

Financial Statements of

KARNALYTE RESOURCES INC.

Years ended December 31, 2016 and 2015



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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Karnalyte Resources Inc.

We have audited the accompanying financial statements of Karnalyte Resources Inc., which comprise the statements of financial position as at December 31, 2016 and 2015, the statements of comprehensive loss, changes in equity and cash flows for the years then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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



Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Karnalyte Resources Inc. as at December 31, 2016 and 2015, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

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 serves as a flourish or underline.

Chartered Professional Accountants

March 14, 2017
Saskatoon, Canada

KARNALYTE RESOURCES INC.

Statements of Financial Position

December 31, 2016 and 2015
(CAD \$ thousands)

| | 2016 | 2015 |
|--|------------------|------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 16,752 | \$ 27,733 |
| Trade and other receivables | 77 | 85 |
| Prepaid expenses | 327 | 249 |
| | <u>17,156</u> | <u>28,067</u> |
| Restricted cash (note 4) | 375 | 375 |
| Capital assets (note 5) | 710 | 992 |
| Exploration and evaluation and other assets (note 6) | 4,783 | 2,528 |
| | <u>\$ 23,024</u> | <u>\$ 31,962</u> |
| LIABILITIES | | |
| Current liabilities: | | |
| Trade and other payables | \$ 406 | \$ 499 |
| Provision (note 7) | 1,344 | 1,384 |
| | <u>1,750</u> | <u>1,883</u> |
| Decommissioning liability (note 8) | 136 | 181 |
| Total liabilities | <u>1,886</u> | <u>2,064</u> |
| Shareholders' equity: | | |
| Share capital (note 9) | 129,879 | 129,786 |
| Contributed surplus | 9,204 | 9,205 |
| Deficit | (117,945) | (109,093) |
| Total shareholders' equity | <u>21,138</u> | <u>29,898</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | <u>\$ 23,024</u> | <u>\$ 31,962</u> |

Commitments (note 15(c))

See accompanying notes to the financial statements.

Approved on behalf of the Board:

"signed"
Robin Phinney, Director

"signed"
Henry Kerkhoven, Director

KARNALYTE RESOURCES INC.

Statements of Comprehensive Loss

For the years ended December 31, 2016 and 2015
(CAD \$ thousands)

| | 2016 | 2015 |
|--|------------|-------------|
| Expenses: | | |
| General and administrative | \$ 6,986 | \$ 8,795 |
| Depreciation and amortization (note 5 and 6) | 340 | 642 |
| Share-based compensation expense (note 9(d)) | 30 | 706 |
| Restructuring expenses | - | 3,451 |
| Impairment expenses (note 6) | 1,980 | 1,125 |
| Gain on sale of asset | (88) | - |
| Other income and expenses | (100) | (33) |
| | 9,148 | 14,686 |
| Finance income | (296) | (160) |
| Finance expense | - | 10 |
| Net finance income (note 12) | (296) | (150) |
| Comprehensive loss | \$ (8,852) | \$ (14,536) |
| Loss per share (note 9(b)) Basic and diluted | \$ (0.32) | \$ (0.53) |

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Statements of Cash Flows

For the years ended December 31, 2016 and 2015
(CAD \$ thousands)

| | 2016 | 2015 |
|--|------------------|------------------|
| Cash Flows from (used in) Operating Activities: | | |
| Net loss for the period | \$ (8,852) | \$ (14,536) |
| Add/deduct: | | |
| Depreciation and amortization (note 5 and 6) | 340 | 642 |
| Stock-based compensation expense | 30 | 706 |
| Impairment expense (note 5 and 6) | 1,980 | 1,125 |
| Net finance income | (296) | (150) |
| Interest income received | 202 | 377 |
| Other non-cash expense | - | 6 |
| Gain on sale of asset | (88) | - |
| Unrealized foreign exchange gain/(loss) | 22 | (216) |
| Changes in non-cash working capital (note 14) | (159) | 272 |
| | <u>(6,821)</u> | <u>(11,774)</u> |
| Cash Flows from (used in) Investing Activities: | | |
| Additions to intangible assets (note 6) | (4,235) | (606) |
| Additions to capital assets (note 5) | (58) | (665) |
| Proceeds on sale of capital assets (note 5) | 88 | - |
| Changes in non-cash working capital (note 14) | (17) | 38 |
| | <u>(4,222)</u> | <u>(1,233)</u> |
| Cash Flows from Financing Activities: | | |
| Exercise of options (note 9(a)) | 62 | - |
| | <u>62</u> | <u>-</u> |
| Change in cash | (10,981) | (13,007) |
| Cash, beginning of period | 27,733 | 40,740 |
| Cash and cash equivalents, end of period | <u>\$ 16,752</u> | <u>\$ 27,733</u> |

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Statements of Changes in Equity

For the years ended December 31, 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 under private placement (note 9(c)) | 556 | - | - | - |
| Common shares issued on exercise of share options (note 9(a)) | 82 | 62 | | |
| Transfer from contributed surplus on options exercise | - | 31 | | |
| Vesting of employee share ownership plan | - | - | - | 1 |
| Balance, end of period | 28,116 | 129,879 | 27,478 | 129,786 |
| Contributed Surplus: | | | | |
| Balance, beginning of period | | 9,205 | | 8,499 |
| Stock-based compensation expense (note 9) | | 30 | | 706 |
| Transfer to share capital on exercise | | (31) | | - |
| Balance, end of period | | 9,204 | | 9,205 |
| Deficit: | | | | |
| Balance, beginning of period | | (109,093) | | (94,557) |
| Loss for the period | | (8,852) | | (14,536) |
| Balance, end of period | | (117,945) | | (109,093) |
| Balance, end of period | | \$ 21,138 | | \$ 29,898 |

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 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 financial statements have been prepared by management in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board.

These financial statements were authorized for issue by the Board of Directors on March 14, 2017.

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis.

(c) Functional and presentation currency

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

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

2. Basis of preparation (continued)

(d) Use of estimates and judgements

The preparation of the financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expense. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements are as follows:

(i) Use of estimates

The following are the key assumptions concerning the sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing adjustments to the carrying amounts of assets and liabilities.

i. Reserve Estimates

The estimation of potash reserves is an inherently complex process. Proven and probable reserves are estimated based on geological data, geophysical data, engineering data, projected future rates of production, estimated commodity prices, costs, discount rates and the timing of future expenditures. Reserves estimates, although not reported as part of the Company's financial statements, can have a significant effect on earnings, assets, as a result of their impact on depletion and impairment, decommissioning provisions and deferred income taxes. Accordingly, the impact to the financial statements of changes to estimates of reserves in future periods could be material.

ii. Decommissioning Provisions

Amounts are recorded for decommissioning provisions that will be incurred by the Company at the end of the operating life of the facilities and properties, and upon retirement of its mining assets. Estimates of these costs are subject to uncertainty associated with the method, timing and extend of future decommissioning activities. The provision and related asset and expense are impacted by estimates with respect to the costs and timing of decommissioning.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

2. Basis of preparation (continued)

(d) Use of estimates and judgements (continued)

(i) Use of estimates (continued)

iii. Share-Based Compensation

Compensation expense recognized for the Company's share-based compensation plan is accrued over the vesting period based on grant date fair values. Fair values are determined using the Black-Scholes option pricing model while the fair value of restricted and performance awards are valued based on the closing share price on the date immediately prior to the grant date. In assessing the fair value of share based compensation, significant assumptions such as expected volatility, dividend yield, expected term, estimated forfeiture rates and performance multipliers for performance awards are made.

iv. Income Taxes

The Company follows the asset/liability method for calculating deferred income taxes. Tax interpretations, regulations and legislation in the various jurisdictions in which the Company operates are subject to change. As such, income taxes are subject to measurement uncertainty. Deferred income tax assets are recognized only to the extent that those assets are considered recoverable. Deferred income tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings.

(ii) Judgements

The following are the critical judgements that management has made in the process of applying the Company's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

i. Cash Generating Unit ("CGU")

For the purpose of impairment testing, mining assets are aggregated in CGU's. The determination of CGUs requires judgement in defining the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or group of assets. CGUs are determined by similar geological structure, shared infrastructure, geographical proximity, commodity type, similar exposure to market risks and materiality. The Company's CGU's are consistent with its operating segments.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

2. Basis of preparation (continued)

(d) Use of estimates and judgements (continued)

(ii) Judgements (continued)

ii. Impairment

Judgements are required to assess when impairment indicators exist and impairment testing is required. The recoverable amounts of CGUs are based on the higher of their value-in-use and fair value less costs to sell. These calculations require the use of estimates and assumptions. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves. Management does not expect a significant difference between value in use and fair value less cost to sell.

iii. Exploration and Evaluation Assets ("E&E")

The decision to transfer assets from E&E to property, plant and equipment requires management to make certain judgements as to future events and is based on whether economic quantities of proven plus probable reserves have been found to determine a project's technical feasibility and commercial viability.

iv. Income Taxes

Judgements are made by management at the end of the reporting period to determine the likelihood that deferred income tax assets will be realized from future taxable earnings. Assessing the recoverability of deferred income tax assets requires the Company to make judgements related to the expectations of future cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that assumptions regarding future profitability change, there can be an increase or decrease in the amounts recognized in profit or loss in the period in which the change occurs.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

3. Significant accounting policies

The accounting policies set out below have been applied consistently by the Company to all periods presented in these financial statements.

(a) Foreign currency

Transactions in foreign currencies are translated to Canadian dollars at exchange rates on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the period end exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on translation are recognized in profit or loss under finance income and expenses on a net basis.

(b) Financial instruments

Financial instruments measured at fair value are recognized at fair value on initial recognition while other financial instruments are measured at fair value, net of transaction costs. Measurement in subsequent periods depends on whether the financial instrument has been classified as “fair value through profit or loss”, “loans and receivables”, “available-for-sale”, “held-to-maturity”, or “other financial liabilities” as defined by the accounting standard. Financial assets and financial liabilities designated at “fair value through profit or loss” are measured at fair value with changes in those fair values recognized in profit or loss. Financial assets classified as loans and receivables or held-to-maturity, or other financial liabilities are measured at amortized cost using the effective interest method. Financial assets classified as available-for-sale are measured at fair value, with changes in fair value recognized in other comprehensive income.

The Company’s cash, trade and other receivables and restricted cash are classified as loans and receivables. Trade and other payables are classified as other financial liabilities.

(c) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

3. Significant accounting policies (continued)

(d) Property, plant and equipment and intangible exploration assets

(i) Recognition and measurement

i. Exploration and evaluation expenditures

Pre-exploration costs are recognized in profit and loss as incurred. After obtaining a license, mineral exploration and evaluation costs, including the costs of acquiring permits and directly attributable general and administrative costs, are initially capitalized as exploration and evaluation assets.

ii. Development and production costs

Upon determination of technical feasibility and commercial viability the costs associated with the exploration and evaluation of the associated proven and probable reserves are transferred to development and production assets. The associated costs are assessed for impairment at the time the costs are transferred from exploration and evaluation expenditures to development and production assets.

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized when they increase the future economic benefits embodied in the specific asset to which they relate, such as developing proven and/or probable reserves and bringing in or enhancing production from reserves or resources, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized and the cost of the replacement part is recognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

Development and production expenditures are recognized as assets under construction until the assets are available for their intended use and not depreciated. When assets are available for their intended use, the asset is depreciated and recognized at its original cost less accumulated depletion and depreciation.

(ii) Depletion and depreciation

When significant parts of an item of property, plant and equipment, including mining interests, have different useful lives, they are accounted for as separate items (major components). Once commercial production begins, the accumulated costs of capital assets and exploration and evaluation assets will be amortized to operations on a unit of production basis over economically recoverable proven plus probable reserves or over the estimated useful life, if shorter.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

3. Significant accounting policies (continued)

(d) Property, plant and equipment and intangible exploration assets (continued)

(ii) Depletion and depreciation (continued)

Reserves are estimated using independent reserve engineer reports and represent the estimated quantities of potash and magnesium which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known resources and which are considered commercially viable.

Depreciation is recognized in profit or loss on a straight-line basis or unit of production over the estimated useful lives of each part of an item of capital assets and intangible exploration and evaluation assets. Land is not depreciated.

The estimated useful lives for capital assets for the current and comparative years are as follows:

| | |
|--------------------------------|--------------|
| Buildings | 25 years |
| Land Improvements | 20 years |
| Processing and other equipment | 5 - 10 years |
| Vehicles | 3 years |

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(e) Other intangible assets

Other intangible assets that are acquired by the Company, which have finite useful lives, are measured at cost less accumulated amortization and accumulated impairment losses. Subsequent expenditures are capitalized only when they increase the future economic benefits embodied in the specific asset to which they relate.

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives of other intangible assets from the date they were available for use.

The estimated useful lives for the intangible assets are as follows:

| | |
|-------------------|----------|
| Patents | 20 years |
| Computer Software | 1 year |

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

3. Significant accounting policies (continued)

(f) Leased assets

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term.

Minimum lease payments made under finance leases are apportioned between finance expenses and the reduction of the outstanding liability using the effective interest method, so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Operating leases are not recognized on the Company's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(g) Impairment

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and its fair value, and is recognized in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in the same statement where the original loss was recognized.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

3. Significant accounting policies (continued)

(g) Impairment (continued)

(ii) Non-financial assets

For the purpose of impairment testing, non-financial assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or cash generating units ("CGU's"). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell. An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount.

Upon the establishment of technical feasibility and at the time sufficient funding becomes available to proceed with plant construction, the related exploration and evaluation assets are transferred to development and production assets and are assessed for impairment at the time that the costs are transferred.

Non-financial assets are assessed for an indication of impairment at each financial reporting period or if facts and circumstances suggest that the carrying amount exceeds the recoverable amount. In determining the recoverable amount of the CGU cash generating unit the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Recoverable amount is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves and therefore is subject to the estimation of mineral reserves or the amount a market participant is willing to pay to acquire the assets of the CGU.

In respect of non-financial assets, impairment losses recognized in prior years are assessed at each reporting date for any indication that the fair value has recovered. An impairment loss is reversed if there has been a change in the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized.

(h) Stock-based compensation expense

The grant date fair value of options granted to employees is calculated using the Black-Scholes option pricing model and is recognized as compensation expense, within profit and loss, with a corresponding increase in contributed surplus over the vesting period. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

3. Significant accounting policies (continued)

(i) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

(j) Decommissioning obligations

The Company's activities give rise to dismantling, decommissioning and site disturbance remediation activities. Provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the reporting date. Subsequent to the initial measurement, the obligations are adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision were established.

(k) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in shareholders' equity. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date. Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if they relate to income taxes levied by the same tax authority.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

3. Significant accounting policies (continued)

(l) Earnings per share

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees.

(m) New standards and interpretations not yet adopted:

The Company will be required to adopt the following new and revised International Financial Reporting Standards (“IFRS”) that were issued by the International Accounting Standards Board (“IASB”):

i) IFRS 9 – Financial Instruments

IFRS 9 introduces new requirements for classifying and measuring financial assets and liabilities and carries over from the previous requirements. The Company intends to adopt IFRS 9 (2014) in its financial statements for the annual period beginning on January 1, 2018. The extent of the impact of adoption of the standard has not yet been determined.

ii) IFRS 15 – Revenue

IFRS 15 “Revenue” specifies how and when to recognize revenue as well as requiring entities to provide users of financial statements with more disclosure. The standard supersedes IAS 18 “Revenue”, IAS 11 “Construction contracts”, and related interpretations. IFRS 15 will be effective for annual periods beginning on or after January 1, 2018. Application of the standard is mandatory and early adoption is permitted. Karnalyte is currently evaluating the impact of adopting IFRS 15 on its financial statements.

iii) IFRS 16 – Leases

IFRS 16 “Leases” introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term greater than 12 months, unless the underlying asset is of a low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. IFRS 16 will replace IAS 17, Leases and is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted. Karnalyte is currently evaluating the impact of adopting IFRS 16 on its financial statements.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

3. Significant accounting policies (continued)

(m) New standards and interpretations not yet adopted (continued):

iv) Amendments to IAS 7

In January 2016, the IASB issued amendments to IAS 7 “Statements of Cash Flows” as part of its “Disclosure Initiative”. These amendments are required to be applied prospectively and are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted. The amendments are intended to clarify IAS 7 to improve information provided to users of financial statements about an entity’s financing activities. Karnalyte does not expect the amendments to have a material impact on the financial statements.

4. Restricted cash

The Company was required to submit three separate \$125,000 (2015 – \$375,000) irrevocable letters of credit to Saskatchewan Ministry of Environment towards any future environmental damage that could potentially be caused by the operation of its test facility near Wynyard, Saskatchewan. The letters of credit have been provided by the Company’s bank on behalf of the Company and are secured by interest-bearing deposits that are not available to the Company for general use. Funds were renewed in June and August of 2014 and are invested in Guaranteed Investment Certificates which are redeemable on the 15th day of each month and are due for renewal in 2019.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

5. 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 |
| Dispositions | - | - | - | - | - |
| Balance at December 31, 2015 | 497 | 100 | 3,721 | 18,711 | 23,029 |
| Additions | - | 46 | 12 | - | 58 |
| Dispositions | - | (29) | (26) | - | (55) |
| Balance at December 31, 2016 | \$ 497 | \$ 117 | \$ 3,707 | \$ 18,711 | \$ 23,032 |
| Accumulated depreciation: | | | | | |
| Balance at January 1, 2015 | \$ 143 | \$ 75 | \$ 2,466 | \$ 18,046 | \$ 20,730 |
| Depreciation | 13 | 25 | 604 | - | 642 |
| Dispositions | - | - | - | - | - |
| Impairment | - | - | - | 665 | 665 |
| Balance at December 31, 2015 | 156 | 100 | 3,070 | 18,711 | 22,037 |
| Depreciation | 13 | 13 | 314 | - | 340 |
| Dispositions | - | (29) | (26) | - | (55) |
| Impairment | - | - | - | - | - |
| Balance at December 31, 2016 | \$ 169 | \$ 84 | \$ 3,358 | \$ 18,711 | \$ 22,322 |
| Carrying amounts: | | | | | |
| December 31, 2015 | \$ 341 | \$ - | \$ 651 | \$ - | \$ 992 |
| December 31, 2016 | \$ 328 | \$ 33 | \$ 349 | \$ - | \$ 710 |

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

6. 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 |
| Sale of assets | - | - | - | - |
| Balance at December 31, 2015 | 43,774 | 165 | 277 | 44,216 |
| Additions | 4,230 | 5 | - | 4,235 |
| Sale of Assets | - | - | - | - |
| Balance at December 31, 2016 | \$ 48,004 | \$ 170 | \$ 277 | \$ 48,451 |
| Amortization and impairment losses: | | | | |
| Balance at January 1, 2015 | \$ 40,796 | \$ 155 | \$ 277 | \$ 41,228 |
| Amortization for the year | - | - | - | - |
| Impairment | 450 | 10 | - | 460 |
| Balance at December 31, 2015 | 41,246 | 165 | 277 | 41,688 |
| Amortization for the period | - | - | - | - |
| Impairment | 1,975 | 5 | - | 1,980 |
| Balance at December 31, 2016 | \$ 43,221 | \$ 170 | \$ 277 | \$ 43,668 |
| Carrying amounts: | | | | |
| December 31, 2015 | \$ 2,528 | \$ - | \$ - | \$ 2,528 |
| December 31, 2016 | \$ 4,783 | \$ - | \$ - | \$ 4,783 |

At December 31, 2016, the Company assessed whether there was any indication that previously recognized impairment losses required reversal. The Company determined that there were no indications that the asset values had increased significantly during the period. The Company has not obtained project financing and the Company's market capitalization continues to be depressed as does the market for potash. Therefore, in addition to the impairment losses recognized at December 31, 2014 and December 31, 2015, the Company recorded an impairment loss of \$1,980,000 during 2016 to impair additions to exploration and evaluation assets to their estimated recoverable amount.

Disclosure of sensitivities of the recoverable amount to changes in management estimates are not meaningful given the methodology described above in determining the fair value less cost to sell, however the identification of a buyer of the project in its entirety, or the Company's ability to secure adequate financing for the development of the mine on economic terms, could result in a material difference from the current estimate of the recoverable amount.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
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7. Provision

A provision in the amount of \$1,344,000 was included in current liabilities as at December 31, 2016 (2015 - \$1,384,000). The amount accrued is based in US dollars and so the change from December 31, 2015 represents the fluctuation in the exchange rate from December 31, 2015 to December 31, 2016. There are uncertainties at this time as to the timing and amount of this provision as the Company disputes that this amount is owing. The amount arose as a result of previous debt financing no longer being probable and previous financing contracts being cancelled by the Company.

8. Decommissioning liability

| December 31, | 2016 | 2015 |
|---------------------|--------|--------|
| Beginning balance | \$ 181 | \$ 164 |
| Changes in estimate | (48) | 7 |
| Accretion | 3 | 10 |
| Ending balance | \$ 136 | \$ 181 |

The undiscounted amount of estimated costs required to settle the obligations at December 31, 2016 is \$212,000 (2015 - \$212,000) which are expected to be incurred between 2028 and 2029. The estimated costs have been inflated at 2.0 percent and discounted at a risk free rate of 2.08 percent (2015 - 1.84 percent) for the year ending December 31, 2016.

9. Share capital

(a) Authorized

As at December 31, 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 year, 82,000 stock options were exercised for 82,000 common shares for gross proceeds of \$61,500. The Company also issued 555,555 common shares to Gujarat State Fertilizers & Chemicals ("GSFC") as detailed at Note 9 (c). Therefore, at December 31, 2016, the Company has 28,116,000 common shares outstanding.

The Company is also entitled to issue an unlimited number of preferred shares. There were no preferred shares issued throughout the year ended December 31, 2016.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

9. Share capital (continued)

(b) Earnings per share

Basic earnings per share were calculated as follows:

| | 2016 | 2015 |
|---|------------|-------------|
| Loss for the year ending December 31, | \$ (8,852) | \$ (14,536) |
| Weighted average number of common shares: | | |
| Issued common shares at beginning of period | 27,478 | 27,478 |
| Common shares issued | 194 | - |
| Weighted average number of common shares | 27,672 | 27,478 |
| Basic loss per share | \$ (0.32) | \$ (0.53) |

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 - 2,078,500) options as their effect would have been anti-dilutive.

(c) Private placement

On March 7, 2013 the Company closed a non-brokered private placement financing with Gujarat State Fertilizers & Chemicals ("GSFC") for \$44,745,994 in exchange for 5,490,306 common shares which represents a 19.98% ownership stake in the Company. Along with the financing, GSFC committed to an off-take agreement for the purchase of approximately 350,000 tonnes per year of potash increasing to 600,000 tonnes per year for a period of 20 years from the commencement of commercial production.

On October 1st, 2016, the Company issued 555,555 common shares to 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. 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 yet 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. This issuance brought GSFC's total ownership stake from 19.98% to 21.5%.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

9. Share capital (continued)

(d) 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.

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 year | 90 | 0.75 | 1,930 | 0.75 |
| Expired during the year | (9) | 8.50 | - | - |
| Forfeited during the year | (60) | 5.49 | (1,544) | 4.96 |
| Exercised during the year | (82) | 0.75 | - | - |
| Outstanding at December 31, | 2,018 | 0.87 | 2,079 | 1.03 |
| Exercisable at December 31, | 1,951 | \$ 0.87 | 2,039 | \$ 1.02 |

| Number of Options Outstanding | Exercise Price | Remaining Life (yrs) | Vested Exercisable Options |
|-------------------------------|----------------|----------------------|----------------------------|
| 50,000 | \$ 1.27 | 1.51 | 50,000 |
| 1,848,000 | 0.75 | 3.54 | 1,848,000 |
| 90,000 | 0.75 | 5.95 | 23,000 |
| 30,000 | 7.95 | 1.22 | 30,000 |
| 2,018,000 | \$ 0.87 | 3.05 | 1,951,000 |

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
(All tabular amounts are in CAD thousands except per share amounts)

9. Share capital (continued)

(d) Stock-based compensation expense (continued)

On January 12, 2016 the Company granted 90,000 stock options to employees, officers and directors 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, and 0% respectively which resulted in a fair value of \$0.43 per option. All of these options vest over two years and have a life of five years.

Share based compensation of \$30,000 (2015 - \$706,000), net of reversals due to forfeitures, was expensed during the year ended December 31, 2016.

10. Nature of general and administrative expenses

The Company is required to present its financial performance by nature or by function. The Company has presented its financial performance by the underlying nature of the expense with the exception of general and administrative expenses. Had the general and administrative expenses been presented by their nature, the Company would disclose payroll expense and employee benefits of \$2,235,000 (2015 - \$1,284,000), accounting and legal of \$2,867,000 (2015 - \$3,282,000), consulting of \$389,000 (2015 - 1,741,000) and office and sundry expense of \$1,776,000 (2014 - \$2,448,000) for the years ending December 31, 2016 and 2015.

11. Key management personnel

The aggregate payroll expense of key management personnel and directors was as follows:

| December 31, | 2016 | 2015 |
|-----------------------|-----------------|-----------------|
| Salaries and benefits | \$ 1,337 | \$ 1,654 |
| Severance payments | - | 2,764 |
| Share-based payments | 18 | 731 |
| | <u>\$ 1,355</u> | <u>\$ 5,149</u> |

KARNALYTE RESOURCES INC.

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For the years ended December 31, 2016 and 2015
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12. Finance income and expenses

| December 31, | 2016 | 2015 |
|---|----------|----------|
| Finance income: | | |
| Interest income on bank deposits | \$ (229) | \$ (377) |
| Foreign exchange (loss)/gain | (22) | 217 |
| | (251) | (160) |
| Financial expenses: | | |
| Accretion of provisions | 3 | 4 |
| Change in estimate of decommissioning liability | (48) | 6 |
| | (45) | 10 |
| Net finance income recognized in comprehensive loss | \$ (296) | \$ (150) |

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
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13. Income tax expense

The provision for income taxes in the statement of loss reflects an effective tax rate which differs from the expected statutory rate. Differences are as follows:

| | 2016 | 2015 |
|---|------------|-------------|
| Loss before tax | \$ (8,852) | \$ (14,536) |
| Expected tax rate | 27% | 26.5% |
| Expected income tax | (2,390) | (3,852) |
| Non-deductible expenses | 219 | 18 |
| Stock-based compensation | 8 | 187 |
| Change in rate from Alberta to Saskatchewan | - | (1,796) |
| Other | - | (91) |
| Change in unrecognized deferred tax assets | 2,163 | 5,534 |
| Total income tax expense | \$ - | \$ - |

Unrecognized deferred tax assets

Deferred tax assets have not been recognized in respect of the following items:

| | 2016 | 2015 |
|---------------------------------------|-----------|-----------|
| Capital assets | \$ 1,105 | \$ 1,027 |
| Share issue costs | 131 | 360 |
| Intangible assets (including E&E) | 10,805 | 9,698 |
| Assets under construction | 4,774 | 4,774 |
| Non-capital losses | 13,330 | 12,123 |
| Net deferred tax assets (liabilities) | \$ 30,145 | \$ 27,982 |

The deferred tax assets have not been recognized at this time because it is not probable that future taxable profit will be available against which the Company can utilize the benefits.

The Company has Canadian non-capital losses for which no benefit has been recognized in the financial statements of approximately \$49,369,000 (2015 - \$45,086,000) which commence expiry in 2027.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
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14. Supplemental cash flow information

Changes in non-cash working capital are as follows:

| December 31, | 2016 | 2015 |
|--|-----------------|---------------|
| Accounts receivable | \$ 35 | \$ 40 |
| Prepaid expenses | (78) | (88) |
| Accounts payable and accrued liabilities | (133) | 358 |
| | <u>\$ (176)</u> | <u>\$ 310</u> |
| Relating to: | | |
| Operating activities | \$ (159) | \$ 272 |
| Investing activities | (17) | 38 |
| | <u>\$ (176)</u> | <u>\$ 310</u> |

15. Financial risk management

(a) Overview

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production and financing activities such as:

- credit risk;
- liquidity risk;
- market risk;
- currency risk; and
- interest rate risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. To date, no specific risk management tools have been put in place to mitigate these risks.

KARNALYTE RESOURCES INC.

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For the years ended December 31, 2016 and 2015
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15. Financial risk management (continued)

(b) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its obligation.

Cash consists of bank balances and short-term deposits that are redeemable at any time at the option of the Company. The Company manages the credit exposure related to short-term investments by depositing only with large Canadian financial institutions which management believes the risk of loss to be remote. The majority of the cash is currently held by one financial institution.

The carrying amounts of trade and other receivables, cash and restricted cash represent the maximum credit exposure.

(c) Liquidity risk and commitments

Liquidity risk is the risk that the Company will not be able to meet its obligations as they come due. The Company has adequate cash available to discharge all current liabilities.

The Company will need to obtain a substantial amount of funding in order to continue mine development and achieve commercial production. It is the intent of the Company to raise these funds through debt and equity financings.

The following are the commitments of the company as at December 31, 2016:

| | Contractual cash flows | Less than one year | Two - three years | Four - five years | More than five years |
|---------------------------|------------------------|--------------------|-------------------|-------------------|----------------------|
| Trade and other payables | \$ 406 | \$ 406 | \$ - | \$ - | \$ - |
| Provisions | 1,344 | 1,344 | - | - | - |
| Office lease | 61 | 61 | - | - | - |
| Lease on mineral property | 6,991 | 390 | 738 | 738 | 5,125 |
| Project contracts | 95 | 95 | - | - | - |
| | <u>\$ 8,897</u> | <u>\$ 2,296</u> | <u>\$ 738</u> | <u>\$ 738</u> | <u>\$ 5,125</u> |

The Company has entered into contracts for various engineering and consulting services.

KARNALYTE RESOURCES INC.

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15. Financial risk management (continued)

(d) Market risk

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's income or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

The Company may use both financial derivatives and physical delivery sales contracts in the future to manage market risks. Should the Company reach commercial production a sales off-take contract exists where GSFC has committed to purchase of approximately 350,000 tonnes per year of potash increasing to 600,000 tonnes per year for a period of 20 years from the commencement of commercial production. Pricing will be based on USD India cfr plus shipping costs.

(e) Currency risk

The following financial instruments were denominated in U.S. dollars:

| December 31, | 2016 | 2015 |
|--------------------------|-------|--------|
| | USD | USD |
| Cash | \$ 11 | \$ 321 |
| Trade and other payables | 1 | - |
| Provisions | 1,344 | 1,384 |

The exchange rate on the period ending date December 31, 2016 was 1 Canadian dollar equals \$0.7448 USD (2015 - \$1 Canadian: \$0.7225 USD). As of December 31, 2016, if the exchange rate would change by 1% it would have an impact of \$9,000 on the reported comprehensive loss.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

For the years ended December 31, 2016 and 2015
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15. Financial risk management (continued)

(e) Currency risk (continued)

The USD cash balances throughout the year fluctuated depending on the amount of funds available and the prevailing foreign exchange rates at the time of the transactions and transfers between the USD and CAD accounts. The exchange rate fluctuated between \$0.6854 USD to \$0.7972 USD equaled to 1 Canadian dollar. The net foreign exchange differences are presented as finance income in the Statement of Comprehensive Loss.

(f) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Interest income is generated through funds invested in regular and high interest savings accounts. Had the interest rate been 100 basis point higher (or lower) throughout the year ended December 31, 2016, comprehensive loss would have been lower (or higher) by approximately \$203,000 (2015 - \$316,000).

(g) Capital management

The Company views its working capital as its capital. The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying potash assets. In order to maintain or adjust the capital structure, the Company may issue shares and adjust its capital spending based on available funding in the capital markets. To advance the Wynyard project, the Company will need to secure a significant amount of additional capital. The Company is 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.

The Company prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

The Company is not subject to externally imposed capital requirements. There were no changes in the Company's approach to capital management during the period.