

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

	June 30, 2024	December 31, 2023
<i>(Cdn\$ thousands)</i>	\$	\$
ASSETS		
Current assets		
Cash and cash equivalents	128,255	146,052
Restricted cash	350	350
Accounts receivable (note 12)	75,447	46,744
Contribution receivable (note 6)	-	1,771
Financial derivative receivable (note 12)	644	3,758
Inventories	820	788
Prepays and deposits	2,258	1,461
Total current assets	207,774	200,924
Financial derivative receivable (note 12)	42	-
Exploration and evaluation assets (note 3)	30,784	17,930
Property, plant and equipment (note 4)	662,656	616,375
Other assets	1,050	1,106
Total assets	902,306	836,335
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (note 12)	95,531	73,715
Stock-based compensation payable (note 8)	3,802	2,431
Financial derivative liability (note 12)	1,136	79
Current portion of lease liability	23	34
Current income tax liability	9,791	22,397
Dividends payable (note 7)	23,765	23,658
Repayable contribution (note 6)	1,322	-
Total current liabilities	135,370	122,314
Stock-based compensation payable (note 8)	430	498
Lease liability	806	808
Decommissioning liability (note 5)	45,300	40,951
Repayable contribution (note 6)	10,515	11,405
Deferred income tax liability	51,437	49,861
Total liabilities	243,858	225,837
Shareholders' Equity		
Capital stock (note 7)	486,520	483,013
Contributed surplus	19,420	18,970
Retained earnings	152,508	108,515
Total shareholders' equity	658,448	610,498
Total liabilities and shareholders' equity	902,306	836,335

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
Director

(signed) "Neil Roszell"
Neil Roszell
Executive Chairman

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

	Three months ended June 30,		Six months ended June 30,	
	2024	2023	2024	2023
<i>(Cdn\$ thousands, except per share data)</i>	\$	\$	\$	\$
REVENUE				
Sales (note 9)	164,281	118,967	298,315	223,176
Royalties	(29,653)	(19,717)	(51,497)	(35,049)
Revenue, net of royalties	134,628	99,250	246,818	188,127
Gains (losses) on financial derivatives (note 12)	941	(584)	1,214	8,659
	135,569	98,666	248,032	196,786
EXPENSES				
Blending and transportation	17,188	14,968	33,324	33,004
Production	13,010	11,435	25,469	21,414
General and administrative	2,703	2,327	5,304	4,390
Stock-based compensation	2,054	1,225	4,777	2,840
Depletion and depreciation	30,958	29,341	61,486	57,998
	65,913	59,296	130,360	119,646
Interest income and other expense (note 10)	850	958	2,016	2,354
Income before income taxes	70,506	40,328	119,688	79,494
Income taxes				
Current income tax expense	14,392	6,103	26,625	14,675
Deferred income tax expense	2,246	3,278	1,576	3,893
	16,638	9,381	28,201	18,568
Net income and comprehensive income	53,868	30,947	91,487	60,926
Net income per share (note 7)				
Basic	0.23	0.13	0.39	0.26
Diluted	0.22	0.13	0.38	0.26

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: <i>(Cdn\$ thousands)</i>	Three months ended June 30,		Six months ended June 30,	
	2024	2023	2024	2023
	\$	\$	\$	\$
OPERATING				
Net income	53,868	30,947	91,487	60,926
Items not involving cash:				
Unrealized (gains) losses on financial derivatives (note 12)	(1,730)	913	4,111	(1,090)
Stock-based compensation	2,054	1,225	4,777	2,840
Depletion and depreciation	30,958	29,341	61,486	57,998
Income tax expense	16,638	9,381	28,201	18,568
Non-cash finance charges	627	531	1,127	825
Settlement of decommissioning liability (note 5)	-	-	(95)	-
Income taxes paid	(10,227)	(4,348)	(39,231)	(20,290)
Change in non-cash operating working capital (note 11)	(1,786)	(1,133)	(6,414)	7,281
Cash flows provided by operating activities	90,402	66,857	145,449	127,058
FINANCING				
Payment of lease liability	(21)	(197)	(43)	(394)
Proceeds from exercise of stock options & warrants (note 7)	516	-	551	743
Dividends paid (note 7)	(23,729)	(23,539)	(47,387)	(46,931)
Proceeds from repayable contribution (note 6)	708	-	1,417	-
Cash flows used in financing activities	(22,526)	(23,736)	(45,462)	(46,582)
INVESTING				
Capital expenditures – property, plant and equipment (note 4)	(43,596)	(55,535)	(89,771)	(109,270)
Capital expenditures – exploration and evaluation (note 3)	(7,121)	(8,559)	(26,213)	(24,318)
Government grant (note 6)	177	-	354	-
Change in non-cash investing working capital (note 11)	(15,664)	(4,917)	(2,154)	6,620
Cash flows used in investing activities	(66,204)	(69,011)	(117,784)	(126,968)
Change in cash and cash equivalents	1,672	(25,890)	(17,797)	(46,492)
Cash and cash equivalents, beginning of period	126,583	154,845	146,052	175,447
Cash and cash equivalents, end of period	128,255	128,955	128,255	128,955

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 \$	Total shareholders' equity \$
Balance at January 1, 2023		479,157	2	17,312	46,864	543,335
Exercise of stock options	7	2,804	-	(2,066)	-	738
Exercise of warrants	7	7	(2)	-	-	5
Stock-based compensation		-	-	2,463	-	2,463
Reclassification to stock-based compensation payable	8	-	-	(563)	-	(563)
Net income		-	-	-	60,926	60,926
Dividends declared	7	-	-	-	(47,125)	(47,125)
Balance at June 30, 2023		481,968	-	17,146	60,665	559,779
Balance at January 1, 2024		483,013	-	18,970	108,515	610,498
Exercise of stock options	7	3,507	-	(2,956)	-	551
Stock-based compensation		-	-	3,406	-	3,406
Net income		-	-	-	91,487	91,487
Dividends declared	7	-	-	-	(47,494)	(47,494)
Balance at June 30, 2024		486,520	-	19,420	152,508	658,448

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 and six months ended June 30, 2024, and 2023

(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, 2023. 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, 2023, except for the below.

The IASB issued amendments 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. These amendments to IAS 1 did not have a material impact on the Company’s financial statements.

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, 2023.

These unaudited interim condensed financial statements were approved and authorized for issue by the Company’s Board of Directors on July 25, 2024.

3. EXPLORATION AND EVALUATION (“E&E”) ASSETS

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

	June 30, 2024	December 31, 2023
	\$	\$
Balance, beginning of period	17,930	42,872
Additions	26,213	28,556
Dispositions ⁽¹⁾	-	(3,750)
Transfers to PP&E	(13,359)	(49,748)
Balance, end of period	30,784	17,930

(1) Relates to the sale of a gross overriding royalty. No gain or loss was recorded related to the sale.

The Company concluded there are no indicators of impairment for its E&E assets as at June 30, 2024.

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

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

Cost	Oil and gas properties		Corporate	Total
	\$	\$	\$	
Balance at December 31, 2022	835,220		2,835	838,055
Additions	213,179		38	213,217
Transfers from E&E	49,748		-	49,748
Government grant	(2,474)		-	(2,474)
Changes in decommissioning liability	7,425		-	7,425
Balance at December 31, 2023	1,103,098		2,873	1,105,971
Additions ⁽¹⁾	90,548		25	90,573
Transfers from E&E	13,359		-	13,359
Changes in decommissioning liabilities	3,779		-	3,779
Balance at June 30, 2024	1,210,784		2,898	1,213,682
Accumulated depletion, depreciation and impairment				
Balance at December 31, 2022	367,717		2,296	370,013
Depletion or depreciation expense	119,510		73	119,583
Balance at December 31, 2023	487,227		2,369	489,596
Depletion and depreciation expense	61,395		35	61,430
Balance at June 30, 2024	548,622		2,404	551,026
Net book value at December 31, 2023	615,871		504	616,375
Net book value at June 30, 2024	662,162		494	662,656

(1) Includes capitalized general and administrative expenses of \$2.1 million and capitalized stock-based compensation of \$0.8 million.

The Company concluded there are no indicators of impairment for its PP&E assets as at June 30, 2024.

5. DECOMMISSIONING LIABILITY

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

	June 30, 2024	December 31, 2023
	\$	\$
Balance, beginning of period	40,951	32,343
Additions	5,831	12,975
Settlements	(95)	-
Change in estimate ⁽¹⁾	(2,052)	(5,550)
Accretion	665	1,183
Balance, end of period	45,300	40,951
Key assumptions		
Risk free rate	3.4%	3.0%
Inflation rate	1.8%	1.6%

- (1) Relates to changes in the inflation rate and risk-free rate. Of this amount, a \$2.1 million upward revision is a result of an increase in the inflation rate over the period from 1.6% at December 31, 2023 to 1.8% at June 30, 2024 and a \$4.2 million downward revision is a result of an increase in the risk-free rate over the period from 3.0% at December 31, 2023 to 3.4% at June 30, 2024.

The Company has estimated the net present value of its total decommissioning liabilities to be \$45.3 million as at June 30, 2024 (December 31, 2023 - \$41.0 million). The total future inflated and undiscounted amount of estimated cash flows required to settle these obligations is \$116.8 million (December 31, 2023 - \$97.4 million). Management estimates the settlement of these obligations will occur over the next 25 to 40 years.

6. REPAYABLE CONTRIBUTION (NRCan ERF)

In 2022 and 2023, the Company received approval of a total of four claims pursuant to a repayable contribution agreement with the Department of Natural Resources Canada ("NRCan"), under the Emissions Reduction Fund ("ERF") Onshore Program. As at June 30, 2024, all funds were received by the Company (December 2023 - \$1.8 million related to the holdback amount).

The Company has recognized a repayable contribution of \$14.2 million, undiscounted, and \$11.8 million discounted as at June 30, 2024 (December 31, 2023 - \$14.2 million and \$11.4 million respectively), 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 7.7%. The undiscounted 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.

	June 30, 2024	December 31, 2023
	\$	\$
Balance, beginning of period	11,405	6,720
Repayable contribution	-	4,195
Interest	432	490
Balance, end of period	11,837	11,405
Current portion of repayable contribution	1,322	-
Long-term portion of repayable contribution	10,515	11,405

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

7. CAPITAL STOCK

a) Issued, authorized and outstanding

	June 30, 2024		December 31, 2023	
	Number of shares	Amount	Number of shares	Amount
		\$		\$
Balance, beginning of period	236,580	483,013	233,920	479,157
Exercise of stock options	1,074	3,507	2,654	3,849
Exercise of warrants	-	-	6	7
Balance, end of period	237,654	486,520	236,580	483,013

Stock Options

During the six months ended June 30, 2024, 1.9 million stock options were exercised for 0.9 million common shares on a cashless basis and 144 thousand stock options were exercised for 144 thousand common shares for total proceeds of \$0.6 million. Contributed surplus related to the options exercised of \$3.0 million was transferred to capital stock.

During the six months ended June 30, 2023, 2.2 million stock options were exercised for 1.5 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 \$2.1 million was 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, warrants, RSUs, PSUs and accrued dividends on RSUs and PSUs.

	Three months ended		Six months ended	
	June 30,		June 30,	
	2024	2023	2024	2023
Weighted average shares outstanding				
Basic	237,275	235,631	236,096	234,854
Diluted	239,452	237,913	238,026	236,925

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. In 2023, Headwater declared \$94.4 million related to its quarterly cash dividend.

During the six months ended June 30, 2024, the Company declared \$47.5 million (six months ended June 30, 2023 - \$47.1 million) related to its quarterly cash dividend. Included in current liabilities is the dividend payable of \$23.8 million for the dividend declared on May 9, 2024 and paid out on July 15, 2024.

8. STOCK-BASED COMPENSATION

a) Share awards

The Company has an awards plan (the “Awards Plan”) which provides for grants of restricted share units (“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. RSUs are cash settled and PSUs are equity settled.

RSUs (Cash Settled)

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

	June 30, 2024	December 31, 2023
Balance, beginning of period	1,188	-
Reclassified from contributed surplus	-	563
Increase in liability/fair value adjustment ⁽¹⁾	1,009	968
Payout	(869)	(343)
Balance, end of period	1,328	1,188
Current portion of stock-based compensation payable	898	690
Long-term portion of stock-based compensation payable	430	498

(1) Includes dividend adjustment.

The RSU liability as at June 30, 2024 of \$1.3 million is based on a fair value of \$7.25 per RSU which is the Company’s closing share price on June 30, 2024.

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

	June 30, 2024	December 31, 2023
Outstanding, beginning of period	377	179
Granted	205	274
Forfeited	(12)	(22)
Exercised	(113)	(54)
Outstanding, end of period	457	377

PSUs (Equity Settled)

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

	June 30, 2024	December 31, 2023
Outstanding, beginning of period	1,917	838
Granted	827	1,082
Forfeited	-	(3)
Outstanding, end of period	2,744	1,917

For the six months ended June 30, 2024, with respect to RSUs and PSUs outstanding, the Company recorded gross stock-based compensation expense of \$4.2 million, of which \$0.8 million was capitalized.

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:

	June 30, 2024	December 31, 2023
	\$	\$
Balance, beginning of period	1,741	825
Increase in liability/fair value adjustment ⁽¹⁾	1,163	916
Balance, end of period	2,904	1,741
Current portion of stock-based compensation payable	2,904	1,741

(1) Includes dividend adjustment.

The DSU liability as at June 30, 2024 of \$2.9 million is based on a fair value of \$7.25 per DSU which is the Company’s closing share price on June 30, 2024.

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

	June 30, 2024	December 31, 2023
Outstanding, beginning of period	264	141
Granted	112	123
Outstanding, end of period	376	264

c) 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 Company does not intend to grant any further options under the Option Plans.

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

	Six months ended June 30, 2024		Year ended December 31, 2023	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Options outstanding, beginning of period	2,508	\$ 3.88	6,086	\$ 2.74
Forfeited or expired	-	-	(8)	\$ 2.39
Exercised ⁽¹⁾	(2,040)	\$ 3.75	(3,570)	\$ 1.94
Options outstanding, end of period	468	\$ 4.42	2,508	\$ 3.88
Options exercisable, end of period	330	\$ 4.37	1,383	\$ 3.60

(1) The Company’s weighted average share price, at the date of exercise, for stock options exercised during the six months ended June 30, 2024 was \$7.35 per common share (six months ended June 30, 2023 - \$6.27 per common share).

There were no stock options granted in the six months ended June 30, 2024, or in the year ended December 31, 2023.

The range of exercise prices of stock options outstanding and exercisable as at June 30, 2024 is as follows:

Exercise prices	Outstanding options			Exercisable options	
	Number of options outstanding	Weighted average remaining term (years)	Weighted average exercise price	Number of options exercisable	Weighted average exercise price
\$ 2.39 - \$ 3.00	41	0.46	\$ 2.39	41	\$ 2.39
\$ 3.01 - \$ 5.23	427	0.87	\$ 4.62	289	\$ 4.66
Total	468	0.83	\$ 4.42	330	\$ 4.37

For the six months ended June 30, 2024, with respect to stock options outstanding, the Company recorded gross stock-based compensation expense of \$175 thousand, of which \$32 thousand was capitalized.

9. SALES

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

	Three months ended		Six months ended	
	June 30, 2024	2023	June 30, 2024	2023
	\$	\$	\$	\$
Heavy oil	162,505	116,085	289,951	212,507
Natural gas	1,020	1,947	6,287	8,384
Natural gas liquids	566	732	1,123	1,278
Gathering, processing and transportation	190	203	954	1,007
	164,281	118,967	298,315	223,176

Included in accounts receivable as at June 30, 2024 is \$55.9 million (December 31, 2023 - \$36.3 million) of accrued sales related to June 2024 production.

10. INTEREST INCOME AND OTHER EXPENSE

Interest income and other expense consists of the following:

	Three months ended		Six months ended	
	June 30, 2024	2023	June 30, 2024	2023
	\$	\$	\$	\$
Interest income	1,438	1,579	3,109	3,367
Realized and unrealized foreign exchange gains (losses)	1	(227)	34	(230)
Accretion on decommissioning liability	(356)	(265)	(665)	(527)
Interest on repayable contribution	(218)	(121)	(432)	(238)
Interest on lease liability	(15)	(8)	(30)	(18)
	850	958	2,016	2,354

(1) Included within non-cash finance charges in the statement of cash flows is unrealized foreign exchange gains (losses), accretion on decommissioning liability, interest on repayable contribution and interest on lease liability.

11. SUPPLEMENTAL CASH FLOW INFORMATION

	Three months ended		Six months ended	
	June 30, 2024	2023	June 30, 2024	2023
	\$	\$	\$	\$
Change in non-cash operating working capital:				
Accounts receivable	(5,688)	(639)	(13,045)	5,068
Inventories	177	(108)	(32)	600
Prepays and deposits	(365)	22	(797)	(246)
Accounts payable and accrued liabilities	4,339	(299)	8,329	2,140
Stock-based compensation payable	(249)	(109)	(869)	(281)
	(1,786)	(1,133)	(6,414)	7,281
Change in non-cash investing working capital:				
Accounts receivable	(4,002)	-	(15,641)	-
Accounts payable and accrued liabilities	(11,662)	(4,917)	13,487	6,620
	(15,664)	(4,917)	(2,154)	6,620
Cash income taxes paid	10,227	4,348	39,231	20,290
Cash standby fees paid	59	40	103	76
Cash interest received	1,498	1,813	3,211	3,473

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 and liquidity 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 June 30, 2024:

Commodity	Index	Type	Term	Daily Volume	Contract Price
Natural Gas	AECO 5A	Fixed	July 2024 - Oct 2024	2,000 GJ	Cdn\$2.12/GJ
Natural Gas	AECO 5A	Fixed	April 2025 - Oct 2025	2,000 GJ	Cdn\$2.78/GJ
Natural Gas	AGT ⁽¹⁾	Fixed	Dec 2024 - Mar 2025	2,500 mmbtu	Cdn\$10.65/mmbtu
Natural Gas	AGT	Fixed	Dec 2024 - Jan 2025	2,500 mmbtu	Cdn\$13.75/mmbtu
Crude Oil	WCS Basis ⁽²⁾	Differential	Jul 2024 – Sep 2024	3,000 bbl	US\$13.25/bbl

(1) AGT = Algonquin city-gates

(2) WCS = Western Canadian Select

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

	Three months ended		Six months ended	
	June 30, 2024	2023	June 30, 2024	2023
	\$	\$	\$	\$
Gains (losses) on financial derivatives:				
- realized gains (losses)	(789)	329	5,325	7,569
- unrealized gains (losses)	1,730	(913)	(4,111)	1,090
Gains (losses) on financial derivatives	941	(584)	1,214	8,659

The following table summarizes the fair value as at June 30, 2024 and the change in fair value for the six months ended June 30, 2024:

	Commodity contracts	Foreign exchange contracts	Total
	\$	\$	\$
Net financial derivative receivable/liability, beginning of period	3,662	17	3,679
Unrealized change in fair value ⁽¹⁾	(4,111)	(18)	(4,129)
Net financial derivative receivable/liability, end of period	(449)	(1)	(450)

(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 net financial derivative liability related to the Company's commodity contracts of \$0.5 million as at June 30, 2024 is based on estimated future natural gas and crude oil prices as of that date. The fair values of these financial derivative commodity contracts are sensitive to changes in the natural gas and crude oil reference prices. Holding other assumptions constant, if the AECO 5A and AGT price increased by 10% and the WCS differential to WTI decreased by 10%, the fair value of the net financial derivative liability would increase (decrease) by \$1.3 million.

ii) Foreign currency risk

As of April 1, 2024, all of Headwater's revenue contracts are settled in Canadian dollars. However, the Company is exposed to fluctuations in 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 WCS commodity contracts. Headwater may decide to mitigate a portion of this risk by periodically entering into foreign exchange contracts.

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 June 30, 2024, the expected credit loss on the Company's accounts receivable was \$nil. As at June 30, 2024, the Company's receivables consisted of \$55.9 million (December 31, 2023 - \$36.3 million) from crude oil and natural gas marketers, \$0.1 million from commodity contract counterparties (December 31, 2023 - \$4.8 million), \$19.2 million (December 31, 2023 - \$3.9 million) from joint venture partners and \$0.2 million (December 31, 2023 - \$1.7 million) related to accrued interest and other.

During the year ended December 31, 2023, Headwater entered into an agreement to construct a natural gas gathering system with an estimated capital cost of approximately \$22.5 million. Once commissioned, which is expected to occur late 2024, the Company is entitled to be reimbursed the capital costs. Included in the joint venture receivable balance at June 30, 2024, is a balance outstanding related to this agreement in the amount of \$19.2 million. As this amount is expected to be collected during the year ended December 31, 2024, it has been recorded as a current asset and included within accounts receivable in the Statement of Financial Position. Except for this joint venture receivable, trade receivables generally have a 30-day term.

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 entered into a \$100.0 million credit facility in the fourth quarter of 2022 and increased the associated borrowing base from \$100.0 million to \$200.0 million in the second quarter of 2024, to add further liquidity. As at June 30, 2024, the Company held cash of \$128.3 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. During the second quarter of 2024, the Company increased the total borrowing base to \$200.0 million from \$100.0 million. Pursuant to the increase in borrowing base, and so long as no event of default has occurred, the Company may request one or more increases in the commitment amount from the current commitment amount of \$100.0 million to a maximum total commitment amount of \$200.0 million. Each increase may not be less than \$1.0 million and the Lenders have no obligation to participate in any requested increase in commitment.

As at June 30, 2024, 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 May 31st and by November 30th of each year. The credit facilities are secured by a demand debenture in the amount of \$500 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. In 2023, Headwater declared \$94.4 million related to its quarterly cash dividend.

On May 9, 2024, Headwater declared a cash dividend of \$0.10 per common share. The dividend was paid on July 15, 2024, to shareholders of record at the close of business on June 28, 2024. In the first half of 2024, Headwater has declared \$47.5 million related to its quarterly cash dividend.

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 June 30, 2024	As at December 31, 2023
	\$	\$
Working capital	72,404	78,610
Repayable contribution	(10,515)	(11,405)
Financial derivative receivable	(644)	(3,758)
Financial derivative liability	1,136	79
Adjusted working capital	62,381	63,526

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		Six months ended	
	June 30,		June 30,	
	2024	2023	2024	2023
	\$	\$	\$	\$
Cash flows provided by operating activities	90,402	66,857	145,449	127,058
Changes in non-cash working capital	1,786	1,133	6,414	(7,281)
Current income taxes	(14,392)	(6,103)	(26,625)	(14,675)
Income taxes paid	10,227	4,348	39,231	20,290
Adjusted funds flow from operations	88,023	66,235	164,469	125,392

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 June 30, 2024, the Company declared a cash dividend of \$0.10 per common share. The dividend will be paid on October 15, 2024, to shareholders of record at the close of business on September 27, 2024.

b) Financial derivative contract

Subsequent to June 30, 2024, Headwater entered into the following commodity contract:

Commodity	Index	Type	Term	Daily Volume	Contract Price
Natural Gas	AECO 5A	Fixed	Nov 2024 - Mar 2025	2,000 GJ	Cdn\$2.55/GJ