

Interim Unaudited Financial Statements of
KARNALYTE RESOURCES INC.
Three months ended March 31, 2012

KARNALYTE RESOURCES INC.

STATEMENTS OF FINANCIAL POSITION

ASSETS

As at	March 31, <u>2012</u>	December 31, <u>2011</u>
Current assets		
Cash	\$ 32,032,143	\$ 34,251,529
Trade and other receivables	104,106	711,774
Prepaid expenses	103,087	99,807
Deferred financing expenses	405,201	102,893
	<hr/> 32,644,537	<hr/> 35,166,003
Restricted cash	375,000	375,000
Capital assets (note 3)	3,135,400	3,223,921
Intangible exploration and evaluation and other assets (note 4)	38,307,124	37,082,201
	<hr/> <hr/>	<hr/> <hr/>
ASSETS	\$ 74,462,061	\$ 75,847,125
	<hr/> <hr/>	<hr/> <hr/>
LIABILITIES		
Current liabilities		
Trade and other payables	\$ 1,248,625	\$ 2,365,895
Capital lease liability	5,178	6,904
	<hr/> 1,253,803	<hr/> 2,372,799
Provisions (note 5)	181,454	185,617
Total liabilities	<hr/> 1,435,257	<hr/> 2,558,416
	<hr/> <hr/>	<hr/> <hr/>
SHAREHOLDERS' EQUITY		
Share capital (note 6)	83,048,638	82,105,674
Warrants and rights	934,950	934,950
Contributed surplus	3,162,562	3,276,698
Deficit	(14,119,346)	(13,028,613)
Total shareholders' equity	<hr/> 73,026,804	<hr/> 73,288,709
	<hr/> <hr/>	<hr/> <hr/>
LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 74,462,061	\$ 75,847,125

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

STATEMENTS OF COMPREHENSIVE LOSS

For the three months ended March 31,

	2012	2011
Expenses		
General and administrative	\$ 798,307	\$ 810,425
Depreciation and amortization	193,345	56,656
Share-based payments (note 8)	130,521	458,204
Other income	(25,678)	(22,480)
Transaction costs	108,984	-
	<hr/> 1,205,479	<hr/> 1,302,805
Finance income	(117,775)	(38,188)
Finance expense	3,029	19,984
Net finance income	<hr/> (114,746)	<hr/> (18,204)
Comprehensive loss	<hr/> <hr/> (1,090,733)	<hr/> <hr/> (1,284,601)
Loss per share (note 7)		
Basic and diluted	<hr/> <hr/> \$ (0.05)	<hr/> <hr/> \$ (0.06)

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

STATEMENTS OF CASH FLOWS

For the three months ended ended March 31,

	<u>2012</u>	<u>2011</u>
Cash Flows from (used in) Operating Activities		
Loss for the period	\$ (1,090,733)	\$ (1,284,601)
Add/deduct:		
Depreciation and amortization	193,345	56,656
Share-based payment expense	130,521	458,204
Net finance and other income	(140,424)	(40,684)
Interest and other income received	143,453	60,668
Changes in non-cash working capital:		
Trade and other receivables	231,153	(286,206)
Trade and other payables	(928,463)	51,210
Prepaid expenses	13,920	13,179
	<u>(1,447,228)</u>	<u>(971,574)</u>
Cash Flows from (used in) Investing Activities		
Additions to intangible assets	(1,284,257)	(4,372,419)
Additions to capital assets	(79,539)	(959,736)
	<u>(1,363,796)</u>	<u>(5,332,155)</u>
Cash Flows from (used in) Financing Activities		
Issuance of common shares	-	4,564,897
Exercise of options	886,000	-
Share issue costs	-	(858,244)
Deferred financing costs	(292,234)	-
	<u>593,766</u>	<u>3,706,653</u>
Effect of foreign exchange on cash	(2,128)	(18,989)
Change in cash	(2,219,386)	(2,616,065)
Cash, beginning of period	34,251,529	59,000,457
Cash, end of period	<u>\$ 32,032,143</u>	<u>\$ 56,384,392</u>

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

STATEMENTS OF CHANGES IN EQUITY

Three months ended March 31,

	2012		2011	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
Share Capital				
Balance, beginning of period	21,418,536	\$ 82,105,674	20,093,740	\$ 72,313,190
Common shares issued	-	-	470,000	4,042,000
Common shares issued on exercise of share options	133,200	666,000	32,600	163,000
Common shares issued on exercise of broker warrants	-	-	33,502	288,117
Transfer of contributed surplus	-	276,964	-	55,325
Transfer on broker warrants exercised	-	-	-	85,158
Share issue costs	-	-	-	(325,473)
Balance, end of period	21,551,736	83,048,638	20,629,842	76,621,317
Warrants and Rights				
Balance, beginning of period	368,528	934,950	585,624	1,273,605
Broker warrants and rights issued	-	-	28,200	71,780
Broker warrants and rights exercised	-	-	(33,502)	(85,158)
Balance, end of period	368,528	934,950	580,322	1,260,227
Contributed Surplus				
Balance, beginning of period		3,276,698		2,359,264
Share-based payment expense (note 8)		162,828		568,723
Transfer to share capital on exercise		(276,964)		(55,325)
Balance, end of period		3,162,562		2,872,662
Deficit				
Balance, beginning of period		(13,028,613)		(7,674,777)
Loss for the period		(1,090,733)		(1,284,601)
Balance, end of period		(14,119,346)		(8,959,378)
Total Shareholders' Equity				
Balance, end of period		\$ 73,026,804		\$ 71,794,828

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

Three months ended March 31, 2012 and 2011

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.

In preparing these interim financial statements the company applied the same accounting policies as disclosed in the year-end financial statements dated December 31, 2011. These statements do not include all information or disclosures normally provided in annual statements. These interim statements should be read in conjunction with our audited financial statements and related notes.

The Company is in its pre-development 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 address is 104 – 26 Crystalridge Drive, Okotoks, Alberta T1S 2C3.

2. **Nature of general and administrative expenses**

We are required to present our financial performance by nature or by function. We have presented our financial performance by the underlying nature of the expense with the exception of general and administrative expenses. Had the general and administrative expenses been presented by their nature, the Company would disclose payroll expense and employee benefits of \$394,220 (2011 – \$363,587) and office and sundry expense of \$404,087 (2011 - \$446,838).

KARNALYTE RESOURCES INC.

Notes to Financial Statements

Three months ended March 31, 2012 and 2011

3. Capital assets:

	Land and Buildings	Processing and other Equipment	Total
Cost:			
Balance at January 1, 2011	\$ 384,118	\$ 131,204	\$ 515,322
Additions	-	3,278,718	3,278,718
Dispositions	-	(35,281)	(35,281)
Balance at December 31, 2011	384,118	3,374,641	3,758,759
Additions	5,120	74,420	79,540
Balance at March 31, 2012	\$ 389,238	\$ 3,449,061	\$ 3,838,299
Accumulated depreciation:			
Balance at January 1, 2011	\$ 21,142	\$ 34,804	\$ 55,946
Depreciation for the period	10,378	473,798	484,176
Dispositions	-	(5,284)	(5,284)
Balance at December 31, 2011	31,520	503,318	534,838
Depreciation for the period	19,371	148,690	168,061
Balance at March 31, 2012	\$ 50,891	\$ 652,008	\$ 702,899
Carrying amounts:			
December 31, 2011	\$ 352,598	\$ 2,871,323	\$ 3,223,921
March 31, 2012	\$ 338,347	\$ 2,797,053	\$ 3,135,400

KARNALYTE RESOURCES INC.

Notes to Financial Statements

Three months ended March 31, 2012 and 2011

4. Intangible exploration and evaluation assets and other intangible assets:

	Mineral Properties	Process Patents	Computer Software	Total
Cost:				
Balance at January 1, 2011	\$ 10,651,252	\$ 62,017	\$ 56,448	\$ 10,769,717
Additions	26,322,544	27,009	35,638	26,385,191
Balance at December 31, 2011	36,973,796	89,026	92,086	37,154,908
Additions	1,220,080	5,058	25,070	1,250,208
Balance at March 31, 2012	\$ 38,193,876	\$ 94,084	\$ 117,156	\$ 38,405,116
Amortization and impairment losses:				
Balance at January 1, 2011	\$ -	\$ 5,589	\$ 15,850	\$ 21,439
Amortization for the year	-	7,715	43,553	51,268
Balance at December 31, 2011	-	13,304	59,403	72,707
Amortization for the period	-	(5,476)	30,761	25,285
Balance at March 31, 2012	\$ -	\$ 7,828	\$ 90,164	\$ 97,992
Carrying amounts:				
December 31, 2011	\$ 36,973,796	\$ 75,722	\$ 32,683	\$ 37,082,201
March 31, 2012	\$ 38,193,876	\$ 86,256	\$ 26,992	\$ 38,307,124

During the period ended March 31, 2012 the Company capitalized employee remuneration of \$227,495 (2011 - \$186,397) and share-based payments of \$32,309 (2011 - \$110,519).

5. Provisions:

	Decommissioning obligations
Balance at January 1, 2012	\$ 185,617
Changes in estimate	(5,262)
Accretion	1,099
Balance at December 31, 2011	\$ 181,454
Non-current	\$ 181,454

KARNALYTE RESOURCES INC.

Notes to Financial Statements

Three months ended March 31, 2012 and 2011

The undiscounted amount of estimated costs required to settle the obligations at March 31, 2012 is \$270,000 (March 31, 2011 - \$212,000). The estimated costs have been inflated at 2.0 percent and discounted at a risk free rate of 2.45 percent (March 31, 2011 – 3.43 percent) for the period ending March 31, 2012.

6. **Share capital:**

(a) *Authorized:*

As at March 31, 2012 and March 31, 2011 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 number of common shares outstanding are as follows:

	2012	2011
Beginning balance as at January 1,	21,418,536	20,093,740
Common shares issued		470,000
Common shares issued on exercise of share options	133,200	32,600
Common shares issued on exercise of broker warrants		33,502
Outstanding at March 31,	21,551,736	20,629,842

The Company is also entitled to issue an unlimited number of preferred shares. There are no preferred shares issued as at March 31, 2012 or 2011.

7. **Earnings per share:**

Basic earnings per share was calculated as follows:

	2012	2011
Loss for the period ending March 31,	\$ (1,090,733)	\$ (1,284,601)
Weighted average number of common shares:		
Issued common shares at beginning of year	21,418,536	20,093,740
Share options exercised	103,651	5,833
Broker warrants exercised	-	8,934
Common shares issued	-	402,111
Weighted average number of common shares:	21,522,187	20,510,618
Basic loss per share	\$ (0.05)	\$ (0.06)

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 1,050,500 (2011 – 1,740,600) options and 368,528 (2011 – 580,322) broker warrants as their effect would have been anti-dilutive.

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8. Share-based payments:

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:

	2012		2011	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at January 1,	1,213,700	\$ 6.91	1,773,200	\$ 6.07
Exercised during the period	(133,200)	5.00	(32,600)	5.00
Expired during the period	(30,000)	5.00	-	-
Outstanding at March 31,	1,050,500	\$ 7.21	1,740,600	\$ 6.09
Exercisable at March 31,	786,500	\$ 6.74	1,212,600	\$ 5.00

The weighted average share price on the dates of exercise was \$10.07 per share during the year ended March 31, 2012 (2011 - \$11.60).

Number of Options		Remaining Life (yrs)	Grant Date Fair Value	Exercisable	
Outstanding	Exercise Price			Options	Exercise Price
476,000	\$ 5.00	0.75	\$ 1.96	476,000	\$ 5.00
524,500	8.60	3.72	4.21	260,500	8.60
25,000	10.99	4.73	5.32	25,000	10.99
25,000	16.22	4.63	7.18	25,000	16.22
1,050,500	\$ 7.21	2.42	\$ 3.28	786,500	\$ 6.74

The fair value of the options granted during the years December 31, 2011 and 2010 were estimated on the date of grant using the Black-Scholes option-pricing model.

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Notes to Financial Statements

Three months ended March 31, 2012 and 2011

9. Commitments:

The following are the commitments of the company as at March 31, 2012:

	Contractual cash flows	Less than one year	Two - three years	Four - five years	More than five years
Non-derivative financial liabilities:					
Trade and other payables	\$1,248,625	\$1,248,625	\$ -	\$ -	\$ -
Capital lease	5,178	5,178	-	-	-
Office lease	219,900	219,900	-	-	-
Permit/lease on mineral property	656,801	67,800	75,838	67,300	445,863
Project contracts	1,290,511	1,290,511	-	-	-
Feasibility/environmental studies	391,859	391,859	-	-	-
	<u>\$3,812,874</u>	<u>\$3,223,873</u>	<u>\$ 75,838</u>	<u>\$ 67,300</u>	<u>\$ 445,863</u>

The Company has entered into contracts for various technical, drilling, geological, environmental, engineering and consulting services. The Company entered into a drilling contract that requires a minimum commitment of 100 operating days to be completed by August 12, 2012. If the Company fails to meet that commitment they are required to pay the drilling company \$950,000. The Company expects to have the rig operational for the minimum time period.

The Company secured computer equipment by entering a capital lease on January 1, 2010. The lease carries a term of 36 months with an implicit interest rate of 13%. The present value of the minimum lease payments at inception was \$20,712.

The Company has also signed a lease agreement for the building space that was being used for management offices. The lease is paid on a monthly basis of \$18,325 and will expire on April 30, 2013.