

Condensed Interim Unaudited Financial Statements of

KARNALYTE RESOURCES INC.

Nine months ended September 30, 2017 and 2016

KARNALYTE RESOURCES INC.

Interim Statements of Financial Position (unaudited)

(CAD \$ thousands)

	September 30, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash	\$ 8,029	\$ 16,752
Trade and other receivables	84	77
Prepaid expenses	439	327
	<u>8,552</u>	<u>17,156</u>
Restricted cash	375	375
Capital assets (note 3)	497	710
Long-term investment (note 4)	4,745	-
Exploration and evaluation and other assets (note 5)	5,066	4,783
	<u>\$ 19,235</u>	<u>\$ 23,024</u>
ASSETS	\$ 19,235	\$ 23,024

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Trade and other payables	\$ 799	\$ 406
Provision	-	1,344
	<u>799</u>	<u>1,750</u>
Decommissioning liability	147	136
Total liabilities	<u>946</u>	<u>1,886</u>
Shareholders' equity:		
Share capital (note 6)	129,879	129,879
Contributed surplus	9,210	9,204
Deficit	(120,800)	(117,945)
Total shareholders' equity	<u>18,289</u>	<u>21,138</u>
LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 19,235	\$ 23,024

Commitments (note 8), Contingent liability (note 10), Subsequent events (note 11)

See accompanying notes to the financial statements.

Approved on behalf of the Board:

"signed"
W. Todd Rowan, Director

"signed"
Peter Matson, Director

KARNALYTE RESOURCES INC.

Interim Statements of Comprehensive Loss (unaudited)

For the three and nine months ended September 30, 2017 and 2016
(CAD \$ thousands)

	Three months ended		Nine months ended	
	2017	2016	2017	2016
Expenses:				
General and administrative	\$ 647	\$ 1,781	\$ 2,258	\$ 6,161
Depreciation and amortization (note 3)	70	71	213	269
Stock-based compensation expense (note 6)	1	6	6	25
Restructuring expenses	398	-	1,238	-
Recovery of provision	-	-	(1,316)	-
Impairment expenses (note 5)	130	477	392	1,726
Gain on sale of asset	(50)	-	(50)	(26)
Other income and expenses	(17)	(93)	(43)	(294)
	1,179	2,242	2,698	7,861
Finance income	(22)	(13)	(109)	(254)
Finance expense	109	-	266	-
Net finance (income) expense	87	(13)	157	(254)
Net and comprehensive loss	\$ (1,266)	\$ (2,229)	\$ (2,855)	\$ (7,607)
Loss per share (note 6(b)) Basic and diluted	\$ (0.05)	\$ (0.08)	\$ (0.10)	\$ (0.28)

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Interim Statements of Cash Flows (unaudited)

For the nine months ended September 30, 2017 and 2016
(CAD \$ thousands)

	2017	2016
Cash Flows from (used in) Operating Activities:		
Net and comprehensive loss for the period	\$ (2,855)	\$ (7,607)
Add/(deduct):		
Depreciation and amortization (note 3)	213	269
Stock-based compensation expense (note 6(c))	6	25
Impairment expense (note 5)	392	1,726
Recovery of provision	(1,316)	-
Net finance income	157	(254)
Interest income received	102	157
Gain on sale of asset	(50)	(26)
Changes in non-cash working capital (note 7)	230	(39)
	(3,121)	(5,749)
Cash Flows from (used in) Investing Activities:		
Investment in long-term investment (note 4)	(5,000)	-
Additions to intangible assets (note 5)	(675)	(3,158)
Additions to capital assets (note 3)	-	(58)
Proceeds on sale of capital assets (note 3)	50	26
Changes in non-cash working capital (note 7)	(1)	(18)
	(5,626)	(3,208)
Cash Flows from (used in) Financing Activities:		
Proceeds on exercise of stock options (note 6)	-	62
	-	62
Effect of foreign exchange on cash	24	(17)
Change in cash	(8,723)	(8,912)
Cash, beginning of period	16,752	27,733
Cash and cash equivalents, end of period	\$ 8,029	\$ 18,821

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Interim Statements of Changes in Equity (unaudited)

For the nine months ended September 30, 2017 and 2016
(CAD \$ thousands)

	2017		2016	
	Number	Amount	Number	Amount
Share Capital:				
Balance, beginning of period	28,116	\$ 129,879	27,478	\$ 129,786
Common shares issued	-	-	82	62
Transfer from contributed surplus on options exercise	-	-	-	31
Balance, end of period	28,116	129,879	27,560	129,879
Contributed Surplus:				
Balance, beginning of period		9,204		9,205
Stock-based compensation expense (note 6(c))		6		25
Transfer to share capital on options exercise		-	-	(31)
Balance, end of period		9,210		9,199
Deficit:				
Balance, beginning of period		(117,945)		(109,093)
Loss for the period		(2,855)		(7,607)
Balance, end of period		(120,800)		(116,700)
Balance, end of period		\$ 18,289		\$ 22,378

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, 2017 and 2016
(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, 2016. 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 13, 2016.

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

For the three and nine months ended September 30, 2017 and 2016
(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, 2016	\$ 497	\$ 100	\$ 3,721	\$ 18,711	\$ 23,029
Additions	-	46	12	-	58
Disposals	-	(29)	(26)	-	(55)
Balance at December 31, 2016	497	117	3,707	18,711	23,032
Additions	-	-	-	-	-
Disposals	-	-	-	-	-
Balance at September 30, 2017	\$ 497	\$ 117	\$ 3,707	\$ 18,711	\$ 23,032
Accumulated depreciation:					
Balance at January 1, 2016	\$ 156	\$ 100	\$ 3,070	\$ 18,711	\$ 22,037
Depreciation	13	13	314	-	340
Impairment	-	(29)	(26)	-	(55)
Balance at December 31, 2016	169	84	3,358	18,711	22,322
Depreciation	10	11	192	-	213
Dispositions	-	-	-	-	-
Balance at September 30, 2017	\$ 179	\$ 95	\$ 3,550	\$ 18,711	\$ 22,535
Carrying amounts:					
December 31, 2016	\$ 328	\$ 33	\$ 349	\$ -	\$ 710
September 30, 2017	\$ 318	\$ 22	\$ 157	\$ -	\$ 497

4. Long-term investment

In May 2017, the Company invested \$5,000,000 into a Bank of Montreal S&P/TSX Composite Low Volatility Index Principal Protected Deposit Note, Series 76 (the "**BMO Note**"). This deposit note will mature on May 10, 2022. At maturity, the Company will receive the deposit amount of \$5,000,000 plus a variable return, if any, that will be determined based on the price performance of the S&P/TSX Composite Low Volatility Index over the term of the Deposit Note. The S&P/TSX Composite Low Volatility Index is designed to measure the performance of the 50 least volatile stocks within the S&P/TSX Composite Index. This investment is classified as a financial asset at fair value through profit or loss and as such is measured at fair value with any gains or losses arising from a change in fair value recognized in the statement of comprehensive loss. This investment is classified as a recurring level 2 fair value measurement. Fair value on this investment is determined by measuring the price performance of S&P/TSX Composite Low Volatility Index and calculating the variable return should the investment be sold on the last day of the reporting period. This determination excludes the application of any early

KARNALYTE RESOURCES INC.

Notes to Interim Financial Statements (unaudited)

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4. Long-term investment (continued)

trading charges. At September 30th, 2017, this investment had a fair value of \$4,745,000 and so an unrecognized loss of \$255,000 was recorded as finance expense.

During the quarter, the Company reviewed its options to cancel or otherwise dispose of the BMO Note. See Note 11 to these financial statements.

5. Exploration and evaluation assets and other assets

	Mineral Properties	Process Patents	Computer Software	Total
Cost:				
Balance at January 1, 2016	\$ 43,774	\$ 165	\$ 277	\$ 44,216
Additions	4,230	5	-	4,235
Balance at December 31, 2016	48,004	170	277	48,451
Additions	675	-	-	675
Balance at September 30, 2017	\$ 48,679	\$ 170	\$ 277	\$ 49,126
Amortization and impairment losses:				
Balance at January 1, 2016	\$ 41,246	\$ 165	\$ 277	\$ 41,688
Impairment	1,975	5	-	1,980
Balance at December 31, 2016	43,221	170	277	43,668
Impairment	392	-	-	392
Balance at September 30, 2017	\$ 43,613	\$ 170	\$ 277	\$ 44,060
Carrying amounts:				
December 31, 2016	\$ 4,783	\$ -	\$ -	\$ 4,783
September 30, 2017	\$ 5,066	\$ -	\$ -	\$ 5,066

6. Share capital

(a) Authorized

As at September 30, 2017 and 2016 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. No common shares were issued throughout the nine months ended September 30, 2017.

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, 2017.

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Notes to Interim Financial Statements (unaudited)

For the three and nine months ended September 30, 2017 and 2016
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6. Share capital (continued)

(b) Earnings per share

Basic earnings per share were calculated as follows:

	Three months ended		Nine months ended	
	2017	2016	2017	2016
Loss for the period ending Sept 30,	\$ (1,266)	\$ (2,229)	\$ (2,855)	\$ (7,607)
Weighted average number of common shares:				
Issued common shares at beginning of period	28,087	27,512	27,672	27,478
Share options exercised	29	-	444	34
Weighted average number of common shares	28,116	27,512	28,116	27,512
Basic loss per share	\$ (0.05)	\$ (0.08)	\$ (0.10)	\$ (0.28)

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 915,000 (2016 – 2,018,000) 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.

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6. Share capital (continued)

(c) Stock-based compensation expense (continued)

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

	2017		2016	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at January 1,	1,943	\$ 0.87	2,079	\$ 1.03
Issued during the period	-	-	90	0.75
Expired during the period	-	-	(9)	8.50
Forfeited during the period	(1,028)	0.75	(60)	5.49
Exercised during the period	-	-	(82)	0.75
Outstanding at September 30,	915	1.01	2,018	0.87
Exercisable at September 30,	900	\$ 1.02	1,951	\$ 0.87

Number of Options Outstanding	Exercise Price	Remaining Life (yrs)	Exercisable Options	Exercisable Price
50,000	\$ 1.27	0.76	50,000	\$ 1.27
775,000	0.75	2.79	775,000	0.75
60,000	0.75	5.20	45,000	0.75
30,000	7.95	0.47	30,000	7.95
915,000	\$ 1.01	2.31	900,000	\$ 1.02

Share based compensation of \$1,000 (2016 - \$6,000) was expensed during the three month period ended September 30, 2017. Share based compensation of \$6,000 (2016 - \$25,000) was expensed during the nine month period ended September 30, 2017.

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7. Supplemental cash flow information

Changes in non-cash working capital are as follows:

September 30,	2017	2016
Accounts receivable	\$ (23)	\$ (24)
Prepaid expenses	(112)	(71)
Trade and other payables	364	38
	<u>\$ 229</u>	<u>\$ (57)</u>
Relating to:		
Operating activities	\$ 230	\$ (39)
Investing activities	(1)	(18)
	<u>\$ 229</u>	<u>\$ (57)</u>

8. Commitments

	Contractual cash flows	Less than one year	Two - three years	Four - five years	More than five years
Trade and other payables	\$ 799	\$ 799	\$ -	\$ -	\$ -
Office lease	193	101	92	-	-
Permit/lease on mineral property	6,601	50	738	738	5,075
Project contracts	262	262	-	-	-
	<u>\$ 7,855</u>	<u>\$ 1,212</u>	<u>\$ 830</u>	<u>\$ 738</u>	<u>\$ 5,075</u>

9. 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. Long-term investments are classified as financial assets at fair value through profit and loss and as such are measured at fair value with any gains or losses arising from a change in fair value recognized in the statement of comprehensive loss.

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Notes to Interim Financial Statements (unaudited)

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10. Contingent liability

Following its annual general meeting on May 5th, 2017, the Company reviewed its strategy and restructured its operations. The restructuring resulted in the terminations and resignations of certain officers and employees. During the second and third quarters of 2017, the Company estimated and accrued \$848,000 for costs of restructuring of which \$450,000 was paid. Actual amounts may vary from this amount.

11. Subsequent events

Subsequent to September 30th, 2017, the Bank of Montreal agreed to cancel the Company's investment in the Bank of Montreal S&P/TSX Composite Low Volatility Principal Protected Deposit Note, Series 76 as described in Note 4 to these financial statements. Upon cancellation, the Company received a refund of \$5,000,000 which was deposited into a high interest savings account.