



Interim Unaudited Financial Statements

Three months ended March 31, 2013

KARNALYTE RESOURCES INC.

STATEMENTS OF FINANCIAL POSITION

ASSETS

As at	March 31, 2013	December 31, 2012
Current assets		
Cash	\$ 61,909,274	\$ 25,114,959
Trade and other receivables	221,828	225,363
Prepaid expenses	109,175	128,927
Deferred financing costs (note 4)	922,251	843,897
	<u>63,162,528</u>	<u>26,313,146</u>
Restricted cash	375,000	375,000
Capital assets (note 5)	7,557,308	6,404,557
Intangible exploration and evaluation and other assets (note 6)	46,089,978	43,197,551
	<u>\$ 117,184,814</u>	<u>\$ 76,290,254</u>

LIABILITIES

Current liabilities		
Trade and other payables	\$ 3,632,968	\$ 3,996,019
	<u>3,632,968</u>	<u>3,996,019</u>
Provisions	150,304	149,956
Total liabilities	<u>3,783,272</u>	<u>4,145,975</u>

SHAREHOLDERS' EQUITY

Share capital (note 7)	129,786,554	87,473,052
Contributed surplus	5,499,685	4,905,686
Deficit	(21,884,697)	(20,234,459)
Total shareholders' equity	<u>113,401,542</u>	<u>72,144,279</u>
	<u>\$ 117,184,814</u>	<u>\$ 76,290,254</u>

Commitments (note 9, note 7(c))

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

STATEMENTS OF COMPREHENSIVE LOSS

For the three months ended March 31,

	2013	2012
Expenses		
General and administrative	\$ 1,081,671	\$ 798,307
Depreciation and amortization	206,616	193,345
Share-based payments (note 8)	424,286	130,521
Transaction costs	-	108,984
Other income and expenses	(12,195)	(25,678)
	1,700,378	1,205,479
Finance income	(77,004)	(117,775)
Finance expense	26,864	3,029
Net finance income	(50,140)	(114,746)
Comprehensive loss	(1,650,238)	(1,090,733)
Loss per share (note 7(b))		
Basic and diluted	\$ (0.07)	\$ (0.05)

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

STATEMENTS OF CASH FLOWS

For the three months ended March 31,

	<u>2013</u>	<u>2012</u>
Cash Flows from (used in) Operating Activities		
Net loss for the period	\$ (1,650,238)	\$ (1,090,733)
Add/deduct:		
Depreciation and amortization	206,616	193,345
Share-based payment expense	424,286	130,521
Net finance and other income	(62,335)	(140,424)
Interest and other income received	89,199	143,453
Changes in non-cash working capital:		
Trade and other receivables	2,823	231,153
Trade and other payables	14,842	(928,463)
Prepaid expenses	(491,990)	13,920
	<u>(1,466,797)</u>	<u>(1,447,228)</u>
Cash Flows from (used in) Investing Activities		
Additions to intangible assets	(2,721,995)	(1,284,257)
Additions to capital assets	(1,175,040)	(79,539)
	<u>(3,897,035)</u>	<u>(1,363,796)</u>
Cash Flows from (used in) Financing Activities		
Issuance of common shares	44,745,994	-
Exercise of options and warrants	-	886,000
Share issue costs	(2,344,384)	-
Deferred financing costs	(217,311)	(292,234)
	<u>42,184,299</u>	<u>593,766</u>
Effect of foreign exchange on cash	(26,152)	(2,128)
Change in cash	36,794,315	(2,219,386)
Cash, beginning of period	25,114,959	34,251,529
Cash and cash equivalents, end of period	<u>\$ 61,909,274</u>	<u>\$ 32,032,143</u>

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

STATEMENTS OF CHANGES IN EQUITY

Three months ended March 31,

	2013		2012	
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>
Share Capital				
Balance, beginning of period	21,988,704	\$ 87,473,052	21,418,536	\$ 82,105,674
Common shares issued (note 7(c))	5,490,306	44,745,994	-	-
Common shares issued on exercise of share options	-	-	133,200	666,000
Transfer from contributed surplus on options exercised	-	-	-	276,964
Share issue costs	-	(2,432,492)	-	-
Balance, end of period	27,479,010	129,786,554	21,551,736	83,048,638
Warrants and Rights				
Balance, beginning of period	-	-	368,528	934,950
Balance, end of period	-	-	368,528	934,950
Contributed Surplus				
Balance, beginning of period		4,905,686		3,276,698
Share-based payment expense (note 8)		593,999		162,828
Transfer to share capital on exercise		-		(276,964)
Balance, end of period		5,499,685		3,162,562
Deficit				
Balance, beginning of period		(20,234,459)		(13,028,613)
Loss for the period		(1,650,238)		(1,090,733)
Balance, end of period		(21,884,697)		(14,119,346)
Total Shareholders' Equity				
Balance, end of period		\$ 113,401,542		\$ 73,026,804

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

Three months ended March 31, 2013 and 2012

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.

2. **Statement of compliance**

These unaudited interim financial statements are prepared in compliance with IAS 34 “Interim Financial Reporting”. In preparing these interim financial statements the Company applied the same accounting policies as disclosed in the year-end financial statements dated December 31, 2012. 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.

3. **Changes in accounting policies**

During the first quarter of 2013, the Company adopted the following standards:

- IFRS 11 “Joint arrangements” outlines the accounting treatment for joint arrangements, notably joint operations and joint ventures, to be applied retrospectively. This new standard became effective on January 1, 2013. There was no impact to the Company on adoption of this standard.
- IFRS 13 “Fair value measurement” defines fair value, provides guidance on measuring fair value and outlines disclosure requirements for fair value measurements. This standard applies when another IFRS standard requires fair value measurements or disclosures, with some exceptions including IFRS 2 “Share based payments” and IAS 17 “Leases”. This new standard became effective and was applied prospectively on January 1, 2013. There was no measurement impact to the Company on adoption of this standard. Refer to note 9 for the additional disclosure required.

4. **Deferred financing**

Deferred financing costs were incurred as a result of the Company continuing to pursue debt financing. These costs will be deferred until the debt has been issued. Such financing costs will be recognized in profit or loss if the financing is no longer considered probable.

KARNALYTE RESOURCES INC.

Notes to Financial Statements

Three months ended March 31, 2013 and 2012

5. Capital assets

	Land and Buildings	Vehicles	Processing and other Equipment	Assets Under Construction	Total
Cost:					
Balance at January 1, 2012	\$ 455,785	\$ -	\$ 3,302,972	\$ -	\$ 3,758,757
Additions	81,388	141,898	137,229	3,466,078	3,826,593
Dispositions	-	-	-	-	-
Balance at December 31, 2012	537,173	141,898	3,440,201	3,466,078	7,585,350
Additions	30,000	-	(2,289)	1,304,068	1,331,779
Balance at March 31, 2013	\$ 567,173	\$ 141,898	\$ 3,437,912	\$ 4,770,146	\$ 8,917,129
Accumulated depreciation:					
Balance at January 1, 2012	\$ 65,356	\$ -	\$ 469,480	\$ -	\$ 534,836
Depreciation for the period	43,311	11,825	590,821	-	645,957
Dispositions	-	-	-	-	-
Balance at December 31, 2012	108,667	11,825	1,060,301	-	1,180,793
Depreciation for the period	14,093	11,825	153,110	-	179,028
Balance at March 31, 2013	\$ 122,760	\$ 23,650	\$ 1,213,411	\$ -	\$ 1,359,821
Carrying amounts:					
December 31, 2012	\$ 428,506	\$ 130,073	\$ 2,379,900	\$ 3,466,078	\$ 6,404,557
March 31, 2013	\$ 444,413	\$ 118,248	\$ 2,224,501	\$ 4,770,146	\$ 7,557,308

KARNALYTE RESOURCES INC.

Notes to Financial Statements

Three months ended March 31, 2013 and 2012

6. Intangible exploration and evaluation assets and other intangible assets

	Mineral Properties	Process Patents	Computer Software	Total
Cost:				
Balance at January 1, 2012	\$ 36,973,796	\$ 89,026	\$ 92,086	\$ 37,154,908
Additions	6,009,602	27,729	157,789	6,195,120
Balance at December 31, 2012	42,983,398	116,755	249,875	43,350,028
Additions	2,889,887	3,218	26,910	2,920,015
Balance at March 31, 2013	\$ 45,873,285	\$ 119,973	\$ 276,785	\$ 46,270,043
Amortization and impairment losses:				
Balance at January 1, 2012	\$ -	\$ 13,304	\$ 59,403	\$ 72,707
Amortization for the year	-	(693)	80,463	79,770
Balance at December 31, 2012	-	12,611	139,866	152,477
Amortization for the period	-	1,478	26,110	27,588
Balance at March 31, 2013	\$ -	\$ 14,089	\$ 165,976	\$ 180,065
Carrying amounts:				
December 31, 2012	\$ 42,983,398	\$ 104,144	\$ 110,009	\$ 43,197,551
March 31, 2013	\$ 45,873,285	\$ 105,884	\$ 110,809	\$ 46,089,978

During the three months ended March 31, 2013 the Company capitalized employee remuneration of \$254,375 (2012 - \$1,247,195) and share-based payments of \$169,713 (2012 - \$798,209).

7. Share capital

(a) Authorized

As at March 31, 2013 and December 31, 2012 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.

(b) Earnings per share

Basic earnings per share were calculated as follows:

	2013	2012
Loss for the three months ending March 31,	\$ (1,650,238)	\$ (1,090,733)
Weighted average number of common shares:		
Issued common shares at beginning of period	21,988,704	21,418,536
Share options exercised	-	103,651
Broker warrants exercised	-	-
Common shares issued	1,464,082	-
Weighted average number of common shares:	23,452,786	21,522,187
Basic loss per share	\$ (0.07)	\$ (0.05)

KARNALYTE RESOURCES INC.

Notes to Financial Statements

Three months ended March 31, 2013 and 2012

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 2,301,500 (2012 – 1,050,500) options and nil (2012 – 368,528) broker warrants as their effect would have been anti-dilutive.

(c) Private placement

On March 7, 2013 the Company closed a non-brokered private placement financing with Gujarat State Fertilizers & Chemicals (“GSFC”) for \$44,745,994 in exchange for 5,490,306 common shares which represents a 19.98% ownership stake in the Company. Along with the financing, GSFC has also committed to an off-take agreement for the purchase of approximately 350,000 tonnes per year of potash increasing to 600,000 tonnes per year for a period of 20 years from the commencement of commercial production.

The Company is obligated to issue an additional 555,555 common shares to GSFC if commercial production has not commenced on or before October 1, 2016.

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:

	March 31, 2013		December 31, 2012	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Outstanding at beginning of period	1,287,500	9.72	1,213,700	6.91
Issued during the period	1,014,000	7.95	-	-
Exercised during the period	-	-	(133,200)	5.00
Expired during the period	-	-	(30,000)	5.00
Outstanding	2,301,500	8.94	1,050,500	7.21
Exercisable	668,750	9.42	786,500	6.74

KARNALYTE RESOURCES INC.

Notes to Financial Statements

Three months ended March 31, 2013 and 2012

Number of Options		Remaining Life (yrs)	Grant Date Fair Value	Exercisable	
Outstanding	Exercise Price			Options	Exercise Price
412,500	8.60	2.72	4.22	412,500	8.60
825,000	10.05	4.05	4.62	206,250	10.05
25,000	10.99	3.73	5.32	25,000	10.99
25,000	16.22	3.63	7.18	25,000	16.22
1,014,000	7.95	4.98	3.03	-	7.95
2,301,500	\$ 8.94	4.21	\$ 3.89	668,750	\$ 9.42

There were 1,014,000 options granted on March 21, 2013. The fair value of the options was estimated on the date of grant using the Black-Scholes option-pricing model. The options granted in 2013 vest over two years and have a life of five years. The interest rate, volatility, dividend yield and forfeiture rate assumptions used in the calculation were 1.02% - 1.25%, 46% - 49%, nil and 6% respectively.

9. Commitments

The following are the commitments of the company as at March 31, 2013:

	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	\$ 2,352,723	\$ 2,352,723	\$ -	\$ -	\$ -
Office lease	1,010,252	300,143	530,476	179,633	-
Permit/lease on mineral property	692,525	41,983	122,300	73,967	454,275
Project contracts	1,392,482	1,392,482	-	-	-
	\$ 5,447,982	\$ 4,087,331	\$ 652,776	\$ 253,600	\$ 454,275

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.