



**HIGHWOOD**

**ASSET MANAGEMENT LTD.**

(formerly Highwood Oil Company Ltd.)

**MANAGEMENT'S DISCUSSION & ANALYSIS  
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2021**

**August 27, 2021**

## Management's Discussion and Analysis

This management's discussion and analysis (MD&A) of operating and financial results of Highwood Asset Management Ltd. ("Highwood" or the "Company"), formerly Highwood Oil Company Ltd., is dated August 27, 2021 and is based on currently available information. It should be read in conjunction with the audited consolidated financial statements and accompanying notes for the years ended December 31, 2020 and 2019. Unless otherwise noted, all financial information is presented in Canadian dollars, and is in accordance with International Financial Reporting Standards (IFRS). Additional information can be found at [www.sedar.com](http://www.sedar.com) and [www.highwoodmgmt.com](http://www.highwoodmgmt.com).

Refer to the end of the MD&A for commonly used abbreviations.

Readers should read "Forward-Looking Statements" at the end of the MD&A, which explains the basis for and limitations of statements throughout this report that are not historical facts and may be considered "forward-looking statements" under securities regulations.

*All figures in tables are stated in thousands of Canadian dollars, except operational and per share amounts or as noted.*

### Description of Business

The Company is engaged in ownership and oversight of various operations including industrial metals and minerals (prospective Lithium, Iron, Rare Earth Elements, Vanadium, Silica, Alumina, etc), oil production & midstream energy operations. Future growth focuses will include clean energy transition subsectors with a focus on ESG.

## Q2 2021 Corporate Highlights and Outlook

- As first announced on March 25, 2021, on July 20, 2021, the Company changed its name from Highwood Oil Company Ltd. to Highwood Asset Management Ltd. to better reflect its renewed focus on driving shareholder return through a multitude of energy focused segments or divisions. The asset management structure will oversee various operations including ESG and other clean energy transition subsectors, which include industrial metals and minerals (Lithium, Iron, Rare Earth Elements including Scandium & Gadolinium, Vanadium, Silica, Alumina, etc), clean energy technologies, upstream and midstream oil & gas production & processing.
- Within the industrial metals and minerals business unit, the Company has amassed industrial metallic and mineral permits of over 3,700,000 acres in Alberta and British Columbia and issued its first National Instrument 43-101 Technical Report on Lithium from Brine on July 16, 2021. The Company has also engaged the third-party resource evaluator to compile a 43-101 Technical Report over the Ironstone prospective permits held by the Company in addition to a 43-101 Lithium from Brine Resource Assessment specific to Drumheller, Alberta.
- Within the upstream and midstream oil & gas production & processing business unit, the Company delivered average production of 94 bbl/d of oil in the second quarter of 2021. Current net production from Highwood is approximately 115 bbl/d of oil.
- Corporately, net debt at June 30, 2021 was \$1.67 million.

## **2021 Second Quarter Operations**

Highwood's focus in the second quarter of 2021 was to continue to amass a sizeable position of industrial mines and minerals permits throughout Western Canada to evaluate for purposes of creating a 43-101 technical report. On July 16, 2021, the Company released its first 43-101 Technical Report on Lithium from Brine evidencing the likely presence of Lithium from Brine within the Company's permitted acreage.

The Company focused time and resources in Q2 2021 on extracting and submitting brine and ironstone samples for purposes of determining the potential Lithium from Brine and Iron, Vanadium, Alumina, Rare Earth Elements and other potential metals and minerals within the Ironstone rock.

## **Outlook and Update to Metallic and Industrial Mineral Permits**

Within the industrial metals and minerals business unit, the Company has engaged a third-party resource evaluator to prepare a 43-101 Technical Report covering the ironstone content within the 3,700,000 permitted acres or 236 blocks in Alberta and British Columbia. This 43-101 report is anticipated to be completed in late Q3 2021.

The Company has also engaged the third-party resource evaluator to prepare a 43-101 Technical Report covering the Lithium from Brine within the region of Drumheller, Alberta. This 43-101 Technical Report is anticipated to show an inferred Lithium from Brine resource within the area and will be completed in early Q4 2021.

Given its clean balance sheet which provides considerable financial and operational flexibility, the Company remains open to completing accretive acquisitions through the balance of 2021. The Company is currently engaged in several encouraging dialogues regarding various acquisitions and partnership opportunities. Global optimism around mitigating COVID-19 and restoring previous economic and industrial activities has created positive market and investment sentiment both within and outside oil & gas space.

While Highwood sold the majority of its producing oil assets in the first quarter of 2021, the Company has, and will continue to evaluate opportunities in the M&A market but will remain disciplined to pursue only those opportunities that are accretive with low to moderate liability profiles.

Corporately, the Company intends to build a growing profile of recurring free funds flow that will provide maximum flexibility for growth and / or other strategic M&A opportunities in a non-dilutive fashion.

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## PART 1 – OUR BUSINESS AND STRATEGY

### Overview

Highwood is a junior asset manager with a current focus in both the upstream & midstream oil and gas space as well as early-stage resource evaluation in the mining sector. Highwood’s intention is to eventually oversee various operations including ESG and other clean energy transition subsectors, which include industrial metals and minerals (Lithium, Iron, Rare Earth Elements including Scandium & Gadolinium, Vanadium, Silica, Alumina, etc), clean energy technologies, upstream and midstream oil & gas production & processing.

#### ✓ **Shareholder Return Focus**

Steering future acquisition and growth opportunities will be the pursuit of shareholder returns through accretive acquisitions and organic growth.

#### ✓ **Diverse Industry Exposure**

While today Highwood holds conventional oil & gas upstream and midstream assets as well as industrial mines & minerals permits, future focuses will include other energy subsectors including ESG and other clean energy transition infrastructure.

#### ✓ **Sustainability**

Committed to having a positive impact in the communities in which we operate – setting partnerships up for long term successes.

## PART 2 – SUMMARY OF CONSOLIDATED FINANCIAL RESULTS

### Highwood Asset Management Ltd. – Consolidated Financial and Operating Highlights

(formerly Highwood Oil Company Ltd.)

(all tabular amounts expressed in thousands of Canadian dollars)

	Three months ended June 30,		Six months ended June 30,	
	2021	2020	2021	2020
<b>Financial</b>				
Oil and natural gas sales	\$ 544	\$ 1,737	\$ 5,702	\$ 8,282
Transportation pipeline revenues	931	769	1,900	1,929
Total revenues, net of royalties and commodity contracts <sup>(1)</sup>	742	1,052	4,917	17,317
Income (Loss)	(930)	(3,837)	(1,708)	(7,561)
Funds flow from operations <sup>(6)</sup>	(61)	2,167	(1,393)	5,954
Capital expenditures	74	223	191	4,415
Proceeds from dispositions	-	-	1,981	648
Working capital surplus (deficit), excluding current bank debt (end of period) <sup>(2)</sup>			(2,481)	(7,779)
Net debt <sup>(3)</sup>			(1,672)	(46,089)
Shareholders' equity (end of period)			8,570	10,860
Shares outstanding (end of period)			6,014	6,014
Options outstanding (end of period)			167	128
Restricted share units outstanding (end of period)			149	110
Weighted-average basic shares outstanding	6,014	6,014	6,014	6,014
<b>Operations <sup>(4)</sup></b>				
Production				
Crude oil (bbls/d)	94	870	549	1,371
Total (boe/d)	94	870	549	1,371
Benchmark prices				
Crude oil				
Canadian Light (Cdn\$/bbl)	72.55	25.20	68.61	34.91
Average realized prices <sup>(5)</sup>				
Crude oil (per bbl)	63.30	21.94	57.42	33.19
Upstream Operating netback (per boe) <sup>(6)</sup>	(3.72)	(14.06)	16.72	(1.32)

<sup>(1)</sup> Includes unrealized gain and losses on commodity contracts

<sup>(2)</sup> Working capital deficit includes commodity contract liability of \$809 thousand, (June 30, 2020 – commodity contract asset of \$1.13 million). Excluding this, the working capital deficit would be \$1.67 million (June 30, 2020 – deficit of \$9.09 million). Working capital deficit also excludes bank debt of \$nil (June 30, 2020 - \$37 million).

<sup>(3)</sup> Net debt consists of bank debt and working capital surplus (deficit) excluding commodity contract assets and/or liabilities.

<sup>(4)</sup> For a description of the boe conversion ratio, see “Basis of Barrel of Oil Equivalent”.

<sup>(5)</sup> Before hedging.

<sup>(6)</sup> See “Non-GAAP measures”.

## **PART 3 – OPERATING SEGMENTS RESULTS**

### **Basis of Presentation**

The Company has three operating groups and a corporate and other segment, which collectively represent four operating segments for internal and external reporting purposes.

Our operating segments include:

- Mining and Minerals
- Midstream Operations
- Upstream Operations
- Corporate and Other

The corporate and other segment includes corporate functions of the Company, such as general and administrative expenses and are included in the select consolidated operating disclosures.

### **Summary of Results**

#### **Mining and Minerals**

The mining and minerals segment includes industrial metal and mineral assets. During 2021, the Company has amassed industrial metallic and mineral permits covering over 3.7 million acres in Alberta and British Columbia and issued its first National Instrument 43-101 Technical Report on Lithium from Brine on July 16, 2021. The Company has also engaged the third-party resource evaluator to compile a 43-101 Technical Report over the Ironstone prospective permits held by the Company in addition to a 43-101 Resource Assessment specific to Drumheller, Alberta over the Lithium Brine prospective permits.

The mining and minerals segment of Highwood had an encouraging quarter with 3.3 million additional acres of mineral leases acquired within Alberta – bringing the total leased area of Highwood to 3.7 million acres as of the date of this MDA.

As the mining and minerals segment entails early-stage exploration projects, there was no revenue and minimal expenses associated with the segment for the second quarter ended June 30, 2021.

Capital of \$74 thousand was deployed within the mining and minerals segment for the second quarter ended June 30, 2021. In the event that the Company is successful in raising funds through an equity raise that is being contemplated, the Company plans, and may be required, under the equity raise to outlay significant exploration capital in the near future.

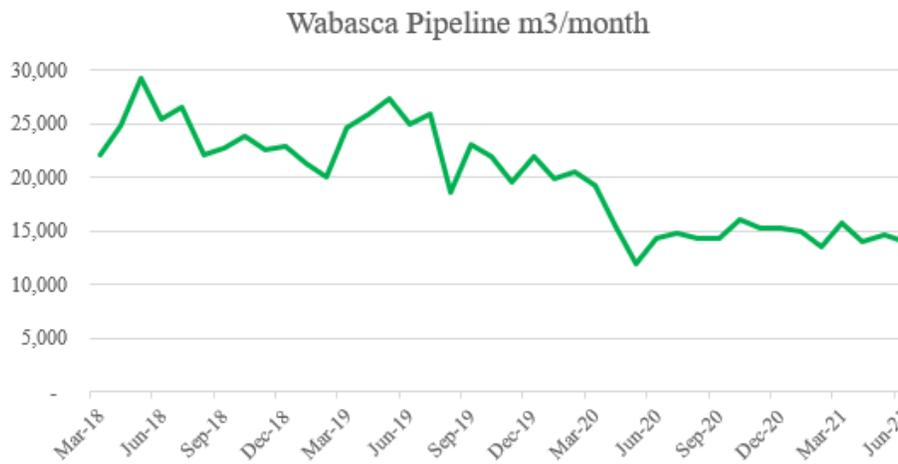
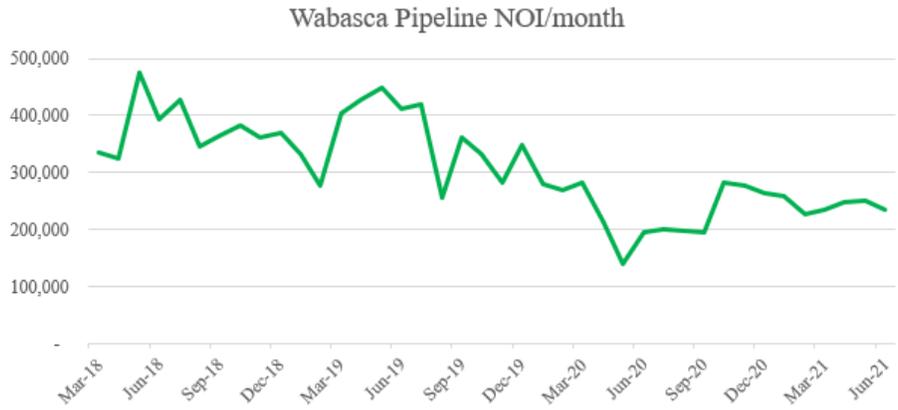
Lithium and ironstone testing remains an ongoing focus for Highwood. Extraction technologies continue to be evaluated as well as potential go forward technology parties whom Highwood may elect to partner with moving forward.

#### **Midstream Operations**

The midstream segment consists of the Company's oil sales transportation pipeline, the Wabasca River Sales Pipeline.

The Company's crude transmission line averaged 14,200 m<sup>3</sup>/month of throughput for the second quarter of 2021 compared to 13,900 m<sup>3</sup>/month for the second quarter of 2020. The Company continues to anticipate additional volumes coming onto the pipeline as area producers continue to revive capital activity in the currently strong price environment. Revenue for the three and six month periods ended June 30, 2021 was \$931 thousand and \$1.9 million, respectively compared to \$767 thousand and \$1.93 million, respectively, for the three and six month periods ended June 30, 2020. Transportation pipeline revenues relate to the Wabasca River Pipeline System that the Company has a 100% working interest in. Revenues are generated from a tariff charged to vendors who transport product on the pipeline.

Throughout the second quarter of 2021, the Company continued to promote strong cost control on the Wabasca River Pipeline and saw \$195 thousand of total expenses compared to \$215 thousand for the same period ended June 30, 2020 (six months ended June 30, 2021 - \$443 thousand, six months ended June 30, 2020 - \$494 thousand). The Company has overall seen a 48% monthly decrease on operating expenses comparing the trailing twelve months of operations to the last twelve months of operations by the previous operator.

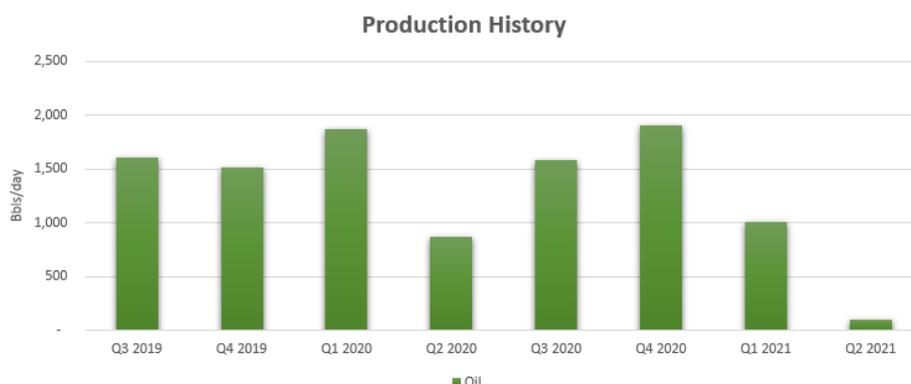


## Upstream Operations

The upstream segment includes oil production and associated processing and other income associated with the upstream assets located in the Western Canada Sedimentary Basin. The operations primarily involve the production of oil, processing facilities and other third-party charges for operating upstream assets.

The Company disposed of the majority of its producing assets in two transactions, one that closed in December 2020 and one that closed in March 2021. The comparative figures include the disposed properties.

## Production



	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2021</b>	<b>2020</b>	<b>2021</b>	<b>2020</b>
<b>Daily average volume</b>				
Crude oil (bbls/d)	<b>94</b>	870	<b>549</b>	1,371
Total sales (boe/d)	<b>94</b>	870	<b>549</b>	1,371
Total sales (boe)	<b>8,594</b>	79,169	<b>99,307</b>	249,540
<b>Production weighting</b>				
Crude oil	<b>100%</b>	100%	<b>100%</b>	100%

The decrease in production from the comparative period is primarily due to the disposition of the Clearwater assets in December 2020 and the Red Earth assets on March 25, 2021. The majority of the production in the second quarter of 2021 came from the Company's Saskatchewan CGU.

## Sales

### Oil sales

	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2021</b>	<b>2020</b>	<b>2021</b>	<b>2020</b>
Crude oil	<b>544</b>	1,737	<b>5,702</b>	8,282
Total	<b>544</b>	1,737	<b>5,702</b>	8,282

### Average realized prices before hedging

Crude oil (\$/bbl)	<b>63.30</b>	21.94	<b>57.42</b>	33.19
Combined average (\$/boe)	<b>63.30</b>	21.94	<b>57.42</b>	33.19

The decrease in production from the comparative period is primarily due to the disposition of the Clearwater assets in December 2020 and the Red Earth assets on March 25, 2021. The Company did see an increase in realized commodity prices from \$21.94/bbl in second quarter of 2020 to \$63.30/bbl in the second quarter of 2021, an increase of 189%.

The second quarter of 2021 has continued to see improvement in commodity prices as demand starts to return. Over the short term, the Company anticipates continued price volatility. With respect to oil prices, a significant factor is the unknown impact of transportation constraints in Alberta, demand levels, as well as global inventory levels. The Company anticipates that there will be continued price volatility for at least the next several quarters as various dynamics play out. There have been significant fluctuations in oil prices and the stock markets worldwide for various reasons linked to the COVID-19 pandemic and other conditions impacting worldwide oil prices. The Company continues to monitor current and forecasted pricing.

The Company's realized prices were consistent with the changes in the benchmark prices.

### Royalties

	Three months ended		Six months ended	
	2021	June 30, 2020	2021	June 30, 2020
	\$	\$	\$	\$
Royalties	159	106	523	834
Per boe	18.50	1.34	5.27	3.34
Percentage of oil sales	29.2%	6.1%	9.2%	10.1%

Highwood's royalty burden includes crown, gross over-riding and freehold royalties applicable on the Company's production sales.

The increase in royalties and percentage of sales during the second quarter of 2021 compared to the second quarter of 2020 is mainly due to the majority of the Company's production coming from the Saskatchewan CGU after the dispositions of Clearwater in December 2020 and Red Earth in March 2021. The Saskatchewan CGU is burdened by several gross over-riding royalties which results in a higher royalty percentage of oil sales. The decrease in royalties between the six months ended June 30, 2021 and June 30, 2020 is directly due to the dispositions made in late 2020 and early 2021.

### Upstream Operating and Transportation Expense

	Three months ended		Six months ended	
	2021	June 30, 2020	2021	June 30, 2020
	\$	\$	\$	\$
Operating and transportation	417	2,743	3,519	7,778
Per boe	48.52	34.66	35.44	31.17

Overall, operating and transportation expense for the upstream segment have decreased significantly for both the three and six month periods ended June 30, 2021 compared to the respective comparative periods due to the dispositions the Company has made in late 2020 and early 2021.

Operating and transportation expense on a per boe basis has increased significantly due to the impact of non-producing upstream properties. The decline in production has resulted in a decrease in economies of scales as the expenses related to non-producing properties now makes up a larger portion of the expenses.

Management continues to look at production and operating costs to identify additional efficiencies.

## Netback Analysis

	Three months ended		Six months ended	
	2021	June 30, 2020	2021	June 30, 2020
	\$/boe	\$/boe	\$/boe	\$/boe
Average sales price	63.30	21.94	57.42	33.19
Royalties	(18.50)	(1.34)	(5.27)	(3.34)
Upstream Operating and transportation	(48.52)	(34.66)	(35.44)	(31.17)
Operating netback	(3.72)	(14.06)	16.72	(1.32)

The main reason for the increase in operating netback for the three and six month periods ended June 30, 2021 compared to three and six month periods ended June 30, 2020 is due to the improvement in average realized sales price. The average realized price for the three and six month periods ended June 30, 2021 was approximately 189% and 73%, respectively, higher than the comparative periods of 2020. The increase in realized prices was offset by an increase in operation and transportation expenses on a per boe basis. Management continues to look at ways to maximize the operating netback.

## PART 4 – SELECT CONSOLIDATED OPERATING DISCLOSURES

### Risk Management

Highwood's cash flow is highly variable, in large part because oil and natural gas are commodities whose prices are determined by worldwide and/or regional supply and demand, transportation constraints, weather conditions, availability of alternative energy sources and other factors, all of which are beyond Highwood's control. World prices for oil and natural gas have improved in recent months but continue to be volatile.

During the first quarter of 2021, oil prices have started to recover from the historic low prices that were realized in the first half of 2020. On January 30, 2020, the World Health Organization declared the Coronavirus outbreak (COVID-19) a "Public Health Emergency of International Concern" and on March 11, 2020 declared COVID-19 a pandemic. As a result, there had been a significant demand shock worldwide which created downward pressure on oil prices. With the emergence of vaccines in late 2020 and early 2021, demand has slowly started to recover resulting in increasing prices.

Management of cash flow variability is an integral component of the Company's business strategy. Business conditions are monitored regularly and reviewed with the Board of Directors to establish risk management guidelines used by management in carrying out the Company's strategic risk management program.

The Company has elected not to use hedge accounting and, accordingly, the fair value of the financial contracts is recorded at each period-end. The fair value may change substantially from period to period depending on commodity forward strip prices for the financial contracts outstanding at the statement of financial position date. The change in fair value from period-end to period-end is reflected in the income for that period. As a result, income may fluctuate considerably.

At June 30, 2021 Highwood had the following commodity contracts, with a total mark-to-market liability of \$809 thousand.

#### CAD Sell Swaps:

Product	Notional Volume	Term	Fixed Price (CAD/bbl)	Index
Crude Oil	250 bbls/day	July 1, 2021 to December 31, 2021	\$ 65.40	WTI - NYMEX

#### CAD Buy Swaps:

Product	Notional Volume	Term	Fixed Price (CAD/bbl)	Index
Crude Oil	125 bbls/day	July 1, 2021 to December 31, 2021	\$ 77.85	WTI - NYMEX

Commodity contracts are considered financial instruments, and the resulting derivative financial asset or liability was recorded on the Company's statement of financial position, with the unrealized gain or loss being recorded on the statement of loss and comprehensive loss.

	Three months ended		Six months ended	
	2021	June 30, 2020	2021	June 30, 2020
Realized gain (loss) on commodity contracts	\$ (1,004)	\$ 1,185	\$ (1,653)	\$ 2,053
Unrealized gain (loss) on commodity contracts	508	(2,684)	(700)	5,214

The realized loss on commodity contracts during the three and six month periods ended June 30, 2021 was due to oil commodity prices being higher than the contract price. The realized gain on commodity contracts during the three and six months ended June 30, 2020 was due to oil commodity prices being lower than the contract price.

### General and Administrative (G&A)

	Three months ended		Six months ended	
	2021	June 30, 2020	2021	June 30, 2020
G&A	\$ 559	\$ 1,537	\$ 1,880	\$ 2,946

G&A expenses decreased significantly for the three and six month periods ended June 30, 2021 compared to the respective periods in 2020 due to cost cutting measures put in place and a significant reduction in risk mitigation expenditures going forward due to the disposition of the Red Earth assets which carried a significantly higher risk profile than the Company's remaining assets. In order to continue to reduce costs, the Company continues to apply for government subsidies such as the Canadian Emergency Wage Subsidy and Canadian Emergency Rent Subsidy and is working with vendors to find additional cost savings.

### Stock-Based Compensation

	Three months ended		Six months ended	
	2021	June 30, 2020	2021	June 30, 2020
Stock-based compensation	\$ 272	\$ 153	\$ 515	\$ 424

The increase in stock-based compensation for the three and six month periods ended June 30, 2021 from the comparative periods of 2020 is due to additional option and RSU grants that occurred in the third quarter of 2020 as these amounts are included in the 2021 stock-based compensation but not the 2020 amounts.

At June 30, 2021 the Company had 167,000 options and 149,000 RSU's outstanding.

### Depletion and Depreciation ("D&D")

	Three months ended		Six months ended	
	2021	June 30, 2020	2021	June 30, 2020
D&D	\$ 202	\$ 1,155	\$ 407	\$ 3,639
Per boe	23.50	14.59	4.10	14.58

During the fourth quarter of 2020, the Company classified its Red Earth CGU's as assets held for sale. In accordance with IFRS 5, assets held for sale are not subject to depletion, therefore, no depletion was recorded during the first quarter of 2021 on the Red Earth CGUs.

The decrease in D&D for the three and six month periods ended June 30, 2021, compared to the prior periods, is mainly due to the classification of the Red Earth CGUs to assets held for sale and the disposition in the fourth quarter of 2020 of the Clearwater assets.

### Impairment

	Three months ended		Six months ended	
	2021	June 30, 2020	2021	June 30, 2020
	\$	\$	\$	\$
Impairment of property, plant and equipment	352	-	352	10,926
Impairment of exploration and evaluation assets	-	-	-	198
Impairment expense	352	-	352	11,124

#### *Impairment of property, plant and equipment*

The Company assesses many factors when determining if an impairment test should be performed. For the period ended June 30, 2021, the Company conducted an assessment of impairment indicators for the Company's CGU's. The Company determined there were indicators of impairment for the non-core Alliance CGU and reversal of prior impairments for the Saskatchewan CGU.

The Company determined that its non-core CGU, Alliance, no longer had any value absent any throughput and recorded an impairment loss in the three month period ended June 30, 2021 of \$352 thousand, representing the full carrying value of the non-core CGU.

### Impairment Reversal

	Three months ended		Six months ended	
	2021	June 30, 2020	2021	June 30, 2020
	\$	\$	\$	\$
Impairment reversal of property, plant and equipment	306	-	306	-
Impairment reversal	306	-	306	-

#### *Impairment reversal of property, plant and equipment*

As at June 30, 2021, management determined that the significant improvement in commodity pricing and the impact this has on the economic performance of the Saskatchewan CGU justified calculation of the recoverable amount for this CGU. During the three month period ended March 31, 2020, the Saskatchewan CGU incurred an impairment charge of \$332 thousand. The recoverable amounts were estimated at the value in use based on the net present value of the before tax future net cash flows from oil and natural gas proved and probable reserves using forecasted prices and costs estimated by external engineers at December 31, 2020 and internally updated by Company engineers at June 30, 2021. The future net cash flows were discounted at a before tax rate of 15% (December 31, 2020 – 15%). As a result of the impairment test, the Company has recorded a reversal of prior impairment loss in the three month period ended June 30, 2021 of \$306 thousand, representing the increased carrying amount factoring in the depletion of the historical cost if the impairment had not previously been recognized. Neither a 1% change in the assumed discount rate over the life of the reserves or a 5% change in cash flows would impact the reversal amount.

## Finance Income and Expenses, Net

	Three months ended		six months ended	
	2021	June 30, 2020	2021	June 30, 2020
	\$	\$	\$	\$
Interest on bank debt	31	119	54	297
Stamping fees on bank debt	11	371	37	647
Finance fees	3	-	3	-
Other interest expense (income)	-	(54)	-	(54)
<b>Cash finance income and expenses</b>	<b>45</b>	<b>436</b>	<b>94</b>	<b>890</b>
Finance fees	-	25	-	131
Accretion of decommissioning liabilities	11	103	22	240
Other expense	1	3	3	6
<b>Non-cash finance expense</b>	<b>12</b>	<b>131</b>	<b>25</b>	<b>377</b>
<b>Total finance income and expenses</b>	<b>57</b>	<b>567</b>	<b>119</b>	<b>1,267</b>

Interest on bank debt and stamping fees relates to interest and fees paid to Highwood's bankers to service the bank debt and bank overdraft. Interest on bank debt and stamping fees three and six month periods ended June 30, 2021 compared to 2020 decreased due to the significant decrease in amount drawn and decrease in interest rates in 2021. At June 30, 2021 the Company was undrawn on its bank facility compared to a draw of \$37 million at June 30, 2020.

Decrease in accretion of decommissioning liabilities was due to the disposition of the Company's Red Earth CGUs which removed approximately \$36 million of liability associated with those assets.

Interest rates are based on the Company's most recent quarter net debt to cash flow ratio. Net debt is defined by the agreement as working capital deficit plus bank debt and cash flow is defined effectively as cash flow from operating activities before changes in non-cash working capital for the most recent quarter annualized and normalized for extraordinary and nonrecurring earnings, gains, and losses.

## Deferred Income Tax

Deferred income tax was recovery of \$252 thousand and \$418 thousand, respectively, for the three and six month periods ended June 30, 2021, compared to a recovery of \$1.48 million and \$2.33 million, respectively, for the three and six month periods ended June 30, 2020.

## Loss

The Company incurred a loss of \$930 thousand and \$1.71 million, respectively, for the three and six month periods ended June 30, 2021, compared to a loss of \$3.84 million and \$7.56 million, respectively, for the comparative three and six month periods ended June 30, 2020. Loss for the three and six month periods ended June 30, 2021 was mainly a result of realized loss of commodity contracts of \$1.0 million and \$1.65 million, respectively. Loss for the six months ended June 30, 2020 was mainly a result of non-cash impairment loss of \$11.12 million offset by a non-cash unrealized gain of commodity contracts of \$5.2 million.

	Three months ended		Six months ended	
	2021	June 30, 2020	2021	June 30, 2020
	\$	\$	\$	\$
Loss	930	3,837	1,708	7,561
Per share, basic and diluted	0.15	0.64	0.28	1.26

## Supplemental Information

The following tables summarize key financial and operating information for the periods indicated:

### Cash Flows from (used in) Operating Activities

	Three Months Ended,		Six Months Ended,	
	June 30,	June 30,	June 30,	June 30,
	2021	2020	2021	2020
<b>Cash provided by (and used in)</b>				
<b>Operating activities</b>				
Loss for the period	\$ (930)	\$ (3,837)	\$ (1,708)	\$ (7,561)
Items not involving cash:				
Unrealized (gain) loss on commodity contracts	(508)	2,684	700	(5,214)
Exploration and evaluation expenditures	127	-	127	-
Depletion and depreciation expense	202	1,155	407	3,639
Impairment loss	352	-	352	11,124
Impairment reversal	(306)	-	(306)	-
Finance expense	12	106	25	352
Deferred tax recovery	(252)	(1,484)	(418)	(2,325)
Stock-based compensation	272	153	515	424
(Gain) loss on disposal of assets	-	-	2	(586)
Cash abandonment expenditures	-	-	(1)	-
Change in non-cash working capital	970	3,390	(1,088)	6,101
	(61)	2,167	(1,393)	5,954

## Selected Quarterly Information

Three months ended	June 30, 2021	Mar. 31, 2021	Dec. 31, 2020	Sept. 30, 2020	June 30, 2020	Mar. 31, 2020	Dec. 31, 2019	Sept. 30, 2019
<b>Financial</b>								
(\$000s, except per share amounts and share numbers)								
Oil sales	544	5,158	6,685	5,752	1,737	6,545	7,908	8,850
Transportation pipeline revenues	931	969	1,021	790	769	1,160	1,228	1,316
Income (loss)	(930)	(778)	18,348	(20,074)	(3,837)	(3,724)	(6,583)	(1,447)
Capital expenditures	74	117	228	67	223	4,191	4,895	2,382
Total assets ( <i>end of quarter</i> )	18,005	21,861	65,650	87,108	103,782	106,906	114,187	120,543
Working capital surplus (deficit), excluding commodity contracts and bank debt ( <i>end of quarter</i> )	(1,672)	956	5,868	(6,028)	(9,089)	(4,064)	(8,811)	2,311
Shareholders' equity ( <i>end of quarter</i> )	8,570	9,228	9,763	(8,977)	10,860	14,544	17,997	24,279
Weighted-average basic shares outstanding ( <i>000s</i> )	6,014	6,014	6,014	6,014	6,014	6,014	6,014	6,014
<b>Operations</b>								
Production								
Crude oil ( <i>bbls/d</i> )	94	1,008	1,908	1,585	870	1,872	1,515	1,495
Total ( <i>boe/d</i> )	94	1,008	1,908	1,585	870	1,872	1,515	1,495
Average realized prices (\$)								
Crude oil ( <i>per bbl</i> )	63.30	56.87	38.08	39.44	21.94	38.42	56.74	64.32

Inherent to the nature of the energy industry, fluctuations in Highwood's quarterly oil sales, transportation pipeline revenues, cash flows from operating activities, and income or loss are primarily caused by variations in production volumes, realized commodity prices and the related impact on royalties, realized and unrealized gains/losses on financial instruments, changes in per-unit expenses, and deferred income taxes. Please refer to the Operating Segment Results and Select Consolidated Operating Disclosures sections above for an explanation of changes.

## Capital Activity

	Three months ended		Six months ended	
	2021	June 30, 2020	2021	June 30, 2020
	\$	\$	\$	\$
Mineral permits	74	-	166	-
Land	-	55	-	4
Seismic and other pre-drilling costs	-	50	-	95
Production equipment and facilities	-	114	3	1,065
Drilling and completions	-	4	-	2,720
Recompletions	-	-	22	531
	74	223	191	4,415

At June 30, 2021, the Company had E&E assets of \$1.28 million (December 31, 2020 – \$1.24 million). This amount is primarily made up of undeveloped land and industrial metals and minerals permit. For the three and six month periods ended June 30, 2021, all E&E capital activity related to industrial metals and mineral permits.

At June 30, 2021, the Company had gross property and equipment of \$19.55 million (December 31, 2020 - \$19.68 million). This included developed land and costs associated with the wells the Company has drilled and acquired to date and the transportation pipelines the Company acquired in 2018.

During the six months ended June 30, 2021, the Company closed the disposition of the Company's Red Earth CGUs to an arm's-length company for gross proceeds of \$2.0 million cash, prior to customary closing adjustments. The transaction was effective on the date of closing. The disposed properties had a net book value in assets held for sale of \$38.52 million and liabilities associated with assets held for sale of \$35.95 million. As a result of the disposition, the Company recognized a gain on disposal of asset of \$4 thousand during the six month period ended June 30, 2021. Transaction costs totalling \$14 thousand have reduced the gain recorded.

## PART 5 – CAPITALIZATION

### Share Capital and Option Activity

As at June 30, 2021 and the date of this MD&A the Company had 6,014,000 common shares, 167,000 options and 149,000 RSU's outstanding.

### Liquidity, Capital Resources and Going Concern

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with the financial liabilities as they become due. The Company conducted a strategic alternatives process during the fourth quarter of 2020 which significantly decrease the liquidity risk of the Company as the disposition resulted in gross proceeds of \$40.75 million. In addition, during the three months ended June 30, 2021 the Company closed the disposition of its Red Earth assets for gross proceeds of \$2.0 million. This transaction significantly reduced the Company's decommissioning liabilities, which will result in increased access to capital.

At June 30, 2021, the Company had negative working capital of \$2.5 million, excluding bank debt. The Company expects to repay its financial liabilities in the normal course of operations and to fund future operational and capital requirements through operating cash flows and through deleveraging transactions. The Company also has a bank facility to facilitate the management of liquidity risk and is in compliance with all associated financial covenants at June 30, 2021. At June 30, 2021, \$10 million was available under a \$10 million bank facility. Subsequent to June 30, 2021, the operating facility was reduced to \$2.0 million and will be further reduced to \$1.0 million effective December 31, 2021, and matures April 30, 2022, subject to the annual bank review.

The borrowing base, currently set at \$2.0 million, will be reviewed at least semi-annually by the lender, and more frequent under certain circumstances. The borrowing base can be determined at the sole discretion of the lender and any amount outstanding under the bank facility in excess of a newly established borrowing base must be repaid in full within 30 days. The Company's next review and borrowing base determination is scheduled on or before November

30, 2021 but may be set at an earlier or later date at the discretion of the bank. The lender has sole discretion on the determination of the borrowing base which is based predominantly on the Company's cash flows forecast from proved developed producing oil and natural gas reserves and midstream assets. The current state of the Western Canadian energy sector coupled with the suppressed global oil and natural gas commodity price environment has negatively impacted the availability for credit within the industry. While prices have begun to recover halfway through 2021, the unknowns regarding COVID-19 and other factors continue to impact the availability for credit.

The Company is required to maintain an adjusted working capital ratio of not less than 1.0:1.0, and such ratio is to be tested at the end of each fiscal quarter. Current ratio is defined as the ratio of (i) current assets, excluding financial derivatives to (ii) current liabilities, excluding financial derivatives, any amounts drawn under the bank facility and any current liabilities related to lease contracts. At June 30, 2021, the Company's current ratio was 2.56:1.0 (December 31, 2020 – 1.13:1.00). The Company is required to maintain a net debt to cash flow ratio no greater than 2.0:1.0 for each quarter beginning with the fiscal quarter ended March 31, 2021. As June 30, 2021 the Company's net debt to cash flow ratio is 0.59:1.0 (December 31, 2020 – 0.87:1.0). For the purposes of the covenant, net debt is defined by the agreement as working capital deficit (excluding financial derivatives) plus bank debt and cash flow is defined as cash flow from operating activities before changes in non-cash working capital normalized for extraordinary and nonrecurring earnings, gains, and losses. For the fiscal quarters ending June 30, 2021, September 30, 2021, and December 31, 2021, the impact of realized gains or losses on commodity contracts is excluded from the calculation of net income for the purposes of the net debt to cash flow covenant. Cashflows are determined as i) the most recent quarter annualized for the quarter ended March 31, 2021, ii) the most recent six months annualized for the quarter ended June 30, 2021, iii) the most recent nine months annualized for the quarter ended September 30, 2021 and iv) the trailing four quarters for the quarter ended December 31, 2021 and all quarters thereafter. The Company is also required to meet certain reporting requirements on a quarterly and annual basis. The Company is also restricted from entering into notional commodity contracts exceeding thirty-six months in term and cannot exceed 60% of gross production volumes (by commodity) for the three month trailing period, at the time the contracts are entered into. The Company's next review and borrowing base determination was amended to be on or before November 30, 2021 but may be set at an earlier or later date at the discretion of the bank.

The bank facility has financial and hedging covenants as outlined in note 8 of the financial statements. The Company was in compliance with all its financial covenants at June 30, 2021. As planned production rates and forward prices for crude oil being traded in the futures market, management is forecasting it will be in compliance with financial covenants for the next 12 months. The Company forecasts that it can continue to meet its obligations including interest payments, general & administrative expenses and operating expenses within its internally generated cash flows. However, there are no assurances that the lender will maintain the borrowing base at the current level, which may result in a borrowing base shortfall. If the Company cannot generate sufficient funds to meet the borrowing base shortfall it would constitute an event of default under the loan agreement and the bank could demand immediate repayment of the outstanding loan amount. However, as of the date of this MD&A, the Company is only drawn \$1.0 million on the operating facility and the Company believes it would be able to settle its bank facility if it were required.

The Company has reduced accounts payable and accrued liabilities by approximately \$3.29 million during the six months ended June 30, 2021 from December 31, 2020. The main reason for the decrease is due to the proceeds received on the disposition of the Red Earth assets along with cash flows generated by the Company's assets.

The Company plans to meet foreseeable obligations by actively monitoring its credit facilities through use of the revolving debt, coordinating payment and revenue cycles each month and secure cash flows. The Company will also seek secondary financing to meet obligations if terms are considered to be economic by the Company.

The Company generally relies on operating cash flows and its bank facility to fund its capital requirements and provide liquidity. Future liquidity depends primarily on funds generated from operations, drawing on existing credit facilities and accessing debt and equity markets.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards applicable to a going concern, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business.

The oil and natural gas commodity price environment has been extremely volatile and suppressed by historical standards in the past few years and was significantly worse with the COVID-19 outbreak and the resulting global oversupply of oil until early in 2021 when prices began to recover.

### **Off-Balance-Sheet Arrangements**

The Company does not have any special-purpose entities nor is it a party to any arrangements that would be excluded from the statement of financial position.

### **Environmental Initiatives Affecting Highwood**

In October 2020, the Government of Canada announced a national carbon pricing regime in response to the Paris Agreement ratified by Canada earlier that month. Under the Carbon Strategy, a benchmark carbon pricing program will be applied, pricing carbon emissions at a minimum of \$10 per tonne in 2020, rising by \$10 per tonne each Year to \$50 per tonne by 2022. The Carbon Strategy also proposes a federal backstop in the event that jurisdictions fail to meet the benchmark. The Government of Alberta established a carbon pricing system referenced in the federal announcement; therefore, in the short term, the national price on carbon will likely have little additional impact to Highwood beyond that imposed by the Government of Alberta.

### **Related-Party Transactions**

During the three and six month periods ended June 30, 2021, the Company incurred charges of \$86 thousand and \$172 thousand, respectively (three and six month periods ended June 30, 2020 – \$59 thousand and \$145 thousand, respectively) from a company with common officers and directors, Tidewater Midstream and Infrastructure Ltd., for management fees, office space, subscriptions and supplies of which \$56 thousand and \$112 thousand, respectively (three and six month periods ended June 30, 2020 – \$29 thousand and \$85 thousand, respectively) was recorded as an increase in general and administrative expense and \$30 thousand and \$60 thousand, respectively (three and six month periods ended June 30, 2020 – \$30 thousand and \$60 thousand, respectively) was recorded as a reduction to lease liabilities. During the three and six month periods ended June 30, 2021, the Company was also charged \$nil and \$nil, respectively (three and six month periods ended June 30, 2020 - \$nil and \$573 thousand, respectively) for propane purchases and distribution from this company which is included in operating and transportation expenses on the statement of Loss and Comprehensive Loss. As at June 30, 2021, \$nil (December 31, 2020 - \$4 thousand) is included within accounts receivable and \$nil (December 31, 2020 - \$249 thousand) is included within accounts payable with respect to these charges.

### **Hedging**

The Company historically practiced an active hedging program, with the objective to provide a measure of downside protection for its oil and natural gas sales and cash flow from operations, while maximizing exposure to potential commodity pricing upside.

## **PART 6 – ACCOUNTING POLICIES**

### **Critical Accounting Judgments, Estimates and Policies**

The Company's critical accounting judgements, estimates and policies are described in notes 2 and 3 to the December 31, 2020 annual consolidated financial statements as well as included in the Company's annual MD&A as at December 31, 2020. Certain accounting policies are identified as critical because they require management to make judgments and estimates based on conditions and assumptions that are inherently uncertain, and because the estimates are of material magnitude to revenue, expenses, funds flow from operations, income or loss and/or other important financial results. These accounting policies could result in materially different results should the underlying conditions change or the assumptions prove incorrect. There have been no changes to the critical accounting judgments, estimates and policies during the three and six months ended June 30, 2021.

## **Non-GAAP Measures**

This MD&A includes references to financial measures commonly used in the oil and natural gas industry. The term “operating netback” (oil and natural gas sales less royalties and production, operating and transportation expenses, all expressed on a per-unit-of-production basis) is not defined under IFRS, and may not be comparable with similar measures presented by other companies. Operating netback is a per-unit-of-production measure that may be used to assess the Company’s performance and efficiency.

The term “working capital surplus (deficit), excluding bank debt” is not defined under IFRS, and may not be comparable with similar measures presented by other companies. Working capital surplus (deficit), excluding bank debt is included to show what the working capital relating to customers, vendors, and joint venture partners would be.

The term “funds flow from operations” is not defined under IFRS, and may not be comparable with similar measures presented by other companies. Funds flow from operations is included to show what the cash flow from operating activities would be prior to changes in working capital.

## **Basis of Barrel of Oil Equivalent**

Petroleum and natural gas reserves and production volumes are stated as a “barrel of oil equivalent” (boe), derived by converting natural gas to oil equivalency in the ratio of 6,000 cubic feet of gas to one barrel of oil. Boe may be misleading, particularly if used in isolation. A boe conversion ratio of 6,000 cubic feet of gas to one barrel of oil is based on energy equivalency, which is primarily applicable at the burner tip, and does not represent a value equivalency at the wellhead. Readers are cautioned that boe figures may be misleading, particularly if used in isolation.

## Forward-Looking Statements

This document contains certain forward-looking statements. Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could influence actual results or events and cause them to differ materially from those stated, anticipated or implied. Such forward-looking statements necessarily involve risks including, without limitation, those associated with oil and natural gas exploration, property development, production, marketing and transportation, such as dry holes and non-commercial wells, facility and pipeline damage, loss of markets, volatility of commodity prices, currency fluctuations, imprecision of reserve estimates, production declines, health, safety and environmental risks, competition from other producers and the ability to access sufficient capital from internal and external sources. Forward-looking information typically includes statements with words such as “anticipate”, “believe”, “expect”, “plan”, “intend”, “estimate”, “propose”, “project”, or similar words suggesting future outcomes. The Company cautions readers and prospective investors in the Company’s securities not to place undue reliance on forward-looking information as, by its nature, it is based on current expectations regarding future events that involve a number of assumptions, inherent risks and uncertainties, which could cause actual results to differ materially from those anticipated by the Company.

Forward-looking information typically involves substantial known and unknown risks and uncertainties, certain of which are beyond the Company’s control. Such risks and uncertainties include, without limitation: financial risk of marketing reserves or metals & minerals at an acceptable price given market conditions; volatility in market prices for metals, minerals, oil and natural gas; delays in business operations; pipeline restrictions; blowouts; the risk of carrying out operations with minimal environmental impact; industry conditions including changes in laws and regulations including the adoption of new environmental laws and regulations and changes in how they are interpreted and enforced; uncertainties associated with estimating mining resources & oil and natural gas reserves; risks and uncertainties related to mining and oil & gas interests and operations on aboriginal lands; economic risk of finding and producing reserves at a reasonable cost; uncertainties associated with partner plans and approvals; operational matters related to non-operated properties; increased competition for, among other things, capital, acquisitions of mining permits, reserves and undeveloped lands; competition for and availability of qualified personnel or management; incorrect assessments of the value of acquisitions and exploration and development programs; unexpected geological, technical, drilling, construction, processing and transportation problems; availability of insurance; fluctuations in foreign exchange and interest rates; stock market volatility; general economic, market and business conditions; uncertainties associated with regulatory approvals; uncertainty of government policy changes; uncertainties associated with credit facilities and counterparty credit risk; changes in income tax laws, Crown royalty rates and incentive programs relating to the oil and gas industry; and other factors, many of which are outside the Company’s control. The Company’s actual results, performance or achievements could, therefore, differ materially from those expressed in, or implied by, these forward-looking estimates and whether or not any such actual results, performance or achievements transpire or occur, there can be no certainty as to what benefits or detriments the Company will derive therefrom.

The forward-looking information included herein is expressly qualified in its entirety by this cautionary statement. It is made as of the date hereof and the Company assumes no obligation to update or revise any forward-looking information to reflect new events or circumstances, except as required by law.

## Abbreviations

The following summarizes the abbreviations used in this document:

### Crude Oil and Natural Gas Liquids

bbl	barrel
Mbbl	thousand barrels
bbls/d	barrels per day
boe	barrel of oil equivalent
Mboe	thousand barrels of oil equivalent
boe/d	barrel of oil equivalent per day
NGL	natural gas liquids

### Natural Gas

Mcf	thousand cubic feet
MMcf	million cubic feet
Mcf/d	thousand cubic feet per day
GJ	Gigajoule; 1 Mcf of natural gas is about 1.05 GJ
MMBtu	million British thermal units; 1 GJ is about 0.95 MMBtu

### Other

\$000s	thousands of dollars
IFRS	International Financial Reporting Standards
IAS	International Accounting Standard

## Corporate Information

### BOARD OF DIRECTORS

**GREG MACDONALD**

President & CEO  
Highwood Asset Management Ltd.  
Calgary, Alberta

**STEPHEN HOLYOAKE**

CEO, Fireweed Energy Ltd.  
Calgary, Alberta

**TREVOR WONG-CHOR**

Partner, DLA Piper (Canada) LLP  
Calgary, Alberta

**RYAN MOONEY**

Managing Director, Investment Banking,  
Echelon Wealth Partners  
Calgary, Alberta

### OFFICERS

**GREG MACDONALD**

President & Chief Executive Officer

**GRAYDON GLANS**

Chief Financial Officer

**KELLY McDONALD**

Vice President, Exploration

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### HEAD OFFICE

Suite 900, 222 – 3<sup>rd</sup> Avenue S.W.  
Calgary, Alberta  
T2P 0B4

Telephone: 403-719-0499

Facsimile: 587-296-4916

### AUDITORS

RSM Alberta LLP

Calgary, Alberta

### BANKERS

National Bank of Canada

Calgary, Alberta

### LEGAL COUNSEL

DLA Piper (Canada) LLP

Calgary, Alberta

### EVALUATION ENGINEERS

GLJ Petroleum Consultants Ltd.

Calgary, Alberta

Apex Geoscience Ltd.

Edmonton, Alberta