

Interim Unaudited Condensed Financial Statements



Three months ended March 31, 2015

KARNALYTE RESOURCES INC.

STATEMENTS OF FINANCIAL POSITION

ASSETS

(CAD \$ thousands, unaudited)	March 31, 2015	December 31, 2014
Current assets		
Cash	\$ 38,503	\$ 40,740
Trade and other receivables	75	125
Prepaid expenses	158	161
	38,736	41,026
Restricted cash	375	375
Capital assets (note 3)	1,442	1,634
Intangible exploration and evaluation and other assets (note 4)	2,382	2,382
ASSETS	\$ 42,935	\$ 45,417
LIABILITIES		
Current liabilities		
Trade and other payables	\$ 1,733	\$ 1,525
	1,733	1,525
Provisions	180	164
Total liabilities	1,913	1,689
SHAREHOLDERS' EQUITY		
Share capital (note 5)	129,786	129,786
Contributed surplus	8,609	8,499
Deficit	(97,373)	(94,557)
Total shareholders' equity	41,022	43,728
LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 42,935	\$ 45,417

Commitments (note 7), Subsequent event (note 9)

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)	2015	2014
Expenses		
General and administrative	\$ 1,666	\$ 944
Depreciation and amortization (note 3)	192	217
Stock-based compensation expense (note 5(c))	110	312
Restructuring expense	899	-
Other income and expenses	(15)	(31)
	2,852	1,442
Finance income	(160)	(192)
Finance expense	124	4
Net finance income	(36)	(188)
Comprehensive loss	(2,816)	(1,254)
Loss per share (note 5(b))		
Basic and diluted	\$ (0.10)	\$ (0.05)

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)	2015	2014
Cash Flows from (used in) Operating Activities		
Net loss for the period	\$ (2,816)	\$ (1,254)
Add/deduct:		
Depreciation and amortization	192	217
Stock-based compensation expense	110	312
Net finance income	(36)	(188)
Interest income received	134	192
Changes in non-cash working capital (note 6)	217	98
	(2,199)	(623)
Cash Flows from (used in) Investing Activities		
Additions to intangible assets	-	(92)
Proceeds on sale of intangible assets	-	62
Additions to capital assets	-	(358)
Changes in non-cash working capital (note 6)	44	664
	44	276
Cash Flows from (used in) Financing Activities		
Changes in non-cash working capital (note 6)	-	(33)
	-	(33)
Effect of foreign exchange on cash	(82)	(2)
Change in cash	(2,237)	(382)
Cash, beginning of period	40,740	46,161
Cash and cash equivalents, end of period	\$ 38,503	\$ 45,779

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)**

(CAD \$ thousands)	2015		2014	
	Number	Amount	Number	Amount
Share Capital				
Balance, beginning of period	27,478	\$129,786	27,477	\$129,774
Common shares issued	-	-	-	-
Share issue costs	-	-	-	-
Balance, end of period	27,478	129,786	27,477	129,774
Contributed Surplus				
Balance, beginning of period		8,499		7,778
Stock-based compensation expense (note 5(c))		110		438
Balance, end of period		8,609		8,216
Deficit				
Balance, beginning of period		(94,557)		(26,976)
Loss for the period		(2,816)		(1,254)
Balance, end of period		(97,373)		(28,230)
Total Shareholders' Equity				
Balance, end of period		\$ 41,022		\$109,760

See accompanying notes to the unaudited interim financial statements.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

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

Three months ended March 31, 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. In the first quarter of 2015 the Company has made a determination to place the Wynyard property on a care and maintenance program. 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 the mine development.

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 May 13, 2015.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

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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	-	-	-	-	-
Balance at March 31, 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	3	8	181	-	192
Balance at March 31, 2015	\$ 146	\$ 83	\$ 2,647	\$ 18,046	\$ 20,922
Carrying amounts:					
December 31, 2014	\$ 354	\$ 25	\$ 1,255	\$ -	\$ 1,634
March 31, 2015	\$ 351	\$ 17	\$ 1,074	\$ -	\$ 1,442

During the three months ended March 31, 2015 the Company capitalized employee remuneration of \$nil (2014 - \$303,000) and stock-based compensation expense of \$nil (2014 - \$119,000) to capital assets.

KARNALYTE RESOURCES INC.

Notes to Financial Statements
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Three months ended March 31, 2015 and 2014

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	-	-	-	-
Balance at March 31, 2015	\$ 43,178	\$ 155	\$ 277	\$ 43,610
Amortization and impairment losses:				
Balance at January 1, 2014	\$ -	\$ 23	\$ 231	\$ 254
Amortization for the period	-	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 March 31, 2015	\$ 40,796	\$ 155	\$ 277	\$ 41,228
Carrying amounts:				
December 31, 2014	\$ 2,382	\$ -	\$ -	\$ 2,382
March 31, 2015	\$ 2,382	\$ -	\$ -	\$ 2,382

During the three months ended March 31, 2015 the Company capitalized employee remuneration of \$nil (2014 - \$28,000) and stock-based compensation expense of \$nil (2014 - \$6,000) to intangible assets.

5. Share capital

(a) Authorized

As at March 31, 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 March 31, 2015.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

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Three months ended March 31, 2015 and 2014

(b) Earnings per share

Basic earnings per share were calculated as follows:

	2015	2014
Loss for the three months ending March 31,	\$ (2,816)	\$ (1,254)
Weighted average number of common shares:		
Issued common shares at beginning of period	27,478	27,477
Common shares issued	-	-
Weighted average number of common shares:	27,478	27,477
Basic loss per share	\$ (0.10)	\$ (0.05)

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 1,702,500 (2014 – 2,083,250) 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.

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	-	-	(12)	7.95
Outstanding	1,703	4.92	2,083	8.87
Exercisable	1,035	7.18	1,438	9.01

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Number of Options Outstanding	Exercise Price	Remaining Life (yrs)	Exercisable Options	Exercisable Price
658	1.27	3.26	164	1.27
232	1.90	3.26	58	1.90
395	7.95	2.98	395	7.95
158	8.60	0.72	158	8.60
260	10.05	2.05	260	10.05
1,703	\$ 4.92	2.77	1,035	\$ 7.18

Share based compensation of \$110,000 (2014 - \$312,000) was expensed during the three month period ended March 31, 2015.

6. Supplemental cash flow information

Changes in non-cash working capital are as follows:

March 31,	2015	2014
Accounts receivable	\$ 50	\$ 1,041
Prepaid expenses	3	(17)
Accounts payable and accrued liabilities	208	(295)
	\$ 261	\$ 729
Relating to:		
Operating activities	\$ 217	\$ 98
Investing activities	44	664
Financing activities	-	(33)
	\$ 261	\$ 729

7. Commitments

The following are the commitments of the company as at March 31, 2015:

	Contractual cash flows	Less than one year	Two - three years	Four - five years	More than five years
Trade and other payables	\$ 1,733	\$ 1,733	\$ -	\$ -	\$ -
Office lease	350	167	183	-	-
Permit/lease on mineral property	2,641	74	215	340	2,012
Project contracts	426	426	-	-	-
	\$ 5,150	\$ 2,400	\$ 398	\$ 340	\$ 2,012

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.

KARNALYTE RESOURCES INC.

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9. Subsequent Event

Subsequent to March 31, 2015 the Company transferred \$1,025,000 in US funds to a restricted account and is not available for the general purposes of the Company. These funds are in relation to a consulting agreement with a related party and the corresponding obligations within the agreement.

In addition, subsequent to March 31, 2015 eight employees were terminated as the Company continues to downsize in order to maintain its strong cash position until such time as the project becomes economically feasible. The Company estimates these severance costs to be \$915,000 to be paid out in the second quarter.

On April 14, 2015, the Issuer commenced legal proceeding against Robin Phinney, Jean Phinney (wife of Robin Phinney) and 1385659 Alberta Ltd., a company controlled by Robin Phinney. The legal action relates to, among other things, serious alleged breaches by Robin Phinney of his past employment and termination contract with the Issuer. In addition the Issuer claims that Phinney has also improperly solicited proxies.

On April 24, 2015, Robin Phinney filed a statement of defence and counterclaim against the Issuer and certain of its directors, namely, Stephen Goodman, Thomas Pressello, Bruce Townsend, Gerald Offet and Jay Sujir. The litigation is proceeding under the Court of Queen's Bench of Alberta.