Management’s Report

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

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

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

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

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

(signed) "Jason Jaskela"

Jason Jaskela
President and Chief Executive Officer

(signed) "Ali Horvath"

Ali Horvath, CPA, CA
Chief Financial Officer

March 13, 2025

KPMG LLP
205 5th Avenue SW
Suite 3100
Calgary AB T2P 4B9
Tel 403-691-8000
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www.kpmg.ca

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Headwater Exploration Inc.

Opinion

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

- the statements of financial position as at December 31, 2024 and December 31, 2023
- the statements of income and comprehensive income for the years then ended
- the statements of changes in shareholders' equity for the years then ended
- the statements of cash flows for the years then ended
- and notes to the financial statements, including a summary of material accounting policy information

(Hereinafter referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Entity as at December 31, 2024 and December 31, 2023, its financial performance and its cash flows for the years then ended in accordance with IFRS Accounting Standards as issued by the International Accounting Standards Board.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the ***"Auditor's Responsibilities for the Audit of the Financial Statements"*** section of our auditor's report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

KPMG

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements for the year ended December 31, 2024. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

We have determined the matters described below to be the key audit matters to be communicated in our auditor’s report.

Assessment of the impact of estimated proved and probable oil and gas reserves on depletion expense for the Alberta cash-generating unit (“CGU”)

Description of the matter

We draw attention to note 2, note 3 and note 6 to the financial statements. Depletion of oil and gas properties is calculated using the unit-of-production basis over the estimated proved and probable oil and gas reserves before royalties. Depletion is calculated at the CGU level and takes into account expenditures incurred to date together with forecasted future development costs to develop the proved plus probable oil and gas reserves. The Entity recorded depletion expense related to its oil and gas properties of $124.5 million for the year ended December 31, 2024, of which a portion relates to the Alberta CGU.

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

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

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

Why the matter is a key audit matter

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

How the matter was addressed in the audit

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

We assessed the depletion expense calculation for compliance with IFRS Accounting Standards as issued by the International Accounting Standards Board.

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

- We evaluated the competence, capabilities and objectivity of the independent third party reserve evaluator engaged by the Entity
- We compared the forecasted oil and natural gas commodity prices to those published by other independent third party reserve evaluators
- We compared the 2024 actual production, operating costs, royalty costs and development costs of the Entity to those estimates used in the prior year's estimate of proved oil and gas reserves to assess the Entity's ability to accurately forecast
- We evaluated the appropriateness of forecasted production and forecasted operating costs, royalty costs and future development cost assumptions by comparing to 2024 actual results. We took into account changes in conditions and events affecting the Entity to assess the adjustments or lack of adjustments made by the Entity in arriving at the assumptions.

Other Information

Management is responsible for the other information. Other information comprises the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indications that the other information appears to be materially misstated.

We obtained the information included in Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditor's report.

If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditor's report.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS Accounting Standards as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Auditor’s Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Entity to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

- Determine, from the matters communicated with those charged with governance, those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this auditor's report is Shane Doig.

KPMG LLP

Chartered Professional Accountants

Calgary, Canada
March 13, 2025

HEADWATER EXPLORATION INC.
Statements of Financial Position

(thousands)	December 31, 2024 $	December 31, 2023 $
ASSETS		
Current assets		
Cash and cash equivalents	142,694	146,052
Restricted cash (note 18)	350	350
Accounts receivable (note 16)	58,623	46,744
Contribution receivable (note 8)	-	1,771
Financial derivative receivable (note 16)	3,088	3,758
Inventories	1,193	788
Prepaids and deposits	1,701	1,461
Total current assets	207,649	200,924
Exploration and evaluation assets (note 5)	30,089	17,930
Property, plant and equipment (note 6)	712,020	616,375
Other assets	2,878	1,106
Total assets	952,636	836,335
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (note 16)	70,846	73,715
Stock-based compensation payable (note 10)	14,768	2,431
Financial derivative liability (note 16)	2,847	79
Current portion of lease liability	631	34
Current income tax liability (note 11)	14,673	22,397
Dividends payable (note 9)	23,776	23,658
Repayable contribution (note 8)	1,373	-
Total current liabilities	128,914	122,314
Lease liability	2,089	808
Financial derivative liability (note 16)	382	-
Stock-based compensation payable (note 10)	6,913	498
Decommissioning liability (note 7)	48,603	40,951
Repayable contribution (note 8)	10,916	11,405
Deferred income tax liability (note 11)	55,360	49,861
Total liabilities	253,177	225,837
Shareholders' Equity		
Capital stock (note 9)	486,984	483,013
Contributed surplus	10,969	18,970
Retained earnings	201,506	108,515
Total shareholders' equity	699,459	610,498
Total liabilities and shareholders' equity	952,636	836,335

Commitments (note 18)
Subsequent events (note 19)

See accompanying notes to the financial statements

Approved on behalf of the Board of Directors:

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

(signed) "Neil Roszell"
Neil Roszell, Executive Chairman

HEADWATER EXPLORATION INC.
Statements of Income and Comprehensive Income

	Year ended December 31, 2024	Year ended December 31, 2023
(thousands, except per share data)	$	$
REVENUE		
Sales (note 12)	619,804	511,234
Royalties	(108,307)	(85,686)
	511,497	425,548
Gains on financial derivatives (note 16)	1,179	18,929
	512,676	444,477
EXPENSES		
Blending and transportation	68,063	63,607
Production	54,551	47,227
General and administrative	10,992	9,675
Stock-based compensation (note 10)	12,004	5,240
Depletion and depreciation (note 6)	124,883	120,197
	270,493	245,946
Interest income and other expense (note 13)	3,306	4,443
Income before income taxes	245,489	202,974
Current income tax expense (note 11)	51,962	36,990
Deferred income tax expense (note 11)	5,499	9,912
	57,461	46,902
Net income and comprehensive income	**188,028**	**156,072**
Net income per share (note 9)		
Basic	0.80	0.66
Diluted	0.80	0.66

See accompanying notes to the financial statements

HEADWATER EXPLORATION INC.
Statements of Cash Flows

	Year ended December 31, 2024	2023
(thousands)	$	$
OPERATING		
Net income	188,028	156,072
Items not involving cash:		
Unrealized losses (gains) on financial derivatives (note 16)	3,803	(4,863)
Stock-based compensation	12,004	5,240
Depletion and depreciation	124,883	120,197
Non-cash finance charges	2,435	1,704
Income tax expense	57,461	46,902
Settlement of decommissioning liability (note 7)	(95)	-
Income taxes paid	(59,686)	(28,986)
Change in non-cash operating working capital (note 15)	(12,096)	7,050
Cash flows provided by operating activities	316,737	303,316
FINANCING		
Dividends paid (note 9)	(94,919)	(94,155)
Payment of lease liability	(292)	(657)
Proceeds from exercise of stock options & warrants (note 9)	551	1,013
Proceeds from repayable contribution (note 8)	1,417	4,802
Cash flows used in financing activities	(93,243)	(88,997)
INVESTING		
Capital expenditures – exploration and evaluation (note 5)	(44,524)	(28,556)
Proceeds from disposition – exploration and evaluation (note 5)	-	3,750
Capital expenditures – property, plant and equipment (note 6)	(178,342)	(211,514)
Government grant (note 8)	354	1,200
Change in non-cash investing working capital (note 15)	(4,340)	(8,594)
Cash flows used in investing activities	(226,852)	(243,714)
Change in cash and cash equivalents	(3,358)	(29,395)
Cash and cash equivalents, beginning of year	146,052	175,447
Cash and cash equivalents, end of year	142,694	146,052

See accompanying notes to the financial statements

HEADWATER EXPLORATION INC.
Statements of Changes in Shareholders' Equity

(thousands)	Notes	Capital stock $	Warrants $	Contributed surplus $	Retained earnings $	Total shareholders' equity $
Balance at January 1, 2023		**479,157**	**2**	**17,312**	**46,864**	**543,335**
Exercise of stock options	9	3,849	-	(2,841)	-	1,008
Exercise of warrants	9	7	(2)	-	-	5
Stock-based compensation	10	-	-	5,062	-	5,062
Reclassification to stock-based compensation payable	10	-	-	(563)	-	(563)
Net income		-	-	-	156,072	156,072
Dividends declared	9	-	-	-	(94,421)	(94,421)
Balance at December 31, 2023		**483,013**	**-**	**18,970**	**108,515**	**610,498**
Balance at January 1, 2024		**483,013**	**-**	**18,970**	**108,515**	**610,498**
Exercise of stock options	9	3,971	-	(3,420)	-	551
Stock-based compensation	10	-	-	7,284	-	7,284
Reclassification to stock-based compensation payable	10	-	-	(11,865)	-	(11,865)
Net income		-	-	-	188,028	188,028
Dividends declared	9	-	-	-	(95,037)	(95,037)
Balance at December 31, 2024		**486,984**	**-**	**10,969**	**201,506**	**699,459**

See accompanying notes to the financial statements

HEADWATER EXPLORATION INC.
Notes to the Financial Statements

As at and for the years ended December 31, 2024 and 2023

(All tabular amounts in thousands, unless otherwise stated)

1. NATURE OF OPERATIONS AND GENERAL INFORMATION

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

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

2. BASIS OF PREPARATION

Statement of compliance

These audited annual financial statements have been prepared in accordance with IFRS Accounting Standards as issued by the International Accounting Standards Board (“IFRS”). Except as disclosed in note 4, the accounting policies discussed in note 3 have been consistently applied for all periods presented in these financial statements.

These audited annual financial statements were approved and authorized for issue by the Company’s Board of Directors on March 13, 2025.

Basis of measurement, functional and presentation currency

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

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

Use of estimates and judgments

The preparation of the Company’s financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Such estimates and assumptions are evaluated at each reporting date and are based on management’s experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Estimates are more difficult to determine, and the range of potential outcomes can be wider, in periods of higher volatility and uncertainty. The impacts of various events such as the Russian invasion of Ukraine and the threat/imposition of United States tariffs on Canadian imported goods and their impact on energy markets and general market conditions, increased interest and inflation rates and supply chain uncertainties have created a higher level of volatility and uncertainty. Management has, to the extent reasonable, incorporated known facts and circumstances into the estimates made however, actual results could differ from those estimates and those differences could be material. The Company has identified the following areas requiring significant judgments, assumptions or estimates:

Tariffs

The government of the United States of America continues to threaten, and for a short period, implemented tariffs on goods that are sourced from Canada. The tariffs being contemplated by the U.S on Canadian energy exports are 10% whilst other goods would be subject to a tariff of 25%. The Canadian government is prepared with counter tariffs, and for a short period implemented counter tariffs of 25% on a wide array of goods that are imported from the U.S. The Company will continue to monitor the impact of this evolving situation.

Climate change

The following provides certain disclosures as to the impact of climate change on the amounts recorded in the financial statements as at and for the year ended December 31, 2024. The below is not a comprehensive list or analysis of all climate change impacts and risks.

Emissions, carbon and other regulations impacting climate and climate related matters are constantly evolving. With respect to climate reporting, the Canadian Sustainability Standards Board ("CSSB"), in December of 2024, finalized two climate-related reporting standards, Canadian Sustainability Disclosure Standard 1 ("CSDS S1") – General Requirements for Disclosure of Sustainability-Related Financial Information and Canadian Sustainability Disclosure Standard 2 ("CSDS S2") – Climate-Related Disclosures. The Canadian Securities Administrators have begun their own consultation process to determine how CSDS S1 and S2 will be translated into reporting requirements for reporting issuers and the timing for the implementation of such mandatory reporting requirements. The cost to comply with standards such as these, when they are approved by Canadian regulators, and others that may be developed or evolve over time, has not yet been quantified.

The Company has considered the impact of the evolving worldwide demand for energy and global advancement of alternative sources of energy that are not sourced from fossil fuels in its assessment as a possible indication of impairment of its oil and gas properties. The Company completed the analysis of triggers for impairment as at December 31, 2024 and climate risk/climate change, in of itself, did not result in the Company completing an impairment test. The Company has considered the impact of the evolving worldwide demand for energy and global advancement of alternative sources of energy that are not sourced from fossil fuels in its assessment of depletion on its oil and gas properties. Depletion of the Company's oil and gas properties was based on proved and probable reserves, the life of which is generally less than 30 years. The ultimate period in which global energy markets can transition from carbon-based sources to alternative energy is highly uncertain, however, the majority of the Company's proved and probable reserves per the 2024 reserve report should be realized prior to the elimination of carbon-based energy. At this time, the Company has not capped its reserve life for purposes of calculating depletion expense, however, this estimate will be monitored as the energy evolution continues.

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

The evolving energy transition and general public sentiment to the oil and gas industry may result in reduced access to capital markets. Management will continue to adjust the capital structure as necessary in response to changing industry conditions.

The Company maintains insurance coverage that provides a level of insurance for certain events that may arise due to climate change factors; however, the Company's insurance program is subject to limits and various restrictions. No claims were made under the Company's insurance policies in 2024 with respect to climate related matters.

a) Critical Judgments in Applying Accounting Policies

Determination of cash-generating units ("CGU") and impairment

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

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

Exploration and evaluation ("E&E") assets

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

b) Key Sources of Estimation Uncertainty

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

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

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

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

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

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

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

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

Decommissioning liabilities

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

Valuation of financial instruments

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

Valuation of performance share units ("PSUs")

The estimate of stock-based compensation in respect of the Company's PSUs is dependent on the performance multiplier estimated by management.

3. SUMMARY OF MATERIAL ACCOUNTING POLICIES

The following accounting policies have been applied consistently for all periods presented in these audited annual financial statements.

a) Joint interest

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

b) Financial instruments

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

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

i) Financial assets at amortized cost

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

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

ii) Financial liabilities at amortized cost

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

iii) Fair value through profit or loss

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

c) Exploration and evaluation assets

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

The Company assesses E&E assets for impairment at a CGU level. E&E assets are not depleted.

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

Oil and gas properties

PP&E primarily consists of crude oil and natural gas development and production assets and is measured at cost less accumulated depletion and depreciation and accumulated impairment losses and reversals. These costs include property acquisitions, development drilling, completion and equipping costs, infrastructure costs, estimated decommissioning liabilities, directly attributable overhead and administration costs and transfers from E&E.

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

Depletion and depreciation

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

e) Income taxes

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

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

f) Decommissioning liabilities

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

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

g) Revenue recognition

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

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

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

h) Transportation and blending

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

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

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

i) Impairment of non-financial assets

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

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

j) Stock-based compensation

Restricted share units ("RSUs") and PSUs are cash-settled. The fair value of the liability is determined based on the Company's closing share price on the financial reporting date. For PSUs, the amount of stock-based compensation payable and related expense is adjusted based on a performance multiplier ranging from 0 to 2 times, which is based on certain corporate performance measures, as determined by the Board of Directors. During the year ended December 31, 2024, the Board of Directors approved the change in form of settlement for the Company's PSUs from equity to cash. Refer to note 10 for more information.

The Company records stock-based compensation expense for stock options using the fair value method. The fair value is determined using the Black-Scholes option pricing model. This fair value is recognized as stock-based compensation expense over the vesting period with a corresponding increase to contributed surplus. When stock options are exercised, the consideration received and the amount previously recognized in contributed surplus are recorded as an increase to capital stock.

The Company capitalizes a portion of stock-based compensation for RSUs, PSUs and stock options that is directly attributable to development activities.

Deferred share units ("DSUs") are cash-settled. The fair value of the liability is determined based on the Company's closing share price on the financial reporting date.

k) Government grants

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

l) Net income per share

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

4. SUMMARY OF NEW ACCOUNTING POLICIES AND DISCLOSURES

New accounting policies

During the year ended December 31, 2024, the Company adopted the IASB 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.

Recently announced accounting pronouncements

IFRS 18 "Presentation and disclosure in financial statements" has been issued which will replace IAS 1 "Presentation of financial statements". The new standard establishes a revised structure for the statements of comprehensive profit with the intention to improve comparability across entities. IFRS 18 is effective for annual periods beginning on or after January 1, 2027 and will be applied retroactively. The Company is currently evaluating the impact of adopting IFRS 18 on the financial statements.

Amendments to IFRS 9 "Financial instruments and IFRS 7 Financial instruments: disclosures" have been issued with the intention to clarify the date of recognition and derecognition of some financial assets and liabilities. The amendments are effective January 1, 2026, with early adoption permitted. The Company is currently evaluating the impact of these amendments on the financial statements.

5. EXPLORATION AND EVALUATION ASSETS

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

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

	December 31, 2024	December 31, 2023
	$	$
Balance, beginning of year	17,930	42,872
Additions	44,524	28,556
Dispositions (1)	-	(3,750)
Transfers to PP&E (note 6)	(32,365)	(49,748)
Balance, end of year	30,089	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 December 31, 2024.

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

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

The following table reconciles the movements of the Company's PP&E balance for the years:

	Oil and gas properties	Corporate	Total
Cost	$	$	$
Balance at December 31, 2022	835,220	2,835	838,055
Additions	213,179	38	213,217
Transfers from E&E (note 5)	49,748	-	49,748
Government grant (note 8)	(2,474)	-	(2,474)
Changes in decommissioning liability (note 7)	7,425	-	7,425
Balance at December 31, 2023	1,103,098	2,873	1,105,971
Additions	181,531	34	181,565
Transfers from E&E (note 5)	32,365	-	32,365
Changes in decommissioning liability (note 7)	6,302	-	6,302
Balance at December 31, 2024	1,323,296	2,907	1,326,203

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 or depreciation expense	124,519	68	124,587
Balance at December 31, 2024	611,746	2,437	614,183
Net book value at December 31, 2023	615,871	504	616,375
Net book value at December 31, 2024	711,550	470	712,020

Future development costs required to develop proved plus probable reserves in the amount of $367.7 million were included in the depletion calculation for the Company's oil and gas properties for the year ended December 31, 2024 (December 31, 2023 – $288.1 million).

The Company capitalized $4.4 million of general and administrative costs for the year ended December 31, 2024 (December 31, 2023 – $3.8 million) and capitalized $3.2 million of stock-based compensation expense for the year ended December 31, 2024 (December 31, 2023 – $1.7 million).

Indicators of Impairment

The Company concluded there are no indicators of impairment for its PP&E assets as at December 31, 2024.

7. DECOMMISSIONING LIABILITY

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

	December 31, 2024	December 31, 2023
	$	$
Balance, beginning of year	40,951	32,343
Additions	10,725	12,975
Liability incurred	(95)	-
Change in estimate (1)	(4,423)	(5,550)
Accretion (note 13)	1,445	1,183
Balance, end of year	48,603	40,951
Key assumptions		
Risk free rate	3.3%	3.0%
Inflation rate	1.8%	1.6%

(1) Relates to changes in the risk-free rate, inflation rate, time to abandonment and cost estimates. Of this amount, a $3.0 million downward revision relates to changes in time to abandonment, a $3.4 million downward revision is a result of an increase in risk-free rate over the year from 3.0% at December 31, 2023 to 3.3% at December 31, 2024 and a $2.5 million upward revision is a result of an increase in inflation rate over the year from 1.6% at December 31, 2023 to 1.8% at December 31, 2024, with the remainder attributed to a downward change in cost estimates of $0.5 million.

The underlying cost estimates are derived from a combination of published industry benchmarks as well as site specific information. The Company has estimated the net present value of its total asset retirement obligations to be $48.6 million as at December 31, 2024 (December 31, 2023 - $41.0 million). The total future inflated and undiscounted amount of estimated cash flows required to settle these obligations is $134.2 million (December 31, 2023 - $97.4 million). Management estimates the settlement of these obligations will occur over the next 30 to 35 years.

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

8. REPAYABLE CONTRIBUTION (NRCan ERF)

In 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 December 31, 2024, all funds were received by the Company with respect to the four claims (December 2023 - $1.8 million related to the holdback amount).

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

Headwater accounts for the non-repayable portion and benefit of the interest-free period of the financial assistance as a government grant. Government grants are recognized when there is reasonable assurance that the grant will be received, and all conditions associated with the grant are met. As this grant relates to the Company's PP&E, the grant is recorded as a reduction to the asset's carrying amount and is depreciated over the useful life of the asset. For the year ended December 31, 2023, $2.5 million was recognized as an offset against PP&E.

The Company has recognized a repayable contribution of $14.2 million, undiscounted, and $12.3 million discounted as at December 31, 2024 (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%.

	December 31, 2024	December 31, 2023
	$	$
Balance, beginning of year	11,405	6,720
Repayable contribution	-	4,195
Interest (note 13)	884	490
Balance, end of year	12,289	11,405
Current portion of repayable contribution	1,373	-
Long-term portion of repayable contribution	10,916	11,405

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

9. CAPITAL STOCK

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

b) Issued and outstanding

	December 31, 2024		December 31, 2023	
	Number of shares	Amount	Number of shares	Amount
		$		$
Balance, beginning of year	236,580	483,013	233,920	479,157
Exercise of stock options	1,177	3,971	2,654	3,849
Exercise of warrants	-	-	6	7
Balance, end of year	237,757	486,984	236,580	483,013

Stock Options

During the year ended December 31, 2024, 2.2 million stock options were exercised for 1.0 million common shares on a cashless basis, and 144 thousand stock options were exercised for 144 thousand common shares for total proceeds of $551 thousand. Contributed surplus related to the options exercised of $3.4 million was transferred to capital stock.

During the year ended December 31, 2023, 3.0 million stock options were exercised for 2.1 million common shares on a cashless basis, and 0.6 million stock options were exercised for 0.6 million common shares for total proceeds of $1.0 million. Contributed surplus related to the options exercised of $2.8 million was transferred to capital stock.

c) Per share amounts

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

	December 31, 2024	December 31, 2023
Weighted average shares outstanding		
Basic	236,386	235,583
Effect of stock options	61	1,025
Effect of RSUs and PSUs (1)	-	1,097
Diluted	236,447	237,705

(1) For the year ended December 31, 2024, RSUs, PSUs and accrued dividends thereon have been excluded as they are antidilutive.

d) 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.

During the year ended December 31, 2024, the Company declared $95.0 million (year ended December 31, 2023 - $94.4 million) related to its quarterly cash dividend. Included in current liabilities is the dividend payable of $23.8 million for the dividend declared on November 7, 2024, and paid out on January 15, 2025.

The Company increased its quarterly cash dividend to $0.11 per common share ($0.44 per common share annualized) effective for the dividend to be paid on April 15, 2025 to shareholders of record at the close of business on March 31, 2025.

10. STOCK-BASED COMPENSATION

a) Stock-based compensation expense

The following table summarizes the breakdown of stock-based compensation expense for the years:

	December 31, 2024	December 31, 2023
	$	$
Stock options	201	1,280
Deferred share units	1,138	916
Share awards	13,888	4,748
Capitalized stock-based compensation	(3,223)	(1,704)
Total stock-based compensation expense	12,004	5,240

b) Share awards

The Company has an awards plan (the “Awards Plan”) which provides for grants of RSUs and 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.

PSUs (Cash-Settled)

On November 7, 2024, the Board of Directors approved the cash settlement of PSUs. Previously, these awards had been accounted for as equity-settled. As a result of this modification to the Company’s outstanding PSUs from equity-settled to cash-settled, the fair value of the awards previously expensed was reclassified from contributed surplus to stock-based compensation payable. Subsequent to modification, the grant date fair value is used to record the cost of the PSUs and any subsequent remeasurement of the liability is also recognized in the Statement of Income and Comprehensive Income. The amount of stock-based compensation payable and related expense is adjusted based on a performance multiplier ranging from 0 to 2 times.

The following table summarizes the changes in the PSU liability for the year:

	December 31, 2024
	$
Balance, beginning of year	-
Reclassified from contributed surplus	11,865
Increase in liability/fair value adjustment (1)	5,087
Balance, end of year	16,952
Current portion of stock-based compensation payable	10,652
Long-term portion of stock-based compensation payable	6,300

(1) Includes dividend and estimated performance multiplier adjustments.

The PSU liability as at December 31, 2024 of $17.0 million is based on a fair value of $6.61 per PSU which is the Company’s closing share price on December 31, 2024.

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

	December 31, 2024	December 31, 2023
Outstanding, beginning of year	1,917	838
Granted	1,199	1,082
Forfeited	-	(3)
Outstanding, end of year (1)	3,116	1,917

(1) An incremental 698 thousand PSUs are expected to be settled in cash, pursuant to an estimated performance multiplier, for PSUs vesting in the year ended December 31, 2025.

RSUs (Cash-Settled)

During the year ended December 31, 2023, the Board of Directors approved the cash settlement of RSUs.

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

	December 31, 2024	December 31, 2023
	$	$
Balance, beginning of year	1,188	-
Reclassified from contributed surplus	-	563
Increase in liability/fair value adjustment (1)	1,718	968
Payout	(1,056)	(343)
Balance, end of year	1,850	1,188
Current portion of stock-based compensation payable	1,237	690
Long-term portion of stock-based compensation payable	613	498

(1) Includes dividend adjustment.

The RSU liability as at December 31, 2024 of $1.9 million is based on a fair value of $6.61 per RSU which is the Company's closing share price on December 31, 2024.

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

	December 31, 2024	December 31, 2023
Outstanding, beginning of year	377	179
Granted	207	274
Forfeited	(14)	(22)
Exercised	(138)	(54)
Outstanding, end of year	432	377

c) Deferred share units

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 years:

	December 31, 2024	December 31, 2023
	$	$
DSUs, beginning of year	1,741	825
Increase in liability/fair value adjustment (1)	1,138	916
DSUs, end of year	2,879	1,741
Current portion of stock-based compensation payable	2,879	1,741

(1) Includes dividend adjustment.

The DSU liability as at December 31, 2024, of $2.9 million is based on a fair value of $6.61 per DSU, which is the Company's closing share price on December 31, 2024.

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

	December 31, 2024	December 31, 2023
Outstanding, beginning of year	264	141
Granted	136	123
Outstanding, end of year	400	264

d) Stock options

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

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

	December 31, 2024		December 31, 2023	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Options outstanding, beginning of year	2,508	$ 3.88	6,086	$ 2.74
Forfeited or expired	-	-	(8)	$ 2.39
Exercised [(1)]	(2,331)	$ 3.82	(3,570)	$ 1.94
Options outstanding, end of year	177	$ 4.56	2,508	$ 3.88
Options exercisable, end of year	177	$ 4.56	1,383	$ 3.60

(1) The Company’s weighted average share price, at the date of exercise, for stock options exercised during the year ended December 31, 2024, was $7.27 per common share (year ended December 31, 2023 - $6.51 per common share).

There were no options granted in 2024 or 2023.

The following table summarizes information regarding stock options outstanding as at December 31, 2024:

	Outstanding and exercisable options		
Exercise prices	Number of options outstanding	Weighted average remaining term (years)	Weighted average exercise price
$ 3.98 - $ 5.23	177	0.6	$ 4.56
Total	177	0.6	$ 4.56

11. INCOME TAXES

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

	December 31, 2024	December 31, 2023
	$	$
Net income before income taxes	245,489	202,974
Blended Canadian statutory tax rate	23.16%	23.16%
Expected income tax expense	56,855	47,009
Increase (decrease) resulting from:		
Non-deductible expenses	264	372
Change in tax rates	(10)	(186)
Other	352	(293)
Total income tax expense	57,461	46,902
Current income tax expense	51,962	36,990
Deferred income tax expense	5,499	9,912

The Canadian statutory tax rate per the rate reconciliation above represents the weighted average combined federal and provincial corporate tax rate. The federal corporate tax rate is 15.0% and the annual average provincial tax rate in Alberta, New Brunswick and Saskatchewan is 8.0%, 14.0% and 12%, respectively.

The deferred income tax liability is comprised of the following as at December 31, 2024 and December 31, 2023:

Deferred income tax liability	December 31, 2023	Movement through Statement of Income and Comprehensive Income	December 31, 2024
	$	$	$
Current assets	24	(4)	20
Lease liability	16	25	41
E&E/PP&E/decommissioning liability	(51,073)	(9,403)	(60,476)
Net financial derivative asset	(852)	885	33
Share issue costs/transaction costs	249	(249)	-
Tax asset related to share awards	1,775	3,247	5,022
	(49,861)	(5,499)	(55,360)

Deferred income tax liability	December 31, 2022	Movement through Statement of Income and Comprehensive Income	December 31, 2023
	$	$	$
Current assets	48	(24)	24
Lease liability	15	1	16
E&E/PP&E/decommissioning liability	(40,967)	(10,106)	(51,073)
Net financial derivative liability	257	(1,109)	(852)
Income tax credit	(397)	397	-
Share issue costs/transaction costs	501	(252)	249
Tax asset related to share awards	594	1,181	1,775
	(39,949)	(9,912)	(49,861)

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

12. SALES

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

	December 31, 2024	December 31, 2023
	$	$
Heavy oil	604,153	495,177
Natural gas	12,285	11,921
Natural gas liquids ("NGLs")	1,959	2,723
Gathering, processing and transportation	1,407	1,413
	619,804	511,234

Primarily all of the Company's heavy oil, natural gas and NGL revenues for the years ended December 31, 2024 and December 31, 2023 are derived from variable priced contracts based on index prices.

Included in accounts receivable as at December 31, 2024 was $56.1 million (December 31, 2023 - $36.3 million) of accrued heavy oil, natural gas and NGLs sales related to December 2024 production.

13. INTEREST INCOME AND OTHER EXPENSE

Interest income and other expense consists of the following:

	December 31, 2024	December 31, 2023
	$	$
Interest income	5,705	6,519
Foreign exchange gains (losses)	36	(354)
Accretion on decommissioning liability (note 7)	(1,445)	(1,183)
Interest on repayable contribution (note 8)	(884)	(490)
Interest on lease liability	(106)	(49)
	3,306	4,443

(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.

14. EXPENSES BY NATURE

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

	December 31, 2024	December 31, 2023
	$	$
Production	475	485
General and administrative	7,490	6,867
Stock-based compensation	12,004	5,240
	19,969	12,592

15. SUPPLEMENTAL CASH FLOW INFORMATION

	December 31, 2024	December 31, 2023
	$	$
Change in non-cash operating working capital:		
Accounts receivable	(14,146)	(3,499)
Inventories	(405)	455
Prepaids and deposits	(240)	(468)
Accounts payable and accrued liabilities	3,751	10,905
Settlement of stock-based compensation	(1,056)	(343)
	(12,096)	7,050
Change in non-cash investing working capital:		
Accounts receivable	2,280	-
Accounts payable and accrued liabilities	(6,620)	(8,594)
	(4,340)	(8,594)
Cash income taxes paid	59,686	28,986
Cash standby fees paid	280	169
Cash interest received	6,140	6,639

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

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

a) Risk management

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 December 31, 2024:

Commodity	Index	Type	Term	Daily Volume	Contract Price
Natural Gas	AGT (1)	Fixed	Jan 2025	2,500 mmbtu	Cdn$13.75/mmbtu
Natural Gas	AGT	Fixed	Jan 2025 - Mar 2025	5,000 mmbtu	Cdn$11.98/mmbtu
Natural Gas	AGT	Fixed	Apr 2025	2,500 mmbtu	Cdn$4.13/mmbtu
Natural Gas	AGT	Fixed	Dec 2025 - Mar 2026	2,500 mmbtu	Cdn$13.75/mmbtu
Natural Gas	AECO 5A	Fixed	Jan 2025 - Mar 2025	3,000 GJ	Cdn$2.49/GJ
Natural Gas	AECO 5A	Fixed	Jan 2025 - Dec 2025	2,000 GJ	Cdn$2.16/GJ
Natural Gas	AECO 5A	Fixed	Apr 2025 - Oct 2025	2,000 GJ	Cdn$2.78/GJ
Crude Oil	WCS Basis (2)	Differential	Jan 2025 – Dec 2025	3,000 bbl	US$13.28/bbl

(1) AGT = Algonquin city-gates
(2) WCS = Western Canadian Select

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

	December 31, 2024	December 31, 2023
	$	$
Financial derivatives gains:		
- realized gains	4,982	14,066
- unrealized (losses) gains	(3,803)	4,863
Financial derivatives gains	1,179	18,929

The following table summarizes the fair value of the Company's financial derivative contracts as at December 31, 2024 and the change in fair value for the year:

	Commodity contracts	Foreign exchange contracts	Total
	$	$	$
Net financial derivative liability, December 31, 2022	(1,201)	100	(1,101)
Unrealized change in fair value (1)	4,863	(83)	4,780
Net financial derivative asset, December 31, 2023	3,662	17	3,679
Unrealized change in fair value (1)	(3,803)	(17)	(3,820)
Net financial derivative liability, December 31, 2024	(141)	-	(141)

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

For the Company's commodity contracts, the fair value of the net financial derivative liability of $141 thousand as at December 31, 2024, is based on estimated future crude oil and natural gas prices as of that date. The fair values of these financial derivative commodity contracts are sensitive to changes in the crude oil and natural gas 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 financial derivative liability would increase (decrease) by $4.0 million.

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

ii) Foreign currency risk

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. As at December 31, 2024, Headwater did not have any foreign exchange contracts outstanding.

Fair Value Measurement

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

- Level 1 – Values are used based on unadjusted quoted prices available in active markets for identical assets and liabilities as of the reporting date.

- Level 2 – Values are based on inputs, including forward prices for commodities, time value and volatility factors, which can be substantially observed or corroborated in the marketplace. Prices in Level 2 are either directly or indirectly observable as of the reporting date.

- Level 3 – Values are based on prices or valuation techniques that are not based on observable market data.

The fair value of cash and cash equivalents, restricted cash, accounts receivable, contribution 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 carrying amount of the repayable contribution was discounted at an estimated market rate upon its initial recognition. The carrying value at December 31, 2024 and 2023 approximates the fair value.

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

iii) Credit risk

As at December 31, 2024, the carrying amount of cash and cash equivalents, restricted cash, accounts receivable, contribution receivable, financial derivative receivable and deposits represent the Company's maximum credit exposure. The Company's cash and cash equivalents are held on deposit with Canadian chartered banks. The Company's contribution receivable is outstanding from the Government of Canada and the Company's financial derivative receivable is outstanding from Canadian chartered banks.

Headwater's receivables from its crude oil and natural gas sales are subject to normal credit risk. During the year ended December 31, 2024, the Company sold its crude oil and natural gas production to various counterparties with no single counterparty accounting for greater than 35% of sales. Headwater mitigates the risk of loss by ensuring its counterparties are credit-worthy or investment grade as ranked by reputable credit agencies, or by periodically entering into parental guarantees. Headwater historically has not experienced any collection issues. Payment of crude oil and natural gas sales occurs on the 25th day following the month of sale. As a result, the Company's production revenues receivable are current.

Headwater's receivables from its joint venture partners are also subject to normal credit risk. Headwater's joint venture partners are highly credit-worthy or investment grade.

At December 31, 2024 and December 31, 2023, the average expected credit loss on the Company's accounts receivable was $nil. Trade receivables generally have a 30-day term and the majority have been collected subsequent to year-end. As at December 31, 2024, the Company's receivables consisted of $56.1 million (December 31, 2023 - $36.3 million) from crude oil and natural gas marketers, $0.1 million (December 31, 2023 - $4.8 million) from commodity contract counterparties, $1.9 million (December 31, 2023 - $3.9 million) from its joint venture partners and $0.5 million (December 31, 2023 - $1.7 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 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 December 31, 2024, the Company was holding cash of $142.7 million.

Credit Facilities

The Company has a senior secured revolving syndicated credit facility with the National Bank of Canada and the Bank of Montreal ("the Lenders"). The credit facility is comprised of extendible revolving credit facilities consisting of a $20.0 million operating facility and an $80.0 million syndicated facility. 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 December 31, 2024 and 2023, Headwater had not drawn on the credit facility.

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

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

b) Management of capital

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

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

During the year ended December 31, 2024, the Company declared $95.0 million (year ended December 31, 2023 - $94.4 million) related to its quarterly cash dividend. Included in current liabilities is the dividend payable of $23.8 million for the dividend declared on November 7, 2024, and paid out on January 15, 2025.

The Company increased its quarterly cash dividend to $0.11 per common share ($0.44 per common share annualized) effective for the dividend to be paid on April 15, 2025 to shareholders of record at the close of business on March 31, 2025.

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

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

i) Adjusted working capital

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

	December 31, 2024	December 31, 2023
	$	$
Working capital	78,735	78,610
Repayable contribution	(10,916)	(11,405)
Financial derivative receivable	(3,088)	(3,758)
Financial derivative liability	2,847	79
Adjusted working capital	67,578	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 deducting current income taxes, adjusted funds flow from operations provides a useful measure of Headwater's ability to generate the funds necessary to manage the capital needs of the Company.

	December 31, 2024	December 31, 2023
	$	$
Cash flows provided by operating activities	316,737	303,316
Changes in non-cash working capital	12,096	(7,050)
Current income taxes	(51,962)	(36,990)
Income taxes paid	59,686	28,986
Adjusted funds flow from operations	336,557	288,262

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

17. RELATED PARTY TRANSACTIONS

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

	December 31, 2024	December 31, 2023
	$	$
Wages and benefits	4,472	4,611
Directors' compensation	205	280
Stock-based compensation	11,586	4,976
	16,263	9,867

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

18. COMMITMENTS

As at December 31, 2024, the Company is committed to future payments under the following agreements:

	Total	2025	2026	2027	2028	2029	Thereafter
	$	$	$	$	$	$	$
Transportation and operating (1)	149,909	19,833	21,723	23,107	23,465	22,232	39,549
Lease (2)	2,138	452	460	468	476	282	-
Government grant (3)	14,168	1,417	4,675	8,076	-	-	-

(1) At December 31, 2024, Headwater has the following transportation commitments:

a. 6- year take-or-pay transportation agreement with a minimum volume commitment of 10,000 boe/d.
b. 6- year financial commitment at $1.9 million per year adjusted for inflation.
c. 6- year take-or-pay transportation agreement with a current minimum volume commitment of 9,750 boe/d, increasing to 12,500 boe/d in 2026.
d. 5- year take-or-pay processing and transportation agreement with a current minimum volume commitment of 191 m^3/d, increasing to 318 m^3/d in 2025 and increasing to 398 m^3/d for the remaining 3 years.
e. Long-term fixed take-or-pay contract with a daily minimum volume commitment of 5,000 mcf/d and a cumulative minimum volume commitment of 21.9 bcf.

(2) Relates to variable operating costs, which are a non-lease component of the Company's head office lease.

(3) Relates to scheduled undiscounted re-payments of federal government funding under the terms of the repayable contribution agreement with NRCan. See note 8.

(4) Excludes leases accounted for under IFRS 16.

(5) Subsequent to December 31, 2024, the Company entered into a 5.5- year take-or-pay transportation agreement with a minimum volume commitment of 4,000 boe/d.

a) Letter of credit

As at December 31, 2024, the Company had a standby letter of credit issued by a Canadian chartered bank in the amount of $0.4 million relating to a transportation arrangement. The standby letter of credit is supported by cash and is recorded in restricted cash in the Statement of Financial Position.

19. SUBSEQUENT EVENTS

a) Dividend

On March 13, 2025, the Company declared a cash dividend of $0.11 per common share. The dividend will be paid on April 15, 2025, to shareholders of record at the close of business on March 31, 2025.

b) Financial derivative contracts:

Subsequent to December 31, 2024, Headwater entered into the following commodity contracts:

Commodity	Index	Type	Term	Daily Volume	Contract Price
Natural Gas	AGT	Fixed	April 2025	2,500 mmbtu	Cdn$5.15/mmbtu
Natural Gas	AGT	Fixed	Dec 2025 – Jan 2026	2,500 mmbtu	Cdn$17.60/mmbtu
Natural Gas	AECO 5A	Fixed	Apr 2025 – Oct 2025	1,000 GJ	Cdn$1.96/GJ