

Condensed Interim Unaudited Financial Statements of

KARNALYTE RESOURCES INC.

Nine months ended September 30, 2016 and 2015



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INTERIM REVIEW REPORT

To the Members of the Audit Committee

In accordance with our engagement letter dated July 30, 2015, we have reviewed the condensed interim financial statements of Karnalyte Resources Inc., consisting of:

- the statement of financial position as at September 30, 2016;
- the statements of comprehensive loss for the three and nine-month periods ended September 30, 2016 and 2015;
- the statements of cash flows for the nine-month periods ended September 30, 2016 and 2015; and
- the statements of changes in equity for the nine-month periods ended September 30, 2016 and 2015.

These condensed interim financial statements are the responsibility of management.

We performed our reviews in accordance with Canadian generally accepted standards for a review of interim financial statements by an entity's auditors (an "interim review"). An interim review is substantially less in scope than an audit, whose objective is the expression of an opinion regarding the financial statements; accordingly, we do not express such an opinion. An interim review does not provide assurance that we would become aware of any or all significant matters that might be identified in an audit.

Based on our interim reviews, we are not aware of any material modification that needs to be made for these condensed interim financial statements to be in accordance with International Accounting Standard No. 34, Interim Financial Reporting.

Comparative Information

We have previously audited, in accordance with Canadian generally accepted auditing standards, the financial statements of Karnalyte Resources Inc., which comprise the statement of financial position as at December 31, 2015, the statements of comprehensive loss, cash flows and changes in equity for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information (not presented herein). In our auditors' report dated March 28, 2016, we expressed an unmodified audit opinion on those financial statements.

In our opinion, the information set forth in the accompanying statement of financial position as at December 31, 2015, is fairly stated, in all material respects, in relation to the financial statements from which it has been derived.



Use of the report

This report is for the use of the Audit Committee and the Board of Directors of Karnalyte Resources Inc. to assist them in discharging their obligation regarding these condensed interim financial statements, and should not be used for any other purpose.

KPMG LLP

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, slanted style. Below the signature is a long, horizontal, slightly curved line that tapers at both ends, serving as a decorative underline.

Chartered Professional Accountants

November 9, 2016
Saskatoon, Canada

KARNALYTE RESOURCES INC.

Interim Statements of Financial Position (unaudited)

(CAD \$ thousands)

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash	\$ 18,821	\$ 27,733
Trade and other receivables	135	85
Prepaid expenses	320	249
	<u>19,276</u>	<u>28,067</u>
Restricted cash	375	375
Capital assets (note 3)	781	992
Exploration and evaluation and other assets (note 4)	3,960	2,528
ASSETS	\$ 24,392	\$ 31,962
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Trade and other payables	\$ 537	\$ 499
Provision	1,318	1,384
	<u>1,855</u>	<u>1,883</u>
Decommissioning liability	159	181
Total liabilities	2,014	2,064
Shareholders' equity:		
Share capital (note 5)	129,879	129,786
Contributed surplus	9,199	9,205
Deficit	(116,700)	(109,093)
Total shareholders' equity	<u>22,378</u>	<u>29,898</u>
LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 24,392	\$ 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 nine months ended September 30, 2016 and 2015
(CAD \$ thousands)

	Three months ended		Nine months ended	
	2016	2015	2016	2015
Expenses:				
General and administrative	\$ 1,781	\$ 1,549	\$ 6,161	\$ 7,533
Depreciation and amortization (note 3)	71	191	269	575
Stock-based compensation expense (note 5)	6	735	25	703
Restructuring expenses	-	-	-	3,451
Impairment expenses (note 4)	477	524	1,726	524
Gain on sale of asset	-	-	(26)	-
Other income and expenses	(93)	-	(294)	(15)
	2,242	2,999	7,861	12,771
Finance income	(13)	(73)	(254)	(310)
Finance expense	-	35	-	139
Net finance income	(13)	(38)	(254)	(171)
Comprehensive loss	\$ (2,229)	\$ (2,961)	\$ (7,607)	\$ (12,600)
Loss per share (note 5(b)) Basic and diluted	\$ (0.08)	\$ (0.11)	\$ (0.28)	\$ (0.46)

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Interim Statements of Cash Flows (unaudited)

For the nine months ended September 30, 2016 and 2015
(CAD \$ thousands)

	2016	2015
Cash Flows from (used in) Operating Activities:		
Net loss for the period	\$ (7,607)	\$ (12,600)
Add/(deduct):		
Depreciation and amortization (note 3)	269	575
Stock-based compensation expense (note 5(c))	25	703
Impairment expense (note 4)	1,726	524
Net finance income	(254)	(171)
Interest income received	157	310
Gain on sale of asset	(26)	-
Changes in non-cash working capital (note 6)	(39)	258
	(5,749)	(10,401)
Cash Flows from (used in) Investing Activities:		
Additions to intangible assets (note 4)	(3,158)	(524)
Additions to capital assets (note 3)	(58)	-
Proceeds on sale of capital assets (note 3)	26	(64)
Changes in non-cash working capital (note 6)	(18)	154
	(3,208)	(434)
Cash Flows from (used in) Financing Activities:		
Proceeds on exercise of stock options (note 5)	62	-
	62	-
Effect of foreign exchange on cash	(17)	(119)
Change in cash	(8,912)	(10,954)
Cash, beginning of period	27,733	40,740
Cash and cash equivalents, end of period	\$ 18,821	\$ 29,786

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Interim Statements of Changes in Equity (unaudited)

For the nine months ended September 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))		25		703
Transfer to share capital on options exercise		(31)	-	-
Balance, end of period		9,199		9,202
Deficit:				
Balance, beginning of period		(109,093)		(94,557)
Loss for the period		(7,607)		(12,600)
Balance, end of period		(116,700)		(107,157)
Balance, end of period		\$ 22,378		\$ 31,831

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and nine months ended September 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 November 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 nine months ended September 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	12	-	58
Disposals	-	(29)	-	-	(29)
Balance at September 30, 2016	\$ 497	\$ 117	\$ 3,733	\$ 18,711	\$ 23,058
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	10	9	250	-	269
Dispositions	-	(29)	-	-	(29)
Balance at September 30, 2016	\$ 166	\$ 80	\$ 3,320	\$ 18,711	\$ 22,277
Carrying amounts:					
December 31, 2015	\$ 341	\$ -	\$ 651	\$ -	\$ 992
September 30, 2016	\$ 331	\$ 37	\$ 413	\$ -	\$ 781

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and nine months ended September 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	3,153	5	-	3,158
Balance at September 30, 2016	\$ 46,927	\$ 170	\$ 277	\$ 47,374
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	1,721	5	-	1,726
Balance at September 30, 2016	\$ 42,967	\$ 170	\$ 277	\$ 43,414
Carrying amounts:				
December 31, 2015	\$ 2,528	\$ -	\$ -	\$ 2,528
September 30, 2016	\$ 3,960	\$ -	\$ -	\$ 3,960

5. Share capital

(a) Authorized

As at September 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 nine months ended September 30, 2016, 82,000 stock options were exercised for 82,000 common shares for gross proceeds of \$61,500. Therefore, at September 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 nine months ended September 30, 2016.

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and nine months ended September 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		Nine months ended	
	2016	2015	2016	2015
Loss for the period ending Sept 30,	\$ (2,229)	\$ (2,961)	\$ (7,607)	\$ (12,600)
Weighted average number of common shares:				
Issued common shares at beginning of period	27,512	27,478	27,478	27,478
Share options exercised	-	-	34	-
Weighted average number of common shares	27,512	27,478	27,512	27,478
Basic loss per share	\$ (0.08)	\$ (0.11)	\$ (0.28)	\$ (0.46)

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 – 2,079, 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 nine months ended September 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	1,930	0.75
Expired during the period	(9)	8.50	-	-
Forfeited during the period	(60)	5.49	(1,554)	4.96
Exercised during the period	(82)	0.75	-	-
Outstanding at September 30,	2,018	0.87	2,079	1.03
Exercisable at September 30,	1,951	\$ 0.87	2,039	\$ 1.02

Number of Options Outstanding	Exercise Price	Remaining Life (yrs)	Exercisable Options	Exercisable Price
50,000	\$ 1.27	1.76	50,000	\$ 1.27
1,848,000	0.75	3.79	1,848,000	0.75
90,000	0.75	6.20	22,000	0.75
30,000	7.95	1.47	30,000	7.95
2,018,000	\$ 0.87	3.31	1,951,000	\$ 0.87

Share based compensation of \$6,000 (2015 - \$735,000) was expensed during the three month period ended September 30, 2016. Share based compensation of \$25,000 (2015 - \$703,000) was expensed during the nine month period ended September 30, 2016.

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and nine months ended September 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:

September 30,	2016	2015
Accounts receivable	\$ (24)	\$ 65
Prepaid expenses	(71)	34
Trade and other payables	38	313
	<u>\$ (57)</u>	<u>\$ 412</u>
Relating to:		
Operating activities	\$ (39)	\$ 258
Investing activities	(18)	154
	<u>\$ (57)</u>	<u>\$ 412</u>

7. Commitments

	Contractual cash flows	Less than one year	Two - three years	Four - five years	More than five years
Trade and other payables	\$ 537	\$ 537	\$ -	\$ -	\$ -
Provisions	1,318	1,318	-	-	-
Office lease	98	98	-	-	-
Permit/lease on mineral property	8,488	483	932	932	6,141
Project contracts	158	158	-	-	-
	<u>\$ 10,599</u>	<u>\$ 2,594</u>	<u>\$ 932</u>	<u>\$ 932</u>	<u>\$ 6,141</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.

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and nine months ended September 30, 2016 and 2015
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9. Subsequent event

On October 1st, 2016, the Company issued 555,555 common shares to Gujarat State Fertilizers & Chemicals (“GSFC”). These shares were issued in order to satisfy a contractual obligation that arose as a result of the subscription agreement that the Company entered into with GSFC on March 7, 2013 when the Company closed a non-brokered private placement financing with GSFC for \$44,745,994 in exchange for 5,490,306 common shares which represented a 19.98% ownership stake in the Company. Under the terms of the subscription agreement, the Company was obligated to issue an additional 555,555 common shares to GSFC if commercial production had not commenced on or before October 1, 2016. Since commercial production had not yet commenced on October 1, 2016, the additional 555,555 common shares were issued on that date.