	(69)	-	17
Exercise of warrants	7	2,400	(2,400)	-	-	-
Stock-based compensation		-	-	977	-	977
Net income		-	-	-	42,363	42,363
Balance at March 31, 2022		**472,007**	**3,037**	**15,594**	**(49,490)**	**441,148**
Balance at January 1, 2023		**479,157**	**2**	**17,312**	**46,864**	**543,335**
Exercise of stock options	7	2,354	-	(1,616)	-	738
Exercise of warrants	7	7	(2)	-	-	5
Stock-based compensation		-	-	1,205	-	1,205
Reclassification to stock-based compensation payable	8	-	-	(563)	-	(563)
Net income		-	-	-	29,979	29,979
Dividends declared		-	-	-	(23,539)	(23,539)
Balance at March 31, 2023		**481,518**	**-**	**16,338**	**53,304**	**551,160**

See accompanying notes to the interim condensed financial statements

HEADWATER EXPLORATION INC.
Notes to the Interim Condensed Financial Statements
(unaudited)

As at and for the three months ended March 31, 2023 and 2022

(All tabular amounts in thousands, unless otherwise stated)

1. NATURE OF OPERATIONS

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

These unaudited interim condensed financial statements have been prepared in accordance with IAS 34 – *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB"). The unaudited interim condensed financial statements do not include all information required for annual financial statements and should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2022. These unaudited interim condensed financial statements have been prepared following the same accounting policies as the Company's audited financial statements for the year ended December 31, 2022, except for the below.

During the three months ended March 31, 2023, the Company's Board of Directors ("the Board") approved the cash settlement of restricted share units ("RSUs"). Previously, these awards had been accounted for as equity-settled. This modification was accounted for following guidance in IFRS 2- *Share-based payment*. See note 8.

The timely preparation of these financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amount of assets, liabilities, income and expenses. Actual results may differ materially from these estimates. Significant judgments, estimates and assumptions made by management in these financial statements are outlined in the audited financial statements for the year ended December 31, 2022.

These unaudited interim condensed financial statements were approved and authorized for issue by the Board on May 11, 2023.

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

E&E assets consist of the Company's undeveloped land, geological and geophysical assets and exploratory drilling costs 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 periods:

	March 31, 2023	December 31, 2022
	$	$
Balance, beginning of period	42,872	28,993
Additions	15,759	79,665
Transfers to PP&E	(19,279)	(65,786)
Balance, end of period	39,352	42,872

The Company concluded there are no indicators of impairment for its E&E assets as at March 31, 2023.

4. PROPERTY, PLANT AND EQUIPMENT ("PP&E")

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

	Oil and gas properties	Corporate	Total
Cost	$	$	$
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	(4,428)	-	(4,428)
Changes in decommissioning liabilities	4,034	-	4,034
Balance at December 31, 2022	835,220	2,835	838,055
Additions (1)	54,075	6	54,081
Transfers from E&E	19,279	-	19,279
Changes in decommissioning liabilities	2,489	-	2,489
Balance at March 31, 2023	911,063	2,841	913,904
Accumulated depletion, depreciation and impairment			
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
Depletion or depreciation expense	28,457	19	28,476
Balance at March 31, 2023	396,174	2,315	398,489
Net book value at December 31, 2022	467,503	539	468,042
Net book value at March 31, 2023	514,889	526	515,415

(1) Includes capitalized general and administrative expenses of $0.8 million and capitalized stock-based compensation of $0.3 million.

The Company concluded there are no indicators of impairment for its CGUs as at March 31, 2023.

5. DECOMMISSIONING LIABILITY

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

	March 31, 2023	December 31, 2022
	$	$
Balance, beginning of period	32,343	27,600
Additions	3,674	14,267
Change in estimate (1)	(1,185)	(10,233)
Accretion	262	709
Balance, end of period	35,094	32,343

(1) Relates to changes in the inflation rate and risk-free rate. Of this amount, a $3.0 million downward revision is a result of a decrease in the inflation rate over the period from 2.1% at December 31, 2022 to 1.7% at March 31, 2023 and a $1.8 million upward revision is a result of a decrease in the risk-free rate over the period from 3.3% at December 31, 2022 to 3.0% at March 31, 2023.

The Company's decommissioning liabilities are based on the Company's net ownership in wells and related infrastructure.

The Company has estimated the net present value of its total decommissioning liabilities to be $35.1 million as at March 31, 2023 (December 31, 2022 - $32.3 million). The total future inflated and undiscounted amount of estimated cash flows required to settle these obligations is $72.7 million (December 31, 2022 - $73.3 million). Management estimates the settlement of these obligations will occur over the next 20 to 40 years. At March 31, 2023, a risk-free rate of 3.0% (December 31, 2022 – 3.3%) and an inflation rate of 1.7% (December 31, 2022 – 2.1%) were used to calculate the estimated fair value of the decommissioning liability.

6. 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.

The Company has recognized a repayable contribution of $8.8 million, undiscounted, and $6.8 million discounted as at March 31, 2023, 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%. 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.

	March 31, 2023	December 31, 2022
	$	$
Balance, beginning of period	6,720	-
Repayable contribution discounted at 7.3%	-	6,614
Interest	117	106
Balance, end of period	6,837	6,720

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

7. CAPITAL STOCK

a) Issued and outstanding

	March 31, 2023		December 31, 2022	
	Number of shares	Amount	Number of shares	Amount
		$		$
Balance, beginning of period	233,920	479,157	217,681	469,521
Exercise of stock options	1,460	2,354	2,706	3,280
Exercise of warrants	6	7	13,533	6,356
Balance, end of period	235,386	481,518	233,920	479,157

Stock Options

During the three months ended March 31, 2023, 1.6 million stock options were exercised for 1.1 million common shares on a cashless basis, and 0.4 million stock options were exercised for 0.4 million common shares for total proceeds of $0.7 million. Contributed surplus related to the options exercised of $1.6 million was transferred to capital stock.

Warrants

During the three months ended March 31, 2023, the remaining balance of the warrants to purchase common shares that were outstanding were exercised for common shares for total proceeds of $5 thousand. The associated fair value of the warrants of $2 thousand, along with the proceeds received, were transferred to capital stock.

b) 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 basic and diluted average common shares outstanding are stock options, RSUs, PSUs and accrued dividends on RSUs and PSUs.

	Three months ended March 31, 2023	Three months ended March 31, 2022
Weighted average shares outstanding		
Basic	234,069	221,209
Diluted	236,279	234,265

c) 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.

On March 9, 2023, Headwater declared a cash dividend of $0.10 per common share. The dividend was paid on April 17, 2023, to shareholders of record at the close of business on March 31, 2023.

8. STOCK-BASED COMPENSATION

a) Stock options

The following table summarizes the changes in the outstanding stock options for the periods:

	Three months ended March 31, 2023		Year ended December 31, 2022	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Options outstanding, beginning of period	6,086	$ 2.74	9,505	$ 2.36
Exercised (1)	(1,999)	$ 2.04	(3,419)	$ 1.70
Options outstanding, end of period	4,087	$ 3.09	6,086	$ 2.74
Options exercisable, end of period	2,050	$ 2.80	1,312	$ 2.93

(1) The Company's weighted average share price, at the date of exercise, for stock options exercised during the three months ended March 31, 2023 was $6.21 per common share (three months ended March 31, 2022 - $5.59 per common share).

There were no stock options granted in three months ended March 31, 2023, or in the year ended December 31, 2022.

The range of exercise prices of stock options outstanding and exercisable as at March 31, 2023 is as follows:

	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	1,213	1.00	$ 1.05	947	$ 1.06
$ 2.01 - $ 3.00	897	1.73	$ 2.49	173	$ 2.46
$ 3.01 - $ 5.23	1,977	2.04	$ 4.60	930	$ 4.65
Total	4,087	1.66	$ 3.09	2,050	$ 2.80

For the three months ended March 31, 2023, with respect to stock options, the Company recorded gross stock-based compensation expense of $0.5 million and capitalized stock-based compensation expense of $0.1 million.

b) Deferred share units ("DSUs")

The Company has a DSU plan (the "DSU Plan") which 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 DSU liability for the periods:

	March 31, 2023	December 31, 2022
	$	$
Balance, beginning of period	825	196
Increase in liability/fair value adjustment (1)	665	629
Balance, end of period	1,490	825
Current portion of stock-based compensation liability	1,490	825

(1) Includes dividend adjustment.

The DSU liability as at March 31, 2023 of $1.5 million is based on a fair value of $6.31 per DSU which is the Company's closing share price on March 31, 2023.

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

	March 31, 2023	December 31, 2022
Outstanding, beginning of period	141	38
Granted	90	103
Outstanding, end of period	231	141

c) Share awards

The Company has an awards plan (the "Awards Plan") which provides for grants of RSUs and performance share units ("PSUs") to officers, employees and consultants of the Company. 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.

RSUs (Cash Settled)

During the three months ended March 31, 2023, the Board approved the cash settlement of RSUs. Previously, these awards had been accounted for as equity-settled. As a result of this modification to the Company's outstanding RSUs from equity-settled to cash-settled, the fair value of the awards previously expensed was reclassified from contributed surplus to stock-based compensation liability. Subsequent to modification, the grant date fair value is used to record the cost of the RSUs and any subsequent remeasurement of the liability is also recognized in the Statement of Income and Comprehensive Income.

The following table summarizes the changes in the RSU liability for the period:

	March 31, 2023
	$
Balance, beginning of period	-
Reclassified from contributed surplus	563
Increase in liability/fair value adjustment (1)	91
Payout	(172)
Balance, end of period	482
Current portion of stock-based compensation liability	117
Long-term portion of stock-based compensation liability	365

(1) Includes dividend adjustment.

The RSU liability as at March 31, 2023 of $0.5 million is based on a fair value of $6.31 per RSU which is the Company's closing share price on March 31, 2023.

The following table summarizes the changes in the number of outstanding RSUs for the periods:

	March 31, 2023	December 31, 2022
Outstanding, beginning of period	179	-
Granted	196	183
Forfeited	(5)	(4)
Exercised	(47)	-
Outstanding, end of period	323	179

PSUs (Equity Settled)

It is the intention of the Company to equity settle PSUs. The Awards Plan allows a holder to receive common shares upon vesting. Headwater uses the fair value method for valuing PSUs. The fair value of PSUs 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 PSUs 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 the number of outstanding PSUs for the periods:

	March 31, 2023	December 31, 2022
Outstanding, beginning of period	838	-
Granted	1,017	838
Forfeited	(3)	-
Outstanding, end of period	1,852	838

For the three months ended March 31, 2023, with respect to RSUs and PSUs outstanding, the Company recorded gross stock-based compensation expense of $0.8 million and capitalized stock-based compensation expense of $0.2 million.

9. SALES

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

	Three months ended March 31,	
	2023	2022
	$	$
Heavy oil	96,422	103,373
Natural gas	6,437	15,252
Natural gas liquids	546	70
Gathering, processing and transportation	804	567
	104,209	119,262

Included in accounts receivable as at March 31, 2023 is $33.9 million (December 31, 2022 - $38.7 million) of accrued sales related to March 2023 production.

10. INTEREST INCOME AND OTHER EXPENSE

Interest income and other consist of the following:

	Three months ended March 31, 2023	2022
	$	$
Interest income	1,788	237
Realized and unrealized foreign exchange losses	(3)	(369)
Accretion on decommissioning liability	(262)	(115)
Interest on repayable contribution	(117)	-
Interest on lease liability	(10)	(18)
	1,396	(265)

11. SUPPLEMENTAL CASH FLOW INFORMATION

	Three months ended March 31, 2023	2022
	$	$
Change in non-cash operating working capital:		
Accounts receivable	5,707	(19,645)
Inventories	708	(2,167)
Prepaids and deposits	(268)	(169)
Accounts payable and accrued liabilities	2,439	6,831
Stock-based compensation payable	(172)	-
	8,414	(15,150)
Change in non-cash investing working capital:		
Accounts payable and accrued liabilities	11,537	6,583
	11,537	6,583
Cash income taxes paid	15,942	-
Cash interest paid	36	-

12. 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 in addition to market risks associated with commodity prices and foreign exchange rates.

a) The Company is exposed to the following risks:

i) 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 March 31, 2023:

Commodity	Index	Type	Term	Daily Volume	Contract Price
Natural Gas	AECO 5A	Fixed	April 2023 - Oct 2023	3,000 GJ	Cdn$3.53/GJ
Oil	WCS Basis (1)	Differential	Oct 2023 - Dec 2023	1,000 bbl	US$16.50/bbl

(1) WCS = Western Canadian Select.

The following table summarizes the Company's financial derivative gains (losses) on commodity contracts for the periods:

	Three months ended March 31, 2023	Three months ended March 31, 2022
	$	$
Gains (losses) on financial derivatives:		
- realized gains (losses)	7,240	(3,945)
- unrealized gains (losses)	2,003	(130)
Gains (losses) on financial derivatives	9,243	(4,075)

The following table summarizes the fair value as at March 31, 2023 and the change in fair value for the three months ended March 31, 2023:

	Commodity contracts	Foreign exchange contracts	Total
	$	$	$
Net financial derivative receivable/liability, beginning of period	(1,201)	100	(1,101)
Unrealized change in fair value (1)	2,003	313	2,316
Net financial derivative receivable, end of period	802	413	1,215

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

The fair value of the financial derivative asset related to the Company's commodity contracts of $0.8 million as at March 31, 2023 is based on estimated future natural gas and oil prices as of that date. The fair values of these financial derivative commodity contracts are sensitive to changes in the natural gas and oil reference prices. Holding other assumptions constant, if AECO 5A and WCS prices increased (decreased) by 10%, the fair value of the financial derivative asset would decrease (increase) by $0.3 million.

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 and natural gas marketing arrangements. At March 31, 2023, US$0.4 million (December 31, 2022 - US$0.2 million) of cash and US$22.8 million (December 31, 2022 - $25.4 million) of accounts receivable were denominated in U.S. dollars.

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 contracts as at March 31, 2023:

Type	Buy Currency	Sell Currency	Rate	Notional Amount	Settlement Date
Forward contract	CAD	USD	March 2023 average (1)	US$26.0 million	April 26, 2023

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

The fair value of the financial derivative asset related to the Company's foreign exchange contract of $0.4 million as at March 31, 2023 is based on the CAD/US exchange rate as of that date. The fair value of this financial derivative contract is sensitive to changes in the reference CAD/US foreign exchange rates. Holding other assumptions constant, if the CAD/US exchange rate increased (decreased) by 1%, the fair value of the financial derivative asset would decrease (increase) by $0.4 million.

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 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

At March 31, 2023, 100% of the Company's accounts receivables were outstanding for less than 30 days. Trade receivables generally have a 30-day term and have all been collected subsequent to March 31, 2023. As at March 31, 2023, the Company's receivables consisted of $33.9 million (December 31, 2022 - $38.7 million) from crude oil and natural gas marketers, $2.3 from commodity contract counterparties (December 31, 2022 - $3.5 million), $0.6 million (December 31, 2022 - $0.6 million) from its joint venture partner and $0.4 million (December 31, 2022 - $0.3 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 March 31, 2023, the Company was holding cash of $154.8 million.

Credit Facilities

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

As at March 31, 2023, Headwater had not drawn on the credit facilities.

The credit facilities have a revolving period of 364 days, extendible annually at the request of the Company, subject to approval of the Lenders. If not extended, the credit 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 facilities are 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 facilities bear 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 facilities are 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. On March 9, 2023, Headwater declared a cash dividend of $0.10 per common share. The dividend was paid on April 17, 2023, to shareholders of record at the close of business on March 31, 2023.

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.

	As at March 31, 2023	As at December 31, 2022
	$	$
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	70,467	104,918

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 adjusting for current income taxes in the period, 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.

	Three months ended March 31, 2023	2022
	$	$
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)
Income taxes paid	15,942	-
Adjusted funds flow from operations	59,157	70,023

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.

13. SUBSEQUENT EVENTS

a) Dividend

Subsequent to March 31, 2023, the Company declared a cash dividend of $0.10 per common share. The dividend will be payable on July 17, 2023, to shareholders of record at the close of business on June 30, 2023.

b) Financial derivative commodity contract and foreign exchange contracts

Subsequent to March 31, 2023, Headwater entered into the following commodity contract:

Commodity	Index	Type	Term	Daily Volume	Contract Price
Oil	WCS Basis	Differential	Oct 2023 - Dec 2023	1,000 bbl	US$16.25/bbl

Subsequent to March 31, 2023, Headwater entered into the following foreign exchange contracts:

Type	Buy Currency	Sell Currency	Rate	Notional Amount	Settlement Date
Forward contract	CAD	USD	April 2023 average	US$29.8 million	May 26, 2023
Forward contract	CAD	USD	May 2023 average	US$26.0 million	June 27, 2023