

**Interim Unaudited Financial Statements**



**Three months ended March 31, 2014**

**KARNALYTE RESOURCES INC.**

**STATEMENTS OF FINANCIAL POSITION**

**ASSETS**

(CAD thousands, unaudited)	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Current assets		
Cash	\$ 45,779	\$ 46,161
Trade and other receivables	307	1,480
Prepaid expenses	123	139
	46,209	47,780
Restricted cash	375	375
Deferred financing costs	1,640	1,606
Capital assets (note 4)	19,036	18,745
Intangible exploration and evaluation and other assets (note 5)	42,960	42,951
<b>ASSETS</b>	<b>\$ 110,220</b>	<b>\$ 111,457</b>
<b>LIABILITIES</b>		
Current liabilities		
Trade and other payables	\$ 317	\$ 746
	317	746
Provisions	143	135
Total liabilities	460	881
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (note 6)	129,774	129,774
Contributed surplus	8,216	7,778
Deficit	(28,230)	(26,976)
Total shareholders' equity	109,760	110,576
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 110,220</b>	<b>\$ 111,457</b>

Commitments (note 8)

See accompanying notes to the unaudited interim financial statements.

**KARNALYTE RESOURCES INC.**

**STATEMENTS OF COMPREHENSIVE LOSS**

**For the three months ended March 31,**

(CAD thousands except per share amounts, unaudited)	<b>2014</b>	<b>2013</b>
Expenses		
General and administrative	\$ 944	\$ 1,082
Depreciation and amortization	217	206
Stock-based compensation expense (note 7)	312	424
Other income and expenses	(31)	(12)
	1,442	1,700
Finance income	(192)	(77)
Finance expense	4	27
Net finance income	(188)	(50)
Comprehensive loss	(1,254)	(1,650)
Loss per share (note 6(b))		
Basic and diluted	\$ (0.05)	\$ (0.07)

See accompanying notes to the unaudited interim financial statements.

**KARNALYTE RESOURCES INC.**

**STATEMENTS OF CASH FLOWS**

**For the three months ended March 31,**

(CAD thousands, unaudited)	<b>2014</b>	<b>2013</b>
<b>Cash Flows from (used in) Operating Activities</b>		
Net loss for the period	\$ (1,254)	\$ (1,650)
Add/deduct:		
Depreciation and amortization	217	207
Stock-based compensation expense	312	424
Net finance income	(188)	(62)
Interest income received	192	89
Changes in non-cash working capital:		
Trade and other receivables	(102)	3
Trade and other payables	178	15
Prepaid expenses	22	(492)
	<u>(623)</u>	<u>(1,466)</u>
<b>Cash Flows from (used in) Investing Activities</b>		
Additions to intangible assets	(100)	(3,395)
Proceeds on sale of intangible assets	1,244	-
Additions to capital assets	(868)	(502)
	<u>276</u>	<u>(3,897)</u>
<b>Cash Flows from (used in) Financing Activities</b>		
Issuance of common shares	-	44,746
Share issue costs	-	(2,344)
Deferred financing costs	(33)	(217)
	<u>(33)</u>	<u>42,185</u>
Effect of foreign exchange on cash	(2)	(26)
Change in cash	(382)	36,796
Cash, beginning of period	46,161	25,115
<b>Cash and cash equivalents, end of period</b>	<u>\$ 45,779</u>	<u>\$ 61,911</u>

See accompanying notes to the unaudited interim financial statements.

**KARNALYTE RESOURCES INC.**

**STATEMENTS OF CHANGES IN EQUITY**

**For the three months ended March 31,  
(Expressed in thousands)**

	2014		2013	
	Number	Amount	Number	Amount
<b>Share Capital</b>				
Balance, beginning of period	27,477	\$ 129,774	21,989	\$ 87,473
Common shares issued	-	-	5,490	44,746
Share issue costs	-	-	-	(2,432)
<b>Balance, end of period</b>	<b>27,477</b>	<b>129,774</b>	<b>27,479</b>	<b>129,787</b>
<b>Contributed Surplus</b>				
Balance, beginning of period		7,778		4,906
Stock-based compensation expense (note 7)		438		594
<b>Balance, end of period</b>		<b>8,216</b>		<b>5,500</b>
<b>Deficit</b>				
Balance, beginning of period		(26,976)		(20,235)
Loss for the period		(1,254)		(1,650)
<b>Balance, end of period</b>		<b>(28,230)</b>		<b>(21,885)</b>
<b>Total Shareholders' Equity</b>				
<b>Balance, end of period</b>		<b>\$ 109,760</b>		<b>\$ 113,402</b>

See accompanying notes to the financial statements.

## KARNALYTE RESOURCES INC.

Notes to Unaudited Financial Statements  
(All tabular amounts are in CAD thousands except per share amounts)

Three months ended March 31, 2014 and 2013

### 1. **Reporting entity**

Karnalyte Resources Inc. (the “Company” or “Karnalyte”) is incorporated under the laws of the province of Alberta. The business of Karnalyte consists 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.

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 has sufficient cash to meet its short-term corporate operating and capital requirements. The Company’s operating segments have been identified as the individual mineral reserve streams. The Company has currently 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 403 – 235 Milligan Drive, Okotoks, Alberta T1S 0B8.

### 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, 2013. These statements do not include all information or disclosures normally provided in annual statements. These interim statements should be read in conjunction with the audited annual financial statements and related notes.

These financial statements were authorized for issue by the Board of Directors on May 13, 2014.

#### *(b) Reclassification*

Certain amounts have been reclassified to conform to current period presentation.

### 3. **Changes in accounting policies**

During the first quarter of 2014, the Company adopted the following standards:

#### *(a) IAS 32 – Financial Instruments: Presentation*

The amendments to IAS 32 pertain to the application guidance on the offsetting of financial assets and financial liabilities. The changes focus on four main areas: the meaning of “currently has a legally enforceable right of set-off”, the application of simultaneous realization and settlement, the offsetting of collateral amounts and the unit of account for applying the offsetting requirements. There was no impact to the Company on adoption of this standard.

**KARNALYTE RESOURCES INC.**

Notes to Unaudited Financial Statements  
(All tabular amounts are in CAD thousands except per share amounts)

Three months ended March 31, 2014 and 2013

(b) *IFRIC 21 – Levies*

The interpretation provided guidance on accounting for levies in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets. IFRIC 21 defines a levy as an outflow from an entity imposed by a government in accordance with legislation and confirms that an entity recognizes a liability for a levy only when the triggering event specified in the legislation occurs. The Company’s current accounting treatment for levies is consistent with the requirements of IFRIC 21, such that the adoption of IFRIC 21 has had no impact on the financial reporting.

(c) *New standard not yet adopted:*

*IFRS 9 – Financial Instruments*

The standard is the first step in the process to replace IAS 39, Financial instruments: recognition and measurement. IFRS 9 introduces new requirements for classifying and measuring financial assets and liabilities and carries over from the requirements of IAS 39, Financial instruments: recognition and measurement, derecognition of financial assets and financial liabilities. The extent of the impact of adoption of these standards has not yet been determined.

**4. Capital assets**

	Land and Buildings	Vehicles	Processing and other Equipment	Assets Under Construction	Total
<b>Cost:</b>					
Balance at January 1, 2013	\$ 537	\$ 142	\$ 3,440	\$ 3,466	\$ 7,585
Additions	181	-	295	12,622	13,098
Dispositions	(77)	-	(14)	-	(91)
Balance at December 31, 2013	641	142	3,721	16,088	20,592
Additions	-	-	-	501	501
Dispositions	-	(42)	-	-	(42)
Balance at March 31, 2014	\$ 641	\$ 100	\$ 3,721	\$ 16,589	\$ 21,051
<b>Accumulated depreciation:</b>					
Balance at January 1, 2013	\$ 109	\$ 12	\$ 1,060	\$ -	\$ 1,181
Depreciation for the period	77	45	621	-	743
Dispositions	(69)	-	(8)	-	(77)
Balance at December 31, 2013	117	57	1,673	-	1,847
Depreciation for the period	16	10	159	-	185
Dispositions	-	(17)	-	-	(17)
Balance at March 31, 2014	\$ 133	\$ 50	\$ 1,832	\$ -	\$ 2,015
<b>Carrying amounts:</b>					
December 31, 2013	\$ 524	\$ 85	\$ 2,048	\$ 16,088	\$ 18,745
March 31, 2014	\$ 508	\$ 50	\$ 1,889	\$ 16,589	\$ 19,036

**KARNALYTE RESOURCES INC.**

Notes to Unaudited Financial Statements  
(All tabular amounts are in CAD thousands except per share amounts)

Three months ended March 31, 2014 and 2013

Assets under construction will not be depreciated until construction is complete and the asset is placed in service. During the three months ended March 31, 2014 the Company capitalized employee remuneration of \$303,000 (2013 - \$233,000) and stock-based compensation expense of \$119,000 (2013 - \$157,000) to capital assets.

**5. Intangible exploration and evaluation assets and other intangible assets**

	Mineral Properties	Process Patents	Computer Software	Total
Cost:				
Balance at January 1, 2013	\$ 42,983	\$ 117	\$ 250	\$ 43,350
Additions	987	22	27	1,036
Sale of assets	(1,181)	-	-	(1,181)
Balance at December 31, 2013	42,789	139	277	43,205
Additions	101	3	-	104
Sale of Assets	(63)	-	-	(63)
Balance at March 31, 2014	\$ 42,827	\$ 142	\$ 277	\$ 43,246
Amortization and impairment losses:				
Balance at January 1, 2013	\$ -	\$ 13	\$ 140	\$ 153
Amortization for the year	-	10	91	101
Balance at December 31, 2013	-	23	231	254
Amortization for the period	-	(1)	33	32
Balance at March 31, 2014	\$ -	\$ 22	\$ 264	\$ 286
Carrying amounts:				
December 31, 2013	\$ 42,789	\$ 116	\$ 46	\$ 42,951
March 31, 2014	\$ 42,827	\$ 120	\$ 13	\$ 42,960

During the three months ended March 31, 2014 the Company capitalized employee remuneration of \$28,000 (2013 - \$21,000) and stock-based compensation expense of \$6,000 (2013 - \$13,000) to intangible assets.

**6. Share capital**

*(a) Authorized*

As at March 31, 2014 and 2013 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. No dividends were declared in any of the periods presented.

The Company is also entitled to issue an unlimited number of preferred shares. There are no preferred shares issued as at March 31, 2014 or 2013.



**KARNALYTE RESOURCES INC.**

Notes to Unaudited Financial Statements  
(All tabular amounts are in CAD thousands except per share amounts)

Three months ended March 31, 2014 and 2013

*(b) Earnings per share*

Basic earnings per share were calculated as follows:

	2014	2013
Loss for the three months ending March 31,	\$ (1,254)	\$ (1,650)
Weighted average number of common shares:		
Issued common shares at beginning of period	27,477	21,989
Common shares issued	-	1,464
Weighted average number of common shares:	27,477	23,453
Basic loss per share	\$ (0.05)	\$ (0.07)

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 2,083,250 (2013 – 2,301,500) options as their effect would have been anti-dilutive.

**7. 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:

	March 31, 2014		December 31, 2013	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at beginning of period	2,095	8.86	1,288	9.72
Issued during the period	-	-	1,029	7.93
Expired during the period	-	-	(78)	11.61
Forfeited during the period	(12)	7.95	(144)	8.44
Outstanding	2,083	8.87	2,095	8.86
Exercisable	1,438	9.01	1,215	9.20

**KARNALYTE RESOURCES INC.**

Notes to Unaudited Financial Statements  
(All tabular amounts are in CAD thousands except per share amounts)

Three months ended March 31, 2014 and 2013

Number of Options Outstanding	Exercise Price	Remaining Life (yrs)	Grant Date Fair Value	Exercisable Options	Exercise Price
390	8.60	1.72	4.24	391	8.60
25	10.99	2.73	5.32	25	10.99
760	10.05	3.05	4.62	570	10.05
893	7.95	3.98	3.06	448	7.95
15	6.73	4.24	1.35	4	6.73
2,083	\$ 8.87	3.20	\$ 3.87	1,438	\$ 9.01

**8. Cash flows from (used in) Investing Activities**

	Intangible Exploration and Evaluation and Other Intangible Assets		Capital Assets	
	2014	2013	2014	2013
Cash Flows from (used in) Investing Activities				
Additions	\$ (104)	\$ (2,920)	\$ (501)	\$ (1,332)
Changes in non-cash working capital				
Trade and other receivables	-	-	-	-
Trade and other payables	-	(493)	(474)	673
Prepaid expenses	(8)	5	2	-
Stock based compensation capitalized	6	13	119	157
Asset retirement obligations	6	-	-	-
	(100)	(3,395)	(854)	(502)
Sale/dispositions	1,244	-	(42)	-
Accumulated amortization reversal on disposition	-	-	28	-
Net sale/disposition of assets	1,244	-	(14)	-
Net change in cash flows used in investing activities	\$ 1,144	\$ (3,395)	\$ (868)	\$ (502)

**9. Commitments**

The following are the commitments of the company as at March 31, 2014:

	Contractual cash flows	Less than one year	Two - three years	Four - five years	More than five years
Trade and other payables	\$ 317	\$ 317	\$ -	\$ -	\$ -
Office lease	745	265	431	49	-
Permit/lease on mineral property	2,695	47	150	341	2,157
Project contracts	1,563	1,563	-	-	-
	\$ 5,320	\$ 2,192	\$ 581	\$ 390	\$ 2,157

**KARNALYTE RESOURCES INC.**

Notes to Unaudited Financial Statements  
(All tabular amounts are in CAD thousands except per share amounts)

Three months ended March 31, 2014 and 2013

**10. 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 carrying amounts due to the short term maturity of the instruments.