

**Interim Unaudited Financial Statements**



**Three and nine months ended September 30, 2014**

**KARNALYTE RESOURCES INC.**

**STATEMENTS OF FINANCIAL POSITION**

**ASSETS**

(CAD thousands, unaudited)	<b>Sept 30, 2014</b>	<b>December 31, 2013</b>
Current assets		
Cash	\$ 42,885	\$ 46,161
Trade and other receivables	102	1,480
Prepaid expenses	97	139
	43,084	47,780
Restricted cash	375	375
Deferred financing costs	1,711	1,606
Capital assets (note 4)	19,454	18,745
Intangible exploration and evaluation and other assets (note 5)	43,045	42,951
<b>ASSETS</b>	<b>\$ 107,669</b>	<b>\$ 111,457</b>

**LIABILITIES**

Current liabilities		
Trade and other payables	\$ 410	\$ 746
	410	746
Provisions	154	135
<b>Total liabilities</b>	<b>564</b>	<b>881</b>

**SHAREHOLDERS' EQUITY**

Share capital (note 6(a))	129,786	129,774
Contributed surplus	8,376	7,778
Deficit	(31,057)	(26,976)
<b>Total shareholders' equity</b>	<b>107,105</b>	<b>110,576</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 107,669</b>	<b>\$ 111,457</b>

Commitments (note 9)

See accompanying notes to the unaudited interim financial statements.

**KARNALYTE RESOURCES INC.**

**STATEMENTS OF COMPREHENSIVE LOSS**

**For the three and nine months ended Sept 30,**

(CAD thousands except per share amounts, unaudited)	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Expenses				
General and administrative	\$ 1,234	\$ 1,418	\$ 3,637	\$ 3,804
Depreciation and amortization	202	227	611	631
Share-based compensation expense (note 7)	156	584	340	1,692
Other (income) and expenses	52	(18)	7	(21)
	1,644	2,211	4,595	6,106
Finance income	(165)	(206)	(525)	(804)
Finance expense	1	1	11	30
Net finance income	(164)	(205)	(514)	(774)
<b>Comprehensive loss</b>	<b>(1,480)</b>	<b>(2,006)</b>	<b>(4,081)</b>	<b>(5,332)</b>
Loss per share (note 6(b))				
Basic and diluted	\$ (0.05)	\$ (0.07)	\$ (0.15)	\$ (0.20)

See accompanying notes to the unaudited interim financial statements.

**KARNALYTE RESOURCES INC.**

**STATEMENTS OF CASH FLOWS**

**For the nine months ended Sept 30,**

(CAD thousands, unaudited)	<b>2014</b>	<b>2013</b>
<b>Cash Flows from (used in) Operating Activities</b>		
Net loss for the period	\$ (4,081)	\$ (5,332)
Add/deduct:		
Depreciation and amortization	611	631
Stock-based compensation expense	340	1,692
Net finance income	(514)	(795)
Interest income received	515	366
Changes in non-cash working capital:		
Trade and other receivables	64	117
Trade and other payables	336	(640)
Prepaid expenses	55	29
Purchase of shares pursuant to compensation plans	-	(12)
	<b>(2,674)</b>	<b>(3,944)</b>
<b>Cash Flows from (used in) Investing Activities</b>		
Additions to intangible assets	(219)	(765)
Proceeds on sale of intangible assets	1,244	-
Additions to capital assets	(1,544)	(10,835)
Proceeds on disposition of capital assets	25	-
	<b>(494)</b>	<b>(11,600)</b>
<b>Cash Flows from (used in) Financing Activities</b>		
Issuance of common shares	-	44,745
Share issue costs	-	(2,432)
Deferred financing costs	(104)	(796)
	<b>(104)</b>	<b>41,517</b>
Effect of foreign exchange on cash	(4)	424
Change in cash	(3,276)	26,397
Cash, beginning of period	46,161	25,115
<b>Cash and cash equivalents, end of period</b>	<b>\$ 42,885</b>	<b>\$ 51,512</b>

See accompanying notes to the unaudited interim financial statements.

**KARNALYTE RESOURCES INC.**

**STATEMENTS OF CHANGES IN EQUITY**

**For the nine months ended September 30,  
(Expressed in CAD thousands, unaudited)**

	<b>2014</b>		<b>2013</b>	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
<b>Share Capital</b>				
Balance, beginning of period	27,477	\$ 129,774	21,989	\$ 87,473
Common shares issued (note 6(b))	-	-	5,490	44,746
Treasury shares purchased	-	-	(2)	(12)
Vesting of employee share ownership plan	1	12	-	-
Share issue costs	-	-	-	(2,432)
<b>Balance, end of period</b>	<b>27,478</b>	<b>129,786</b>	<b>27,477</b>	<b>129,775</b>
<b>Contributed Surplus</b>				
Balance, beginning of period		7,778		4,906
Share-based payment expense (note 7)		608		2,364
Vesting of employee ownership plan		(10)		-
<b>Balance, end of period</b>		<b>8,376</b>		<b>7,270</b>
<b>Deficit</b>				
Balance, beginning of period		(26,976)		(20,234)
Loss for the period		(4,081)		(5,332)
<b>Balance, end of period</b>		<b>(31,057)</b>		<b>(25,566)</b>
<b>Total Shareholders' Equity</b>				
<b>Balance, end of period</b>		<b>\$ 107,105</b>		<b>\$ 111,479</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, unaudited)

Three and nine months ended September 30, 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 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 #14, 11410 – 27<sup>th</sup> Street SE, Calgary, Alberta T2Z 3R6.

#### 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 November 12, 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

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(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.

*IFRS 15 – Revenue*

On May 28, 2014, the IAS board issued IFRS 15 "Revenue", which 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, 2017. Application of the standard is mandatory and early adoption is permitted. The Company is currently evaluating the impact of adopting IFRS 15 on its consolidated financial statements.

**KARNALYTE RESOURCES INC.**

Notes to Unaudited Financial Statements

(All tabular amounts are in CAD thousands except per share amounts, unaudited)

Three and nine months ended September 30, 2014 and 2013

**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	-	-	-	1,382	1,382
Dispositions	(144)	(42)	-	-	(186)
Balance at September 30, 2014	\$ 497	\$ 100	\$ 3,721	\$ 17,470	\$ 21,788
<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	59	27	482	-	568
Dispositions	(64)	(17)	-	-	(81)
Balance at September 30, 2014	\$ 112	\$ 67	\$ 2,155	\$ -	\$ 2,334
<b>Carrying amounts:</b>					
December 31, 2013	\$ 524	\$ 85	\$ 2,048	\$ 16,088	\$ 18,745
September 30, 2014	\$ 385	\$ 33	\$ 1,566	\$ 17,470	\$ 19,454

Assets under construction will not be depreciated until construction is complete and the asset is placed in service. During the three and nine months ended September 30, 2014 the Company capitalized employee remuneration of \$277,000 and \$865,000 (2013 - \$287,000 and \$809,000) and stock-based compensation expense of \$76,000 and \$254,000 (2013 - \$212,000 and \$634,000) to capital assets.



**KARNALYTE RESOURCES INC.**

Notes to Unaudited Financial Statements

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Three and nine months ended September 30, 2014 and 2013

**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	195	10	-	205
Sale of Assets	(63)	-	-	(63)
Balance at September 30, 2014	\$ 42,921	\$ 149	\$ 277	\$ 43,347
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	-	2	46	48
Balance at September 30, 2014	\$ -	\$ 25	\$ 277	\$ 302
Carrying amounts:				
December 31, 2013	\$ 42,789	\$ 116	\$ 46	\$ 42,951
September 30, 2014	\$ 42,921	\$ 124	\$ -	\$ 43,045

During the three and nine months ended September 30, 2014 the Company capitalized employee remuneration of \$26,000 and \$82,000 (2013 - \$22,000 and \$65,000) and stock-based compensation expense of \$6,000 and \$14,000 (2013 - \$12,000 and \$38,000) to intangible assets.

**6. Share capital**

*(a) Authorized*

As at September 30, 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 September 30, 2014 or 2013.

**KARNALYTE RESOURCES INC.**

Notes to Unaudited Financial Statements

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(b) *Earnings per share*

Basic earnings per share were calculated as follows:

	Three months ended		Nine months ended	
	2014	2013	2014	2013
Loss for the period ending September 30,	\$ (1,480)	\$ (2,006)	\$ (4,081)	\$ (5,332)
Weighted average number of common shares:				
Issued common shares at beginning of period	27,479	27,479	27,477	21,989
Common shares issued	-	-	-	4,163
Treasury shares issued pursuant to ESOP	-	(2)	1	(1)
Weighted average number of common shares:	27,479	27,477	27,478	26,151
Basic loss per share	\$ (0.05)	\$ (0.07)	\$ (0.15)	\$ (0.20)

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 1,895,000 (2013 – 2,126,500) 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:

	September 30, 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	695	1.27	1,029	7.93
Expired during the period	(500)	9.14	(78)	11.61
Forfeited during the period	(395)	3.72	(144)	8.44
Outstanding	1,895	4.58	2,095	8.86
Exercisable	813	8.75	1,215	9.20

**KARNALYTE RESOURCES INC.**

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Number of Options Outstanding	Exercise Price	Remaining Life (yrs)	Grant Date Fair Value	Exercisable Options	Exercise Price
157	8.60	1.22	4.24	157	8.60
260	10.05	2.55	4.62	260	10.05
395	7.95	3.47	3.00	395	7.95
764	1.27	3.76	0.59	-	-
319	1.90	3.76	0.45	-	-
1,895	\$ 4.58	3.33	\$ 1.92	812	\$ 8.75

On July 4, 2014 the Company granted 695,000 stock options. The fair value of the options 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 1.47%, 59%, nil, 11% respectively. In addition, there were 651,000 options that were repriced. Simultaneous with the repricing of options, a term of service condition was included for both the repriced and granted instruments. The options vest over two years, have a life of five years and range in strike price from \$1.27 to \$1.90.

**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	\$ (205)	\$ (810)	\$ (1,382)	\$ (10,615)
Add back non-cash disposal of assets	-	-	120	-
Changes in non-cash working capital				
Trade and other payables	-	-	(537)	-
Prepaid expenses	(11)	(9)	-	(854)
Stock based compensation capitalized	15	38	255	634
Asset retirement obligations	(18)	16	-	-
	\$ (219)	\$ (765)	\$ (1,544)	\$ (10,835)

**9. Commitments**

The following are the commitments of the company as at September 30, 2014:

	Contractual cash flows	Less than one year	Two - three years	Four - five years	More than five years
Trade and other payables	\$ 410	\$ 410	\$ -	\$ -	\$ -
Office lease	455	199	256	-	-
Permit/lease on mineral property	2,667	65	232	341	2,029
Project contracts	1,486	1,486	-	-	-
	\$ 5,018	\$ 2,160	\$ 488	\$ 341	\$ 2,029

**KARNALYTE RESOURCES INC.**

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(All tabular amounts are in CAD thousands except per share amounts, unaudited)

Three and nine months ended September 30, 2014 and 2013

The company has entered into an engagement letter pursuant to which it has engaged BNP Paribas and Natixis to act as lead arrangers for a senior secured project finance facility of up to US \$300,000,000. If the facility is terminated the lead arrangers are entitled to a break fee in the amount of \$500,000 each.

**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.