August 3, 2023

HEADWATER EXPLORATION INC. ANNOUNCES SECOND QUARTER OPERATING AND FINANCIAL RESULTS AND INCREASED 2023 CAPITAL GUIDANCE

CALGARY, ALBERTA – Headwater Exploration Inc. (the "**Company**" or "**Headwater**") **(TSX:HWX)** is pleased to announce its operating and financial results for the three and six months ended June 30, 2023. Selected financial and operational information is outlined below and should be read in conjunction with the unaudited condensed interim financial statements and the related management's discussion and analysis **("MD&A")**. These filings will be available at www.sedarplus.ca and the Company's website at www.headwaterexp.com.

Financial and Operating Highlights

	Three months ended June 30,		Percent Change	Six months ended June 30,		Percent Change
	2023	2022		2023	2022	
Financial ***(thousands of dollars except share data)***						
Sales, net of blending (1) (4)	112,560	122,102	(8)	207,130	232,124	(11)
Adjusted funds flow from operations (2)	66,235	79,435	(17)	125,392	149,458	(16)
Per share - basic	0.28	0.35	(20)	0.53	0.67	(21)
- diluted	0.28	0.34	(18)	0.53	0.65	(18)
Cash flow provided by operating activities	66,857	84,728	(21)	127,058	145,417	(13)
Per share - basic	0.28	0.37	(24)	0.54	0.65	(17)
- diluted	0.28	0.36	(22)	0.54	0.63	(14)
Net income	30,947	48,412	(36)	60,926	90,775	(33)
Per share - basic	0.13	0.21	(38)	0.26	0.41	(37)
- diluted	0.13	0.21	(38)	0.26	0.39	(33)
Capital expenditures (1)	64,094	30,860	108	133,588	112,817	18
Adjusted working capital (2)				48,968	130,206	(62)
Shareholders' equity				559,779	492,145	14
Dividends declared	23,586	-	100	47,125	-	100
Per share	0.10	-	100	0.20	-	100
Weighted average shares *(thousands)*						
Basic	235,631	226,168	4	234,854	223,702	5
Diluted	237,913	233,479	2	236,925	230,957	3
Shares outstanding, end of period *(thousands)*						
Basic				235,864	229,908	3
Diluted (5)				241,240	241,585	-
Operating ***(6:1 boe conversion)***						
Average daily production						
Heavy crude oil *(bbls/d)*	15,624	10,637	47	15,203	10,620	43
Natural gas *(mmcf/d)*	8.5	6.4	33	10.7	8.6	24
Natural gas liquids *(bbl/d)*	107	66	62	99	36	175
Barrels of oil equivalent (9) *(boe/d)*	17,152	11,772	46	17,078	12,091	41
Average daily sales (6) *(boe/d)*	17,154	11,705	47	17,061	12,050	42
Netbacks *($/boe)* (3) (7)						
Operating						
Sales, net of blending (4)	72.11	114.63	(37)	67.07	106.43	(37)
Royalties	(12.63)	(23.85)	(47)	(11.35)	(19.37)	(41)
Transportation	(5.48)	(4.07)	35	(5.49)	(4.49)	22
Production expenses	(7.33)	(5.66)	30	(6.93)	(5.72)	21
Operating netback (3)	46.67	81.05	(42)	43.30	76.85	(44)
Realized gains (losses) on financial derivatives	0.21	(0.24)	(188)	2.45	(1.93)	(227)
Operating netback, including financial derivatives (3)	46.88	80.81	(42)	45.75	74.92	(39)
General and administrative expense	(1.49)	(1.52)	(2)	(1.42)	(1.50)	(5)
Interest income and other (8)	0.96	0.44	118	1.03	0.29	255
Current tax expense	(3.91)	(5.16)	(24)	(4.75)	(5.19)	(8)
Adjusted funds flow netback (3)	42.44	74.57	(43)	40.61	68.52	(41)

(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 June 30, 2023 includes 3.4 million stock options with a weighted average exercise price of $3.37 and 1.9 million PSUs.
(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. For the three months ended June 30, 2023, sales volumes comprised of 15,625 bbs/d of heavy oil, 8.5 mmcf/d of natural gas and 107 bbls/d of natural gas liquids (2022- 10,571 bbls/d, 6.4 mmcf/d and 66 bbls/d). For the six months ended June 30, 2023, sales volumes comprised of 15,186 bbls/d of heavy oil, 10.7 mmcf/d of natural gas and 99 bbls/d of natural gas liquids (2022- 10,579 bbls/d, 8.6 mmcf/d and 36 bbls/d).
(8) Excludes unrealized foreign exchange gains/losses, accretion on decommissioning liabilities, interest on lease liability and interest on repayable contribution.
(9) See '"Barrels of Oil Equivalent."

SECOND QUARTER 2023 HIGHLIGHTS

- Returned $23.5 million to shareholders. Since announcing the Company's inaugural dividend in November 2022, Headwater has returned a total of $70.5 million to shareholders.

- Achieved record production averaging 17,152 boe/d (consisting of 15,624 bbls/d of heavy oil, 8.5 mmcf/d of natural gas and 107 bbls/d of natural gas liquids) representing an increase of 46% from the second quarter of 2022.

- Realized adjusted funds flow from operations (1) of $66.2 million ($0.28 per share basic).

- Achieved an operating netback inclusive of financial derivatives (2) of $46.88/boe and an adjusted funds flow netback (2) of $42.44/boe.

- Achieved net income of $30.9 million ($0.13 per share basic).

- Executed a $64.1 million capital expenditure (3) program inclusive of $8.5 million of land expenditures adding a total of 90 sections of undeveloped acreage, while also focusing on development in Marten Hills West, drilling a total of 24 crude oil wells in the area at a 100% success rate.

- As at June 30, 2023, Headwater had adjusted working capital (1) of $49.0 million, working capital of $54.8 million, and no outstanding bank debt. Balance sheet strength has allowed the Board of Directors to confidently increase the 2023 capital expenditure guidance to $225.0 million to pursue additional strategic land and exploration prospects.

(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 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.

OPERATIONS UPDATE

Marten Hills West

Marten Hills West continues to be a compelling growth area for Headwater. July production averaged over 7,000 bbls/d, representing greater than 50% growth from production levels achieved in April 2023. From January through to the end of June 2023, 25 wells have been brought on production in the area achieving an average 30-day initial production ("IP30") rate of 215 bbls/d.

Key highlights of the drilling program since the end of the first quarter include the 02/13-16-075-02W5 well, achieving an IP30 rate of 208 bbls/d. This well has continued the southwest extension of our previously defined pool boundaries. In addition, the 04/03-13-75-02W5 well achieved an IP30 rate of 177 bbls/d continuing the southeast extension of the Marten Hills West pool.

Headwater resumed Central Marten Hills development with the drilling of the 00/08-11-075-26W4 well. The well came off load recovery on July 10th and has achieved a 20-day initial production rate of 280 bbls/d. This well has exceeded our expectations for this area and we now have increased confidence of a southern extension of this play on our 100% owned lands.

Implementation of enhanced oil recovery pilot projects has continued in Marten Hills West. Our first pilot has been on injection for 120 days, while our second pilot has been on injection for 50 days. The supported producing wells, in both cases, are exhibiting the expected initial behavior with a moderation in gas-oil ratios ('GOR's).

Marten Hills Core

Although no new wells were placed on production in this area in the second quarter, the team has been active optimizing and expanding the waterflood. We continue to be encouraged by the waterflood response since the expansion of our water injection capability in January 2023. The enhanced oil recovery implemented to date has resulted in approximately 2,800 bbls/d of stabilized oil production. GOR's on the supported production continue to decline as we have witnessed a 30% decrease in GOR's since January. This leading indicator of declining GOR's, with no water breakthrough and stabilized oil production continue to validate the early success of the enhanced recovery scheme.

Exploration Update and Capital Guidance Increase

The Headwater team continues to pursue organic growth opportunities in and beyond the Clearwater play. Year to date we have added 63 net sections to our Clearwater land base with multiple potential new pools identified.

In addition to our Clearwater land expansion strategy, the team has also accumulated 121 net sections of land with multiple exploration opportunities throughout various oil prone areas in Western Canada. Our land accumulation strategy will continue through these areas and we intend to drill and test multiple prospects in 2024.

Considering our continued success, the Board of Directors has approved an expansion to our 2023 capital expenditure budget from $200 million to $225 million. The incremental capital will be allocated to approximately $15 million of land expenditures and an additional $10 million on currently identified drill ready Clearwater exploration prospects. The exploration drilling will occur in the fourth quarter of 2023 and is not anticipated to add any incremental production to our previously released 2023 guidance of 18,000 boe/d. The revised 2023 capital expenditure guidance will result in exit adjusted working capital of approximately $65.0 million.

EXECUTIVE APPOINTMENT

With the continued evolution of Headwater, the Board of Directors is pleased to announce the creation of a new ventures group.

Jon Grimwood, our current Vice President of Exploration, will now spearhead our recently created new ventures team. As Vice President of New Ventures, Jon will continue to be actively involved in all geotechnical aspects of Headwater with a significantly increased focus on new play development.

Dieter Deines will be appointed as our Vice President of Exploration effective September 1st, 2023. Dieter will assume a portion of Jon Grimwood's current duties, primarily focused on leading the geotechnical team in the continued development of our Clearwater assets. Mr. Deines extensive experience in the Western Canadian Sedimentary Basin will provide for a seamless integration into this role.

OUTLOOK

The positive working capital balance that has been maintained throughout our corporate history continues to allow Headwater to be opportunistic on expanding its prospects, while achieving top tier production per share growth combined with paying an approximate 5.4% dividend yield to our shareholders.

Our business continues to evolve in and beyond the Clearwater, providing a path of stable and increasing dividends, while continuing to add per share production and cash flow growth. Headwater remains committed to long term top quartile total shareholder returns through a combination of growth and return of capital.

Additional corporate information can be found in the Company's corporate presentation and on Headwater's website at [www.headwaterexp.com.](http://www.headwaterexp.com)

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FORWARD LOOKING STATEMENTS: This press release contains forward-looking statements. The use of any of the words "guidance", "initial, "anticipate", "scheduled", "can", "will", "prior to", "estimate", "believe", "potential", "should", "unaudited", "forecast", "future", "continue", "may", "expect", "project", and similar expressions are intended to identify forward-looking statements. The forward-looking statements contained herein, include, without limitation, the expected timing of testing of enhanced oil recovery in Marten Hills West and Marten Hill Core; Headwater's land accumulation strategy and the intention to drill and test multiple prospects in 2024; the revised 2023 capital budget guidance of $225 million and the breakdown thereof; the expectation that exploration drilling will occur in the fourth quarter of 2023 and is not anticipated to add any incremental production to the previously released 2023 guidance of 18,000 boe/d; the appointment of Dieter Deines as Headwater's Vice President of Exploration and the anticipated timing thereof; the expectation the Company will achieve top tier production per share growth combined with paying an approximate 5.4% dividend yield to shareholders and the expectation that the Company will achieve a continuous path of stable and increasing dividends, while continuing to add per share production and cash flow growth. 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.sedarplus.ca, 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. Headwater's 2023 adjusted funds flow from operations is forecasted to be approximately $280.0 million with dividends of $94.0 million. The assumptions used in the 2023 guidance include: annual average production of 18,000 boe/d, WTI of US$75.21/bbl, WCS of Cdn$77.67/bbl, AGT US$7.61/mmbtu, foreign exchange rate of US$/Cdn$ of 0.74, blending expense of WCS less $2.00, royalty rate of 17%, operating and transportation costs of $11.50/boe, financial derivatives gains of $1.00/boe, G&A and interest income and other expense of $1.05/boe and cash taxes of $6.00/boe. The AGT price is the average price for the winter producing months in the McCully field which include January to April and November to December. 2023 annual production guidance comprised of: 16,390 bbls/d of heavy oil, 60 bbls/d of natural gas liquids and 9.3 mmcf/d of natural gas.

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 and capital expenditures) 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.

<u>Non-GAAP Financial Measures</u>

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 June 30,		Six months ended June 30,	
	2023	2022	2023	2022
	(thousands of dollars)		*(thousands of dollars)*	
Total sales	118,967	130,153	223,176	249,415
Blending expense	(6,407)	(8,051)	(16,046)	(17,291)
Total sales, net of blending expense	112,560	122,102	207,130	232,124

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 netted by the government grant.

	Three months ended June 30,		Six months ended June 30,	
	2023	2022	2023	2022
	(thousands of dollars)		*(thousands of dollars)*	
Cash flows used in investing activities	69,011	35,663	126,968	116,037
Restricted cash	-	-	-	(5,000)
Change in non-cash working capital	(4,917)	(2,212)	6,620	4,371
Government grant	-	(2,591)	-	(2,591)
Capital expenditures	64,094	30,860	133,588	112,817

<u>Capital Management Measures</u>

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 June 30,		Six months ended June 30,	
	2023	2022	2023	2022
	(thousands of dollars)		*(thousands of dollars)*	
Cash flows provided by operating activities	68,857	84,728	127,058	145,417
Changes in non–cash working capital	1,133	200	(7,281)	15,350
Current income taxes	(6,103)	(5,493)	(14,675)	(11,309)
Current income taxes paid	4,348	-	20,290	
Adjusted funds flow from operations	66,235	79,435	125,392	149,458

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.

	June 30, 2023	December 31, 2022
	(thousands of dollars)	
Working capital	54,765	109,433
Contribution receivable (long-term)	1,104	1,104
Repayable contribution	(6,958)	(6,720)
Financial derivative receivable	(54)	(419)
Financial derivative liability	111	1,520
Adjusted working capital	48,968	104,918

<u>Non-GAAP Ratios</u>

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 or 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.