KARNALYTE RESOURCES INC.

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

Three and six months ended June 30, 2015 and 2014

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 a proposed production facility and 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 at 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 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 #14, 11410 – 27th 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, 2014. 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 August 12, 2015.

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

3. Capital assets

	Land and Buildings	Vehicles	Processing and other Equipment	Assets Under Construction	Total
Cost:					
Balance at January 1, 2014	$ 641	$ 142	$ 3,721	$ 16,088	$ 20,592
Additions	-	-	-	1,958	1,958
Dispositions	(144)	(42)	-	-	(186)
Balance at December 31, 2014	497	100	3,721	18,046	22,364
Additions	-	-	-	-	-
Dispositions	-	-	-	-	-
Balance at June 30, 2015	$ 497	$ 100	$ 3,721	$ 18,046	$ 22,364
Accumulated depreciation:					
Balance at January 1, 2014	$ 117	$ 57	$ 1,673	$ -	$ 1,847
Depreciation for the period	64	35	641	-	740
Dispositions	(64)	(17)	-	-	(81)
Impairment	26	-	152	18,046	18,224
Balance at December 31, 2014	143	75	2,466	18,046	20,730
Depreciation for the period	6	16	361	-	383
Dispositions	-	-	-	-	-
Balance at June 30, 2015	$ 149	$ 91	$ 2,827	$ 18,046	$ 21,113
Carrying amounts:					
December 31, 2014	$ 354	$ 25	$ 1,255	$ -	$ 1,634
June 30, 2015	$ 348	$ 9	$ 894	$ -	$ 1,251

During the three and six months ended June 30, 2015 the Company capitalized employee remuneration of $nil and $nil (2014 - $285,000 and $588,000) and stock-based compensation expense of $nil and $nil (2014 - $60,000 and $179,000) to capital assets.

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4. Exploration and evaluation assets and other assets

	Mineral Properties	Process Patents	Computer Software	Total
Cost:				
Balance at January 1, 2014	$ 42,789	$ 139	$ 277	$ 43,205
Additions	452	16	-	468
Sale of assets	(63)	-	-	(63)
Balance at December 31, 2014	43,178	155	277	43,610
Additions	-	-	-	-
Sale of Assets	-	-	-	-
Balance at June 30, 2015	$ 43,178	$ 155	$ 277	$ 43,610
Amortization and impairment losses:				
Balance at January 1, 2014	$ -	$ 23	$ 231	$ 254
Amortization for the year	-	3	46	49
Impairment	40,796	129	-	40,925
Balance at December 31, 2014	40,796	155	277	41,228
Amortization for the period	-	-	-	-
Balance at June 30, 2015	$ 40,796	$ 155	$ 277	$ 41,228
Carrying amounts:				
December 31, 2014	$ 2,382	$ -	$ -	$ 2,382
June 30, 2015	$ 2,382	$ -	$ -	$ 2,382

During the three and six months ended June 30, 2015 the Company capitalized employee remuneration of $nil and $nil (2014 - $28,000 and $56,000) and stock-based compensation expense of $nil and $nil (2014 - $3,000 and $9,000) to intangible assets.

5. Share capital

(a) Authorized

As at June 30, 2015 and 2014 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.

The Company is also entitled to issue an unlimited number of preferred shares. There were no preferred shares issued as at June 30, 2015.

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

(b) Earnings per share

Basic earnings per share were calculated as follows:

	Three months ended		Six months ended	
	2015	2014	2015	2014
Loss for the period ending June 30,	$ (6,824)	$ (1,347)	$ (9,639)	$ (2,601)
Weighted average number of common shares:				
Issued common shares at beginning of period	27,478	27,478	27,478	27,478
Common shares issued	-		-	
Weighted average number of common shares:	27,478	27,478	27,478	27,478
Basic loss per share	$ (0.25)	$ (0.05)	$ (0.35)	$ (0.09)

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 1,035,000 (2014 – 2,249,500) 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 consultants 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:

	2015		2014	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at beginning of period	1,703	4.92	2,095	8.86
Forfeited during the period	(608)	1.45	(12)	7.95
Outstanding	1,095	6.85	2,083	8.87
Exercisable	1,035	7.18	1,438	9.01

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

Number of Options Outstanding	Exercise Price	Remaining Life (yrs)	Exercisable Options	Exercise Price
224	1.27	3.01	164	1.27
58	1.90	3.01	58	1.90
395	7.95	2.73	395	7.95
158	8.60	0.47	158	8.60
260	10.05	1.80	260	10.05
1,095	$ 6.85	2.20	1,035	$ 7.18

The Company recognized a reversal of share based compensation expense of $(142,000) and $(32,000) (2014 - $(128,000) and expense of $184,000) was expensed during the three and six month period ended June 30, 2015.

6. Supplemental cash flow information

Changes in non-cash working capital are as follows:

June 30,	2015	2014
Trade and other receivables	$ 40	$ 1,151
Prepaid expenses	(7)	50
Trade and other payables	546	(118)
	$ 579	$ 1,083
Relating to:		
Operating activities	$ 609	$ 381
Investing activities	(30)	768
Financing activities	-	(66)
	$ 579	$ 1,083

7. Commitments

The following are the commitments of the company as at June 30, 2015:

	Contractual cash flows	Less than one year	Two - three years	Four - five years	More than five years
Trade and other payables	$ 2,072	$ 2,072	$ -	$ -	$ -
Office lease	303	157	146	-	-
Permit/lease on mineral property	2,633	74	318	340	1,901
Project contracts	434	434	-	-	-
	$ 5,442	$ 2,737	$ 464	$ 340	$ 1,901

8. Risk management

Financial instruments included in the statements of financial position consist of cash, trade and other receivables, restricted cash, and trades and other payables. The fair values of these financial instruments approximate their carrying amounts due to the short term maturity of the instruments.

9. Restructuring Expenses

During the six month period ended June 30, 2015, the company's employee headcount was significantly reduced. This headcount reduction was a result of the corporate restructuring which resulted in employee termination and employee resignations. For the three and six month period ended June 30, 2015, the company had accrued \$2.55 million and \$3.45 million in restructuring expenses. In addition to the restructuring expenses, all of the former employees have forfeited their unvested stock options totalling 607,500 during the three month period ended 2015.

10. Related Party Transactions

During the quarter ended June 30, 2015, there was a significant change in management personnel and control of company; these changes have resulted in new related parties.

During the quarter, compensation of key management personnel consisted of the following amounts: \$99,064 in consulting fees and \$980,912 paid as reimbursement for legal costs, and \$358,375 for severance costs.

The former CEO was paid \$31,515 in consulting fees and \$1,218,255 in relation to the termination of the consulting agreement; and the former CFO was paid \$184,115 in consulting fees and \$188,274 for the termination of the consulting agreement.

The Company's largest shareholder Gujarat State Fertilizer Company Limited ("GSFC") was reimbursed \$458,831 for legal fees incurred in connection with the proxy contest.

11. Subsequent Event

Subsequent to the period ended June 30, 2015, the company has granted 1,930,000 stock options to employees, officers and directors of the company, subject to regulatory approval.