

Interim Unaudited Financial Statements of

KARNALYTE RESOURCES INC.

Six months ended June 30, 2016 and 2015

KARNALYTE RESOURCES INC.

Interim Statements of Financial Position (unaudited)

(CAD \$ thousands)

	June 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash	\$ 21,757	\$ 27,733
Trade and other receivables	194	85
Prepaid expenses	410	249
	<u>22,361</u>	<u>28,067</u>
Restricted cash	375	375
Capital assets (note 3)	841	992
Exploration and evaluation and other assets (note 4)	3,017	2,528
ASSETS	\$ 26,594	\$ 31,962
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Trade and other payables	\$ 544	\$ 499
Provision	1,290	1,384
	<u>1,834</u>	<u>1,883</u>
Decommissioning liability	158	181
Total liabilities	1,992	2,064
Shareholders' equity:		
Share capital (note 5)	129,879	129,786
Contributed surplus	9,194	9,205
Deficit	(114,471)	(109,093)
Total shareholders' equity	<u>24,602</u>	<u>29,898</u>
LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 26,594	\$ 31,962

Commitments (note 7)

See accompanying notes to the financial statements.

Approved on behalf of the Board:

"signed"
Robin Phinney, Director

"signed"
Henry Kerkhoven, Director

KARNALYTE RESOURCES INC.

Interim Statements of Comprehensive Loss (unaudited)

For the three and six months ended June 30, 2016 and 2015
(CAD \$ thousands)

	Three months ended		Six months ended	
	2016	2015	2016	2015
Expenses:				
General and administrative	\$ 2,427	\$ 4,285	\$ 4,380	\$ 5,910
Depreciation and amortization (note 3)	71	191	197	383
Share-based compensation expense (note 5)	10	(142)	20	(32)
Restructuring expenses	-	2,553	-	3,451
Impairment expenses (note 4)	840	34	1,249	75
Gain on sale of asset	(26)	-	(26)	-
Other income and expenses	(42)	-	(201)	(15)
	3,280	6,921	5,619	9,772
Finance income	(59)	(97)	(241)	(237)
Finance expense	-	-	-	104
Net finance income	(59)	(97)	(241)	(133)
Comprehensive loss	\$ (3,221)	\$ (6,824)	\$ (5,378)	\$ (9,639)
Loss per share (note 5(b)) Basic and diluted	\$ (0.12)	\$ (0.25)	\$ (0.20)	\$ (0.35)

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Interim Statements of Cash Flows (unaudited)

For the six months ended June 30, 2016 and 2015
(CAD \$ thousands)

	2016	2015
Cash Flows from (used in) Operating Activities:		
Net loss for the period	\$ (5,378)	\$ (9,639)
Add/(deduct):		
Depreciation and amortization (note 3)	197	383
Stock-based compensation expense (note 5(c))	20	(32)
Impairment expense (note 4)	1,249	-
Net finance income	(241)	(133)
Interest income received	105	216
Gain on sale of asset	(26)	-
Changes in non-cash working capital (note 6)	(170)	609
	(4,244)	(8,696)
Cash Flows from (used in) Investing Activities:		
Additions to intangible assets (note 4)	(1,738)	-
Additions to capital assets (note 3)	(46)	-
Proceeds on sale of capital assets (note 3)	26	-
Changes in non-cash working capital (note 6)	(29)	(30)
	(1,787)	(30)
Cash Flows from (used in) Financing Activities:		
Proceeds on exercise of stock options (note 5)	62	-
	62	-
Effect of foreign exchange on cash	(7)	(99)
Change in cash	(5,976)	(8,725)
Cash, beginning of period	27,733	40,740
Cash and cash equivalents, end of period	\$ 21,757	\$ 32,015

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Interim Statements of Changes in Equity (unaudited)

For the six months ended June 30, 2016 and 2015
(CAD \$ thousands)

	2016		2015	
	Number	Amount	Number	Amount
Share Capital:				
Balance, beginning of period	27,478	\$ 129,786	27,478	\$ 129,786
Common shares issued	82	62	-	-
Transfer from contributed surplus on options exercise	-	31	-	-
Balance, end of period	27,560	129,879	27,478	129,786
Contributed Surplus:				
Balance, beginning of period		9,205		8,499
Stock-based compensation expense (note 5(c))		20		(32)
Transfer to share capital on options exercise		(31)	-	-
Balance, end of period		9,194		8,467
Deficit:				
Balance, beginning of period		(109,093)		(94,557)
Loss for the period		(5,378)		(9,639)
Balance, end of period		(114,471)		(104,196)
Balance, end of period		\$ 24,602		\$ 34,057

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and six months ended June 30, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

1. Reporting entity

Karnalyte Resources Inc. (the “Company” or “Karnalyte”) is incorporated under the laws of the province of Alberta. As at the date of the financial statements, the business of Karnalyte consisted of the exploration and development of its property and planned construction of a production facility and development of a potash mine. The property is situated in Saskatchewan, south of Wynyard and contains a dominant zone of potash and magnesium minerals. The recoverability of amounts recorded as mineral properties and deferred exploration and development costs is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain necessary financing to develop the property and upon future profitable production and the sale thereof.

As of the date of these financial statements, the Company was in its pre-development phase and therefore there is no certainty that the Company will be able to raise additional funds to obtain the necessary capital to move forward to the production stage. While the Company has sufficient cash to meet its short-term corporate operating and capital requirements, it does not currently have adequate funds to proceed with full-scale development of the solution mining facility.

The Company’s operating segments have been identified as the individual mineral reserve streams. As at the date of these financial statements, the Company identified two operating segments, potash and magnesium; however as investment in the magnesium segment is negligible they are grouped as one reporting segment for financial reporting purposes.

The Company’s address is 3150B Faithfull Ave. Saskatoon, SK S7K 8H3.

2. Basis of preparation

(a) Statement of compliance

These unaudited financial statements have been prepared by management in accordance with International Accounting Standard (“IAS”) 34, Interim Financial Reporting, as issued by the International Accounting Standards Board. In preparing these interim financial statements the Company applied the same accounting policies as disclosed in the year-end financial statements dated December 31, 2015. These statements do not include all information or disclosures normally provided in annual statements. These interim statements should be read in conjunction with the audit annual financial statements and related notes.

These financial statements were authorized for issue by the Board of Directors on August 9, 2016.

Certain of the prior period figures have been reclassified in order to conform to the current period presentation.

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and six months ended June 30, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

3. Capital assets

	Land and Buildings	Vehicles	Processing and other Equipment	Assets Under Construction	Total
Cost:					
Balance at January 1, 2015	\$ 497	\$ 100	\$ 3,721	\$ 18,046	\$ 22,364
Additions	-	-	-	665	665
Balance at December 31, 2015	497	100	3,721	18,711	23,029
Additions	-	46	-	-	46
Disposals	-	(29)	-	-	(29)
Balance at June 30, 2016	\$ 497	\$ 117	\$ 3,721	\$ 18,711	\$ 23,046
Accumulated depreciation:					
Balance at January 1, 2015	\$ 143	\$ 75	\$ 2,466	\$ 18,046	\$ 20,730
Depreciation	13	25	604	-	642
Impairment	-	-	-	665	665
Balance at December 31, 2015	156	100	3,070	18,711	22,037
Depreciation	6	5	186	-	197
Dispositions	-	(29)	-	-	(29)
Balance at June 30, 2016	\$ 162	\$ 76	\$ 3,256	\$ 18,711	\$ 22,205
Carrying amounts:					
December 31, 2015	\$ 341	\$ -	\$ 651	\$ -	\$ 992
June 30, 2016	\$ 335	\$ 41	\$ 465	\$ -	\$ 841

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and six months ended June 30, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

4. Exploration and evaluation assets and other assets

	Mineral Properties	Process Patents	Computer Software	Total
Cost:				
Balance at January 1, 2015	\$ 43,178	\$ 155	\$ 277	\$ 43,610
Additions	596	10	-	606
Balance at December 31, 2015	43,774	165	277	44,216
Additions	1,733	5	-	1,738
Balance at June 30, 2016	\$ 45,507	\$ 170	\$ 277	\$ 45,954
Amortization and impairment losses:				
Balance at January 1, 2015	\$ 40,796	\$ 155	\$ 277	\$ 41,228
Impairment	450	10	-	460
Balance at December 31, 2015	41,246	165	277	41,688
Impairment	1,244	5	-	1,249
Balance at June 30, 2016	\$ 42,490	\$ 170	\$ 277	\$ 42,937
Carrying amounts:				
December 31, 2015	\$ 2,528	\$ -	\$ -	\$ 2,528
June 30, 2016	\$ 3,017	\$ -	\$ -	\$ 3,017

5. Share capital

(a) Authorized

As at June 30, 2016 and 2015 the Company was authorized to issue an unlimited number of common shares. The holders of common shares are entitled to receive dividends as declared by the Company and are entitled to one vote per share. Since its inception, the Company has not declared a dividend.

During the six months ended June 30, 2016, 82,000 stock options were exercised for 82,000 common shares for gross proceeds of \$61,500. Therefore, at June 30, 2016, the Company has 27.56 million common shares outstanding.

The Company is also entitled to issue an unlimited number of preferred shares. There were no preferred shares issued throughout the six months ended June 30, 2016.

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and six months ended June 30, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

5. Share capital (continued)

(b) Earnings per share

Basic earnings per share were calculated as follows:

	Three months ended		Six months ended	
	2016	2015	2016	2015
Loss for the period ending June 30,	\$ (3,221)	\$ (6,824)	\$ (5,378)	\$ (9,639)
Weighted average number of common shares:				
Issued common shares at beginning of period	27,478	27,478	27,478	27,478
Share options exercised	13	-	13	-
Weighted average number of common shares	27,491	27,478	27,491	27,478
Basic loss per share	\$ (0.12)	\$ (0.25)	\$ (0.20)	\$ (0.35)

Basic loss per share is calculated using the weighted average number of shares outstanding during the year. Diluted per share amounts are equal to basic per share amounts due to the Company incurring a net loss for the period. Excluded from the diluted per share calculations were 2,018,000 (2015 - 1,035,000) options as their effect would have been anti-dilutive.

(c) Stock-based compensation expense

The Company has a stock option plan under which directors, officers and non-employees of the Company are eligible to receive stock options. The aggregate number of common shares to be issued upon the exercise of all stock options granted under the plan shall not exceed 10% of the issued common shares of the Company at the time of granting of the options. Options granted under the plan generally have a term of two to five years and vest at terms to be determined by the directors at the time of grant. The exercise price of each option shall be determined by the directors at the time of grant but shall not be less than the price permitted by the policies of the stock exchange on which the Company's common shares are then listed.

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and six months ended June 30, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

5. Share capital (continued)

(c) Stock-based compensation expense (continued)

On January 12, 2016 the Company granted 90,000 stock options to employees and officers in accordance with the Company's Stock Option Plan as approved by shareholders on June 20, 2013. The fair value of the options issued was estimated on the date of grant using the Black-Scholes option-pricing model. The interest rate, volatility, dividend yield and forfeiture rate assumptions used in the calculation were 0.58%, 68.37%, nil, 11% respectively. The options vest over two years, have a life of five years and a strike price of \$0.75.

The number and weighted average exercise prices of share options are as follows:

	2016		2015	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at January 1,	2,079	\$ 1.03	1,703	\$ 4.92
Issued during the period	90	0.75	-	-
Expired during the period	(9)	8.50	-	-
Forfeited during the period	(60)	5.49	(608)	1.45
Exercised during the period	(82)	0.75	-	-
Outstanding at June 30,	2,018	0.87	1,095	6.85
Exercisable at June 30,	1,938	\$ 0.87	1,035	\$ 7.18

Number of Options Outstanding	Exercise Price	Remaining Life (yrs)	Exercisable Options	Exercisable Price
50,000	\$ 1.27	2.01	38,000	\$ 1.27
1,848,000	0.75	4.04	1,848,000	0.75
90,000	0.75	6.45	22,000	0.75
30,000	7.95	1.72	30,000	7.95
2,018,000	\$ 0.87	3.56	1,938,000	\$ 0.87

Share based compensation of \$10,000 (2015 - \$142,000 reversal) was expensed during the three month period ended June 30, 2016. Share based compensation of \$20,000 (2015 - \$32,000 reversal) was expensed during the six month period ended June 30, 2016.

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and six months ended June 30, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

6. Supplemental cash flow information

Changes in non-cash working capital are as follows:

June 30,	2016	2015
Accounts receivable	\$ (81)	\$ 40
Prepaid expenses	(161)	(7)
Trade and other payables	43	546
	<u>\$ (199)</u>	<u>\$ 579</u>
Relating to:		
Operating activities	\$ (170)	\$ 609
Investing activities	(29)	(30)
	<u>\$ (199)</u>	<u>\$ 579</u>

7. Commitments

	Contractual cash flows	Less than one year	Two - three years	Four - five years	More than five years
Trade and other payables	\$ 544	\$ 544	\$ -	\$ -	\$ -
Provisions	1,290	1,290	-	-	-
Office lease	146	146	-	-	-
Permit/lease on mineral property	8,495	246	932	932	6,385
Project contracts	851	851	-	-	-
	<u>\$ 11,326</u>	<u>\$ 3,077</u>	<u>\$ 932</u>	<u>\$ 932</u>	<u>\$ 6,385</u>

8. Risk management

Financial instruments included in the statements of financial position consist of cash, trade and other receivables, restricted cash, and trades and other payables. The fair values of these financial instruments approximate their varying amounts due to the short term maturity of the instruments.