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

(Cdn$ thousands)	June 30, 2026	December 31, 2025
	$	$
ASSETS		
Current assets		
Cash and cash equivalents	87,658	99,655
Restricted cash (note 12)	2,350	2,350
Accounts receivable (note 12)	66,529	53,003
Financial derivative receivable (note 12)	1,397	393
Inventories	1,080	1,078
Prepaids and deposits	3,668	1,562
Total current assets	162,682	158,041
Exploration and evaluation assets (note 3)	56,142	44,113
Property, plant and equipment (note 4)	877,027	790,753
Other assets	1,807	2,260
Total assets	1,097,658	995,167
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities (note 12)	94,702	65,695
Stock-based compensation payable (note 8)	19,892	28,711
Financial derivative liability (note 12)	216	1,225
Current portion of lease liability	999	959
Current income tax liability	670	790
Dividend payable (note 7)	28,532	26,154
Repayable contribution (note 6)	7,472	4,556
Total current liabilities	152,483	128,090
Lease liability	777	1,325
Stock-based compensation payable (note 8)	9,982	11,266
Decommissioning liability (note 5)	40,489	35,177
Repayable contribution (note 6)	-	7,202
Deferred income tax liability	79,475	63,952
Total liabilities	283,206	247,012
Shareholders' equity		
Capital stock (note 7)	487,378	487,378
Contributed surplus	10,792	10,792
Retained earnings	316,282	249,985
Total shareholders' equity	814,452	748,155
Total liabilities and shareholders' equity	1,097,658	995,167

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,	
	2026	2025	2026	2025
(Cdn$ thousands, except per share data)	$	$	$	$
REVENUE				
Sales (note 9)	237,928	144,944	414,649	315,099
Royalties	(49,509)	(25,847)	(76,350)	(54,512)
Revenue, net of royalties	188,419	119,097	338,299	260,587
Gains (losses) on financial derivatives (note 12)	2,120	1,360	(15,316)	(4,292)
	190,539	120,457	322,983	256,295
EXPENSES				
Blending and transportation	23,836	17,507	43,119	35,201
Production	18,527	14,986	36,177	30,692
General and administrative	3,386	2,904	6,559	5,753
Stock-based compensation (note 8)	1,926	3,089	18,950	5,453
Depletion and depreciation	29,720	32,636	58,665	65,151
Exploration and evaluation expense	1,814	-	1,814	-
	79,209	71,122	165,284	142,250
Interest income and other expense (note 10)	(105)	226	(113)	698
Income before income taxes	111,225	49,561	157,586	114,743
Income taxes				
Current income tax expense	13,541	9,683	21,080	20,453
Deferred income tax expense	12,268	1,855	15,523	6,263
	25,809	11,538	36,603	26,716
Net income and comprehensive income	**85,416**	**38,023**	**120,983**	**88,027**
Net income per share (note 7)				
Basic	0.36	0.16	0.51	0.37
Diluted	0.36	0.16	0.51	0.37

See accompanying notes to the interim condensed financial statements

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

Cash flow related to the following activities:	Three months ended June 30, 2026	Three months ended June 30, 2025	Six months ended June 30, 2026	Six months ended June 30, 2025
(Cdn$ thousands)	$	$	$	$
OPERATING				
Net income	85,416	38,023	120,983	88,027
Items not involving cash:				
Unrealized (gains) losses on financial derivatives (note 12)	(13,985)	(2,082)	(2,015)	404
Stock-based compensation	1,926	3,089	18,950	5,453
Depletion and depreciation	29,720	32,636	58,665	65,151
Exploration and evaluation expense (note 3)	1,814	-	1,814	-
Income tax expense	25,809	11,538	36,603	26,716
Non-cash finance charges	590	697	1,188	1,380
Restricted cash	-	(2,000)	-	(2,000)
Settlement of decommissioning liability (note 5)	-	-	-	(101)
Income taxes paid (note 11)	(10,055)	(9,106)	(21,200)	(35,412)
Change in non-cash operating working capital (note 11)	13,331	(4,122)	(40,353)	(11,010)
Cash flows provided by operating activities	134,566	68,673	174,635	138,608
FINANCING				
Payment of lease liability	(308)	(198)	(590)	(397)
Dividends paid (note 7)	(26,154)	(26,155)	(52,308)	(49,931)
Purchase of common shares for cancellation (note 7)	-	(270)	-	(270)
Repayment of repayable contribution (note 6)	(4,718)	(1,417)	(4,718)	(1,417)
Cash flows used in financing activities	(31,180)	(28,040)	(57,616)	(52,015)
INVESTING				
Capital expenditures – exploration and evaluation (note 3)	(6,477)	(2,675)	(13,843)	(11,063)
Capital expenditures – property, plant and equipment (note 4)	(75,075)	(48,029)	(134,449)	(102,488)
Change in non-cash investing working capital (note 11)	2,768	9,923	19,276	9,667
Cash flows used in investing activities	(78,784)	(40,781)	(129,016)	(103,884)
Change in cash and cash equivalents	24,602	(148)	(11,997)	(17,291)
Cash and cash equivalents, beginning of period	63,056	125,551	99,655	142,694
Cash and cash equivalents, end of period	87,658	125,403	87,658	125,403

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 $	Contributed surplus $	Retained earnings $	Total shareholders' equity $
Balance at January 1, 2025		**486,984**	**10,969**	**201,506**	**699,459**
Exercise of stock options	7	331	(331)	-	-
Stock-based compensation	8	-	154	-	154
Net income		-	-	88,027	88,027
Dividends declared	7	-	-	(52,310)	(52,310)
Purchase of common shares for cancellation	7	(275)	-	-	(275)
Balance at June 30, 2025		**487,040**	**10,792**	**237,223**	**735,055**
Balance at January 1, 2026		**487,378**	**10,792**	**249,985**	**748,155**
Net income		-	-	120,983	120,983
Dividends declared	7	-	-	(54,686)	(54,686)
Balance at June 30, 2026		**487,378**	**10,792**	**316,282**	**814,452**

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, 2026 and 2025

(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, 2025. 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, 2025, except for the below.

During the six months ended June 30, 2026, the Company adopted amendments to IFRS 9 "Financial Instruments" and IFRS 7 "Financial Instruments: Disclosures". These amendments clarify the date of recognition and derecognition of some financial assets and liabilities. These amendments 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, 2025.

These unaudited interim condensed financial statements were approved and authorized for issue by the Board of Directors on July 23, 2026.

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, 2026	December 31, 2025
	$	$
Balance, beginning of period	44,113	30,089
Additions	13,843	48,908
E&E expense	(1,814)	(8,256)
Transfers to PP&E (note 4)	-	(26,628)
Balance, end of period	56,142	44,113

During the six months ended June 30, 2026, the Company recognized $1.8 million of E&E expense related to its non-core Alberta assets. During the year ended December 31, 2025, the Company recognized $8.3 million of E&E expense related to its Saskatchewan assets.

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

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

	Oil and gas properties	Corporate	Total
Cost	$	$	$
Balance at December 31, 2024	1,323,296	2,907	1,326,203
Additions	193,058	36	193,094
Transfers from E&E	26,628	-	26,628
Changes in decommissioning liability	(14,781)	-	(14,781)
Balance at December 31, 2025	1,528,201	2,943	1,531,144
Additions (1)	139,851	16	139,867
Changes in decommissioning liability (note 5)	4,618	-	4,618
Balance at June 30, 2026	1,672,670	2,959	1,675,629
Accumulated depletion, depreciation and impairment			
Balance at December 31, 2024	611,746	2,437	614,183
Depletion or depreciation expense	126,147	61	126,208
Balance at December 31, 2025	737,893	2,498	740,391
Depletion or depreciation expense	58,182	29	58,211
Balance at June 30, 2026	796,075	2,527	798,602
Net book value at December 31, 2025	790,308	445	790,753
Net book value at June 30, 2026	876,595	432	877,027

(1) Includes capitalized general and administrative expenses of $2.5 million and capitalized stock-based compensation of $5.4 million.

The Company concluded there are no indicators of impairment for its PP&E assets as at June 30, 2026 and December 31, 2025.

5. DECOMMISSIONING LIABILITY

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

	June 30, 2026	December 31, 2025
	$	$
Balance, beginning of period	35,177	48,603
Additions	2,776	8,773
Settlements	-	(332)
Change in estimate (1)	1,842	(23,554)
Accretion (note 10)	694	1,687
Balance, end of period	40,489	35,177
Key assumptions		
Risk free rate	3.8%	3.9%
Inflation rate	2.1%	2.0%

(1) Relates to changes in the risk-free rate, inflation rate and cost estimates for the period ended June 30, 2026. For the year ended December 31, 2025, relates to changes in the risk-free rate, inflation rate, time to abandonment and cost estimates. Of this amount, a $12.9 million downward revision is the result of a change in cost estimates underpinned by a decrease to the industry's abandonment cost benchmarks, a $6.2 million downward revision relates to changes in time to abandonment, a $6.5 million downward revision is a result of an increase in risk-free rate over the year from 3.3% at December 31, 2024 to 3.9% at December 31, 2025 and a $2.0 million upward revision is a result of an increase in the inflation rate over the year from 1.8% at December 31, 2024 to 2.0% at December 31, 2025.

The Company has estimated the net present value of its total decommissioning liabilities to be $40.5 million as at June 30, 2026 (December 31, 2025 - $35.2 million). The total future inflated and undiscounted amount of estimated cash flows required to settle these obligations is $162.2 million (December 31, 2025 - $147.1 million). Management estimates the settlement of these obligations will occur over the next 30 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. All funds have been received by the Company with respect to the four claims.

The Company has recognized a repayable contribution of $8.0 million, undiscounted, and $7.5 million, discounted, as at June 30, 2026 (December 31, 2025 – $12.8 million and $11.8 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 repayable portion of the funds received are to be repaid as follows: 10% was repaid on June 30, 2025, 33% was repaid June 30, 2026, and 57% to be repaid on June 30, 2027.

	June 30, 2026	December 31, 2025
	$	$
Balance, beginning of period	11,758	12,289
Repayment	(4,718)	(1,417)
Interest (note 10)	432	886
Balance, end of period	7,472	11,758
Current portion of repayable contribution	7,472	4,556
Long-term portion of repayable contribution	-	7,202

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, 2026		December 31, 2025	
	Number of shares	Amount	Number of shares	Amount
		$		$
Balance, beginning of period	237,763	487,378	237,757	486,984
Exercise of stock options	-	-	53	331
Purchase of common shares for cancellation	-	-	(1,047)	(7,654)
Issued on land acquisition	-	-	1,000	7,740
Share issue costs, net of deferred tax	-	-	-	(23)
Balance, end of period	237,763	487,378	237,763	487,378

During the year ended December 31, 2025, 177 thousand stock options were exercised for 53 thousand common shares on a cashless basis. Contributed surplus related to the options exercised of $331 thousand was transferred to capital stock.

During the year ended December 31, 2025, Headwater issued 1.0 million common shares as consideration for certain E&E assets.

b) Normal Course Issuer Bid ("NCIB")

On May 11, 2026, Headwater announced TSX approval of its NCIB renewal to purchase for cancellation up to 22,287,602 common shares during the period commencing on May 13, 2026, and terminating on the earlier of: (i) the date on which the Company has acquired all common shares sought pursuant to the NCIB; or (ii) to May 12, 2027, unless earlier terminated at the option of the Company, upon prior notice being given to the TSX.

During the year ended December 31, 2025, Headwater utilized its NCIB which resulted in approximately 1.05 million common shares being purchased for cancellation at an average price of $7.30 per common share for total consideration of $7.7 million. Total consideration includes commissions and a 2% federal tax accrued on the purchase, which is charged against capital stock.

The Company did not utilize its NCIB during the six months ended June 30, 2026

c) Dividends

During the six months ended June 30, 2026, the Company declared $54.7 million (year ended December 31, 2025 – 104.7 million) related to its quarterly cash dividend. Included in current liabilities is the dividend payable of $28.5 million for the dividend declared on April 30, 2026, and paid on July 15, 2026.

The Company increased its quarterly cash dividend to $0.12 per common share, from $0.11 per common share, effective for the dividend paid on July 15, 2026, to shareholders of record at the close of business on June 30, 2026.

d) 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 restricted share units ("RSUs"), performance share units ("PSUs") and accrued dividends on RSUs and PSUs.

	Three months ended June 30,		Six months ended June 30,	
	2026	2025	2026	2025
Weighted average shares outstanding				
Basic	237,763	237,763	237,763	237,767
Diluted	240,052	239,471	239,897	239,469

8. STOCK-BASED COMPENSATION

a) Stock-based compensation expense

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

	Three months ended June 30,		Six months ended June 30,	
	2026	2025	2026	2025
	$	$	$	$
Deferred share units	(368)	336	2,171	1,126
Share awards	2,935	3,353	22,197	5,407
Capitalized stock-based compensation	(641)	(600)	(5,418)	(1,080)
Total stock-based compensation expense	1,926	3,089	18,950	5,453

b) Share awards

The Company has an 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. RSUs and PSUs are cash-settled. 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.

PSUs (Cash-Settled)

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

	June 30, 2026	December 31, 2025
	$	$
Balance, beginning of period	32,886	16,952
Increase in liability/fair value adjustment (1)	20,036	26,916
Payout (1) (2)	(31,101)	(10,982)
Balance, end of period	21,821	32,886
Current portion of stock-based compensation payable	12,355	22,445
Long-term portion of stock-based compensation payable	9,466	10,441

(1) Includes dividend adjustment.

(2) Includes an incremental 1.2 million units cash settled pursuant to a performance multiplier adjustment for the six months ended June 30, 2026.

The PSU liability as at June 30, 2026 of $21.8 million is based on a fair value of $11.83 per PSU, which is the Company's closing share price on June 30, 2026.

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

	June 30, 2026	December 31, 2025
Outstanding, beginning of period	3,729	3,116
Granted	747	1,441
Forfeited	-	(7)
Released upon vesting	(1,032)	(821)
Outstanding, end of period	3,444	3,729

RSUs (Cash-Settled)

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

	June 30, 2026	December 31, 2025
	$	$
Balance, beginning of period	2,743	1,850
Increase in liability/fair value adjustment (1)	2,161	2,352
Payout (1)	(2,797)	(1,459)
Balance, end of period	2,107	2,743
Current portion of stock-based compensation payable	1,591	1,918
Long-term portion of stock-based compensation payable	516	825

(1) Includes dividend adjustment.

The RSU liability as at June 30, 2026 of $2.1 million is based on a fair value of $11.83 per RSU, which is the Company's closing share price on June 30, 2026.

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

	June 30, 2026	December 31, 2025
Outstanding, beginning of period	443	432
Granted	133	253
Forfeited	(8)	(37)
Released upon vesting	(196)	(205)
Outstanding, end of period	372	443

c) Deferred share units ("DSUs")

The Company has a 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, 2026	December 31, 2025
	$	$
Balance, beginning of period	4,348	2,879
Increase in liability/fair value adjustment [1]	2,171	2,563
Payout [1]	(573)	(1,094)
Balance, end of period	5,946	4,348
Current portion of stock-based compensation payable	5,946	4,348

(1) Includes dividend adjustment.

The DSU liability as at June 30, 2026 of $5.9 million is based on a fair value of $11.83 per DSU, which is the Company's closing share price on June 30, 2026.

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

	June 30, 2026	December 31, 2025
Outstanding, beginning of period	409	400
Granted	82	161
Released	(46)	(152)
Outstanding, end of period	445	409

9. SALES

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

	Three months ended June 30,		Six months ended June 30,	
	2026	2025	2026	2025
	$	$	$	$
Heavy oil	234,629	141,282	394,552	294,966
Natural gas	1,599	2,183	16,890	16,806
Natural gas liquids	1,403	1,187	2,303	2,219
Gathering, processing and transportation	297	292	904	1,108
	237,928	144,944	414,649	315,099

Included in accounts receivable as at June 30, 2026 is $66.0 million (December 31, 2025 - $52.2 million) of accrued sales related to June 2026 production.

10. INTEREST INCOME AND OTHER EXPENSE

Interest income and other expense consists of the following:

	Three months ended June 30, 2026	2025	Six months ended June 30, 2026	2025
	$	$	$	$
Interest income	485	924	1,075	2,079
Realized and unrealized foreign exchange gains	18	6	18	5
Accretion on decommissioning liability (note 5)	(356)	(428)	(694)	(832)
Interest on repayable contribution (note 6)	(214)	(226)	(432)	(454)
Interest on lease liability	(38)	(50)	(80)	(100)
	(105)	226	(113)	698

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

11. SUPPLEMENTAL CASH FLOW INFORMATION

	Three months ended June 30, 2026	2025	Six months ended June 30, 2026	2025
	$	$	$	$
Change in non-cash operating working capital:				
Accounts receivable	9,872	785	(13,487)	5,934
Inventories	296	8	(2)	58
Prepaids and deposits	(1,903)	(1,485)	(2,106)	(1,505)
Accounts payable and accrued liabilities	5,840	(1,901)	9,713	(2,270)
Payout of stock-based compensation	(774)	(1,529)	(34,471)	(13,227)
	13,331	(4,122)	(40,353)	(11,010)
Change in non-cash investing working capital:				
Accounts receivable	(20)	4,800	(18)	571
Accounts payable and accrued liabilities	2,788	5,123	19,294	9,096
	2,768	9,923	19,276	9,667
Cash income taxes paid	10,055	9,106	21,200	35,412
Cash interest received	560	1,203	1,224	2,421

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, accounts payable and accrued liabilities, dividends payable and repayable contribution. The Company is exposed to financial risks arising from its financial assets and liabilities that include credit risk in addition to market risks associated with commodity prices and foreign exchange rates.

a) The Company is exposed to the following risks:

i) Commodity price risk

Headwater enters into financial derivative commodity contracts to manage the risks associated with fluctuations in commodity prices. All such transactions are conducted in accordance with the Company's established risk management policies. The Company does not use derivative financial instruments for speculative purposes.

The Company had the following outstanding financial derivative commodity contracts as at June 30, 2026:

Commodity	Index	Type	Term	Daily Volume	Contract Price
Natural Gas	AGT (1)	Fixed	Dec 2026 – Mar 2027	5,000 mmbtu	Cdn$17.88/mmbtu
Natural Gas	AECO 5A	Fixed	Jul 2026 - Oct 2026	4,000 GJ	Cdn$2.49/GJ
Natural Gas	AECO 5A	Fixed	Apr 2027 - Oct 2027	1,000 GJ	Cdn$2.00/GJ
Crude Oil	WCS Basis (2)	Differential	Jul 2026 – Dec 2026	2,000 bbl	US$13.00/bbl

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

The Company has recorded $2.0 million (December 31, 2025 - $2.0 million) of restricted cash in the Statement of Financial Position as collateral for certain financial derivatives with a counterparty.

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

	Three months ended June 30, 2026	Three months ended June 30, 2025	Six months ended June 30, 2026	Six months ended June 30, 2025
	$	$	$	$
Gains (losses) on financial derivatives:				
- realized losses	(11,865)	(722)	(17,331)	(3,888)
- unrealized gains (losses)	13,985	2,082	2,015	(404)
Gains (losses) on financial derivatives	2,120	1,360	(15,316)	(4,292)

The following table summarizes the fair value as at June 30, 2026 and the change in fair value for the six months ended June 30, 2026:

	Commodity contracts
	$
Net financial derivative liability, beginning of period	(832)
Unrealized change in fair value	2,015
Net financial derivative receivable, end of period	1,183

The fair value of the net financial derivative receivable related to the Company's commodity contracts of $1.2 million as at June 30, 2026 is based on estimated future natural gas and oil prices as of that date. The fair values of these financial derivative commodity contracts are sensitive to changes in the natural gas and oil reference prices. Holding other assumptions constant, if 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 asset would decrease by $2.0 million.

ii) Foreign currency risk

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 June 30, 2026, 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 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, 2026, the expected credit loss on the Company's accounts receivable was $nil. As at June 30, 2026, the Company's receivables consisted of $66.0 million (December 31, 2025 - $52.2 million) from crude oil and natural gas marketers, $0.3 million from commodity contract counterparties (December 31, 2025 - $nil) and $0.2 million (December 31, 2025 - $0.8 million) from joint venture partners. With the exception of amounts outstanding from the Company's joint venture partners, trade receivables generally have a 30-day term. The majority of receivables are expected to be collected by July 25, 2026.

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. As at June 30, 2026, the Company was holding cash of $87.7 million.

Credit Facilities

The Company has senior secured revolving syndicated credit facilities with the National Bank of Canada and the Bank of Montreal (together, the "Lenders"). The credit facilities are comprised of extendible revolving credit facilities consisting of a $20.0 million operating facility and an $80.0 million syndicated facility. Headwater also has an uncommitted accordion feature that provides the Company with the ability to access an incremental $100.0 million, subject to certain conditions including approval from the Lenders.

As at June 30, 2026, Headwater had not drawn on the credit facilities.

The credit facilities have a revolving period of two years, extendible annually at the request of the Company, subject to approval of the Lenders. The next scheduled borrowing base redetermination is to occur by May 31, 2027. The credit facilities are secured by a demand debenture in the amount of $500 million. Principal repayments are not required until the maturity date, provided that the borrowings under the credit facilities 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 distribution 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.

During the six months ended June 30, 2026, the Company declared $54.7 million related to its quarterly cash dividend (year ended December 31, 2025 – $104.7 million). The Company increased its quarterly cash dividend to $0.12 per common share, from $0.11 per common share, effective for the dividend paid on July 15, 2026 to shareholders of record at the close of business on June 30, 2026.

On May 11, 2026, Headwater announced that it received TSX approval for the renewal of its normal course issuer bid ("NCIB"). The renewed NCIB allows Headwater to purchase for cancellation up to 22,287,602 common shares during the one-year period commencing on May 13, 2026. During the three and six months ended June 30, 2026, Headwater did not purchase any common shares under its NCIB.

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 return of capital 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, 2026	As at December 31, 2025
	$	$
Working capital	10,199	29,951
Repayable contribution	-	(7,202)
Financial derivative receivable	(1,397)	(393)
Financial derivative liability	216	1,225
Adjusted working capital	9,018	23,581

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 structure and return of capital policy. Management believes that by excluding the impact of changes in non-cash working capital and restricted cash 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. In addition to being a capital management measure, adjusted funds flow from operations is used by management to assess the Company's financial performance.

	Three months ended June 30, 2026	2025	Six months ended June 30, 2026	2025
	$	$	$	$
Cash flows provided by operating activities	134,566	68,673	174,635	138,608
Changes in non-cash working capital	(13,331)	4,122	40,353	11,010
Current income taxes	(13,541)	(9,683)	(21,080)	(20,453)
Income taxes paid	10,055	9,106	21,200	35,412
Restricted cash	-	2,000	-	2,000
Adjusted funds flow from operations	117,749	74,218	215,108	166,577

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, 2026, the Company declared a cash dividend of $0.12 per common share. The dividend will be paid on October 15, 2026, to shareholders of record at the close of business on September 30, 2026.

b) Financial derivative commodity contract

Subsequent to June 30, 2026, Headwater entered into the following commodity contract:

Commodity	Index	Type	Term	Daily Volume	Contract Price
Natural Gas	AGT	Fixed	Dec 2026 – Jan 2027	1,000 mmbtu	Cdn$25.00/mmbtu