Financial Statements of

KARNALYTE RESOURCES INC.

Years ended December 31, 2018 and 2017

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Karnalyte Resources Inc.

Opinion

We have audited the financial statements of Karnalyte Resources Inc. (the Entity), which comprise:

- the statements of financial position as at December 31, 2018 and December 31, 2017
- the statements of loss and comprehensive loss for the years then ended
- the statement of changes in equity for the year for the years then ended
- the statement cash flows for the years then ended
- and notes to the financial statements including a summary of significant accounting policies and other explanatory information.

(hereinafter referred to as the "financial statements")

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Entity as at December 31, 2018 and December 31, 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the "***Auditors' Responsibilities for the Audit of the Financial Statements***" section of our auditors' report.

We are independent of the Entity in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. Other information comprises:

- the information in the Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions.

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit and remain alert for indication that the other information appears to be materially misstated.

We obtained the Management's Discussion and Analysis filed with the relevant Canadian Securities Commissions as at the date of this auditors' report. If, based on the work we have performed on this other information, we conclude that there is a material misstatement of this other information, we are required to report that fact in the auditors' report.

We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards (IFRS), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Entity's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Entity or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Entity's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

KPMG

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit.

We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

  The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Entity's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Entity to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

- Provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

KPMG LLP

Chartered Professional Accountants
The engagement partner on the audit resulting in this auditors' report is Scott Douglas Verity.

Saskatoon, Canada
March 22, 2019

KARNALYTE RESOURCES INC.
Statements of Financial Position

December 31, 2018 and 2017
(CAD $ thousands)

	2018	2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,504	$ 12,265
Trade and other receivables	104	122
Prepaid expenses	528	370
	11,136	12,757
Restricted cash (note 4)	375	375
Capital assets (note 5)	366	426
Exploration and evaluation and other assets (note 6)	5,044	5,044
ASSETS	$ 16,921	$ 18,602
LIABILITIES		
Current liabilities:		
Trade and other payables	$ 901	$ 691
	901	691
Decommissioning liability (note 8)	1,707	155
Total liabilities	2,608	846
Shareholders' equity:		
Share capital (note 9)	132,149	129,879
Contributed surplus	9,522	9,217
Deficit	(127,358)	(121,340)
Total shareholders' equity	14,313	17,756
LIABILITIES AND SHAREHOLDERS' EQUITY	$ 16,921	$ 18,602

Commitments (note 15(c)), Contingent liability (note 16)

See accompanying notes to the financial statements.

Approved on behalf of the Board:

"signed"	"signed"
W. Todd Rowan, Director	Sanjeev Varma, Director

KARNALYTE RESOURCES INC.

Statements of Loss and Comprehensive Loss

For the years ended December 31, 2018 and 2017
(CAD $ thousands)

		2018		2017
Expenses:				
General and administrative (notes 10 and 11)	$	3,762	$	2,838
Depreciation and amortization (notes 5 and 6)		60		284
Share-based compensation expense (note 9(d))		305		13
Restructuring expenses		10		1,238
Recovery of provision (note 7)		-		(1,316)
Impairment expenses (note 5 and 6)		2,079		597
Gain on sale of asset		-		(50)
Other income and expenses		(104)		(95)
		6,112		3,509
Finance income		(122)		(133)
Finance expense		28		19
Net finance income (note 12)		(94)		(114)
Loss and Comprehensive loss	$	(6,018)	$	(3,395)
Loss per share (note 9(b)) Basic and diluted	$	(0.21)	$	(0.12)

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Statements of Cash Flows

For the years ended December 31, 2018 and 2017
(CAD $ thousands)

	2018	2017
Cash Flows from (used in) Operating Activities:		
Net loss for the period	$ (6,018)	$ (3,395)
Add/deduct:		
Depreciation and amortization (notes 5 and 6)	60	284
Stock-based compensation expense (note 9(d))	305	13
Impairment expense (notes 5 and 6)	2,079	597
Recovery of provision (note 7)	-	(1,316)
Net finance income (note 12)	(94)	(114)
Interest income received	135	125
Gain on sale of asset	-	(50)
Changes in non-cash working capital (note 14)	58	157
	(3,475)	(3,699)
Cash Flows from (used in) Investing Activities:		
Additions to mineral rights and intangible assets (note 6)	(550)	(879)
Additions to capital assets (note 5)	-	-
Proceeds on sale of intangible assets (note 6)	-	21
Proceeds on sale of capital assets (note 5)	-	50
Changes in non-cash working capital (note 14)	(1)	-
	(551)	(808)
Cash Flows from Financing Activities:		
Issuance of common shares (note 9(c))	2,390	-
Costs of issuance of common shares(note 9(c))	(120)	-
	2,270	-
Effect of foreign exchange on cash	(5)	20
Change in cash	(1,761)	(4,487)
Cash, beginning of period	12,265	16,752
Cash and cash equivalents, end of period	$ 10,504	$ 12,265

See accompanying notes to the financial statements.

KARNALYTE RESOURCES INC.

Statements of Changes in Equity

For the years ended December 31, 2018 and 2017
(CAD $ thousands)

	2018		2017	
	Number	Amount	Number	Amount
Share Capital:				
Balance, beginning of period	28,116	$ 129,879	28,116	$ 129,879
Common shares issued under rights offering, net of share issuance costs (note 9(c))	14,058	2,270	-	-
Balance, end of period	42,174	132,149	28,116	129,879
Contributed Surplus:				
Balance, beginning of period		9,217		9,204
Stock-based compensation expense (note 9(d))		305		13
Balance, end of period		9,522		9,217
Deficit:				
Balance, beginning of period		(121,340)		(117,945)
Loss for the period		(6,018)		(3,395)
Balance, end of period		(127,358)		(121,340)
Balance, end of period		$ 14,313		$ 17,756

See accompanying notes to the financial statements.

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 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.

As at the date of these financial statements, 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. While the Company has sufficient cash to meet its short-term corporate operating and capital requirements for at least the next twelve months, it does not currently have adequate funds to proceed with full-scale development of the solution mining facility.

The Company's address is 3150B Faithfull Ave. Saskatoon, SK S7K 8H3.

2. Basis of preparation

(a) Statement of compliance

These financial statements have been prepared by management in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board.

These financial statements were authorized for issue by the Board of Directors on March 22, 2019.

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis.

(c) Functional and presentation currency

These financial statements are presented in Canadian dollars, which is the Company's functional currency.

2. Basis of preparation (continued)

(d) Changes in accounting policy

On January 1, 2018, the Company adopted the new standards, IFRS 15 and IFRS 9, as issued by the IASB.

(i) IFRS 9 - Financial instruments

IFRS 9 includes revised guidance on the classification and measurement of financial assets. While the new standard largely retains the existing requirements for the classification and measurement of financial liabilities, it changes the previous categories for financial assets. Upon adoption, the Company reclassified its financial assets, primarily cash, from the previous category “loans and receivable” to the new category “amortized cost”. There was no impact on the measurement of these instruments.

The new standard also includes a new expected credit loss model for calculating impairment on financial assets. This change did not have an impact on the financial statements.

(ii) IFRS 15 - Revenue

IFRS 15 clarifies the principles for recognizing revenue from contracts with customers. As the Company does not have any contracts with customers there was no impact on the financial statements as a result of the adoption of this standard.

(e) Use of estimates and judgements

The preparation of the financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expense. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements are as follows:

(i) Use of estimates

The following are the key assumptions concerning the sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing adjustments to the carrying amounts of assets and liabilities.

2. Basis of preparation (continued)

(e) Use of estimates and judgements (continued)

(i) Use of estimates (continued)

i. Reserve Estimates

The estimation of potash reserves is an inherently complex process. Proven and probable reserves are estimated based on geological data, geophysical data, engineering data, projected future rates of production, estimated commodity prices, costs, discount rates and the timing of future expenditures. Reserves estimates, although not reported as part of the Company's financial statements, can have a significant effect on earnings, assets, as a result of their impact on depletion and impairment, decommissioning provisions and deferred income taxes. Accordingly, the impact to the financial statements of changes to estimates of reserves in future periods could be material.

ii. Decommissioning Provisions

Amounts are recorded for decommissioning provisions that will be incurred by the Company at the end of the operating life of the facilities and properties, and upon retirement of its mining assets. Estimates of these costs are subject to uncertainty associated with the method, timing and extend of future decommissioning activities. The provision and related asset and expense are impacted by estimates with respect to the costs and timing of decommissioning.

iii. Share-Based Compensation

Compensation expense recognized for the Company's share-based compensation plan is accrued over the vesting period based on grant date fair values. Fair values are determined using the Black-Scholes option pricing model while the fair value of restricted and performance awards are valued based on the closing share price on the date immediately prior to the grant date. In assessing the fair value of share based compensation, significant assumptions such as expected volatility, dividend yield, expected term, estimated forfeiture rates and performance multipliers for performance awards are made.

2. Basis of preparation (continued)

(e) Use of estimates and judgements (continued)

(i) Use of estimates (continued)

iv. Income Taxes

The Company follows the asset/liability method for calculating deferred income taxes. Tax interpretations, regulations and legislation in the various jurisdictions in which the Company operates are subject to change. As such, income taxes are subject to measurement uncertainty. Deferred income tax assets are recognized only to the extent that those assets are considered recoverable. Deferred income tax assets are assessed by management at the end of the reporting period to determine the likelihood that they will be realized from future taxable earnings.

(ii) Judgements

The following are the critical judgements that management has made in the process of applying the Company's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

i. Cash Generating Unit ("CGU")

For the purpose of impairment testing, mining assets are aggregated in CGU's. The determination of CGUs requires judgement in defining the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or group of assets. CGUs are determined by similar geological structure, shared infrastructure, geographical proximity, commodity type, similar exposure to market risks and materiality. The Company's CGU's are consistent with its operating segments.

2. Basis of preparation (continued)

(e) Use of estimates and judgements (continued)

(ii) Judgements (continued)

ii. Impairment

Judgements are required to assess when impairment indicators exist and impairment testing is required. The recoverable amounts of CGUs are based on the higher of their value-in-use and fair value less costs to sell. These calculations require the use of estimates and assumptions. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves. Management does not expect a significant difference between value in use and fair value less cost to sell.

iii. Exploration and Evaluation Assets (“E&E”)

The decision to transfer assets from E&E to property, plant and equipment requires management to make certain judgements as to future events and is based on whether economic quantities of proven plus probable reserves have been found to determine a project’s technical feasibility and commercial viability.

iv. Income Taxes

Judgements are made by management at the end of the reporting period to determine the likelihood that deferred income tax assets will be realized from future taxable earnings. Assessing the recoverability of deferred income tax assets requires the Company to make judgements related to the expectations of future cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that assumptions regarding future profitability change, there can be an increase or decrease in the amounts recognized in profit or loss in the period in which the change occurs.

3. Significant accounting policies

The accounting policies set out below have been applied consistently by the Company to all periods presented in these financial statements.

(a) Foreign currency

Transactions in foreign currencies are translated to Canadian dollars at exchange rates on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the period end exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on translation are recognized in profit or loss under finance income and expenses on a net basis.

(b) Financial instruments

Classification

Financial Instruments are classified upon initial recognition into one of the following categories: fair value through profit and loss (“FVTPL”), fair value through other comprehensive income (“FVTOVI”), or amortized cost. Financial assets are classified into one of these categories upon initial recognition based on the Company’s business model for managing its financial assets and their cash flow characteristics. Classifications are not changed subsequent to initial recognition unless the Company changes its business model for managing its financial assets, in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in business model. Financial liabilities are measured at amortized cost, unless they are required to be measured at FVTPL (such as instruments held for trading or derivatives) or the Company has opted to measure them at FVTPL.

The Company’s cash, trade and other receivables and restricted cash are classified as amortized cost. Trade and other payables are also classified as amortized cost. Interest income, foreign exchange gains and losses and impairment are recognized in profit or loss, as well as any gain or loss on derecognition.

Measurement

Financial assets and liabilities at amortized cost are initially recognized at fair value, and subsequently carried at amortized cost less any impairment.

Derecognition

The Company derecognizes financial assets only when the contractual rights to cash flows from the financial assets expire, or when it transfers the financial assets and substantially all

3. Significant accounting policies (continued)

(b) Financial instruments (continued)

the associated risks and rewards of ownership to another entity. Gains and losses on derecognition are recognized in the statements of profit or loss.

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires. The Company also derecognizes a financial liability when its terms are modified and the cash flows of the modified liability are substantially different, in which case a new financial liability based on the modified terms is recognized at fair value. On derecognition of a financial liability, the difference between the carrying amount extinguished and the consideration paid is recognized in profit or loss.

(c) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

(d) Property, plant and equipment and intangible exploration assets

(i) Recognition and measurement

i. Exploration and evaluation expenditures

Pre-exploration costs are recognized in profit and loss as incurred. After obtaining a license, mineral exploration and evaluation costs, including the costs of acquiring permits and directly attributable general and administrative costs, are initially capitalized as exploration and evaluation assets.

ii. Development and production costs

Upon determination of technical feasibility and commercial viability the costs associated with the exploration and evaluation of the associated proven and probable reserves are transferred to development and production assets. The associated costs are assessed for impairment at the time the costs are transferred from exploration and evaluation expenditures to development and production assets.

3. Significant accounting policies (continued)

(d) Property, plant and equipment and intangible exploration assets (continued)

(i) Recognition and measurement (continued)

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property, plant and equipment are recognized when they increase the future economic benefits embodied in the specific asset to which they relate, such as developing proven and/or probable reserves and bringing in or enhancing production from reserves or resources, and are accumulated on a field or geotechnical area basis. The carrying amount of any replaced or sold component is derecognized and the cost of the replacement part is recognized. The costs of the day-to-day servicing of property, plant and equipment are recognized in profit or loss as incurred.

Development and production expenditures are recognized as assets under construction until the assets are available for their intended use and not depreciated. When assets are available for their intended use, the asset is depreciated and recognized at its original cost less accumulated depletion and depreciation.

(ii) Depletion and depreciation

When significant parts of an item of property, plant and equipment, including mining interests, have different useful lives, they are accounted for as separate items (major components). Once commercial production begins, the accumulated costs of capital assets and exploration and evaluation assets will be amortized to operations on a unit of production basis over economically recoverable proven plus probable reserves or over the estimated useful life, if shorter.

Reserves are estimated using independent reserve engineer reports and represent the estimated quantities of potash and magnesium which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known resources and which are considered commercially viable.

Depreciation is recognized in profit or loss on a straight-line basis or unit of production over the estimated useful lives of each part of an item of capital assets and intangible exploration and evaluation assets. Land is not depreciated.

3. Significant accounting policies (continued)

(d) Property, plant and equipment and intangible exploration assets (continued)

(ii) Depletion and depreciation (continued)

The estimated useful lives for capital assets for the current and comparative years are as follows:

Buildings	25 years
Land Improvements	20 years
Processing and other equipment	5 - 10 years
Vehicles	3 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date.

(e) Other intangible assets

Other intangible assets that are acquired by the Company, which have finite useful lives, are measured at cost less accumulated amortization and accumulated impairment losses. Subsequent expenditures are capitalized only when they increase the future economic benefits embodied in the specific asset to which they relate.

Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives of other intangible assets from the date they were available for use.

The estimated useful lives for the intangible assets are as follows:

Patents	20 years
Computer Software	1 year

3. Significant accounting policies (continued)

(f) Leased assets

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Company will obtain ownership by the end of the lease term.

Minimum lease payments made under finance leases are apportioned between finance expenses and the reduction of the outstanding liability using the effective interest method, so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Operating leases are not recognized on the Company's statement of financial position. Payments made under operating leases are recognized in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognized as an integral part of the total lease expense, over the term of the lease.

(g) Impairment

(i) Financial assets

The Company recognizes loss allowances for expected credit losses ("ECL") on financial assets that are measured at amortized cost. At each reporting date, the Corporation measures the loss allowance for the financial asset at an amount equal to the lifetime ECL's if the credit risk on the financial asset has increased significantly since initial recognition. If at the reporting date, the credit risk for the financial asset has not increased significantly since initial recognition, the Company measures the loss allowance for the financial asset at an amount equal to twelve months of expected credit losses.

Loss allowances for financial assets measured at amortized cost are deducted from the gross carrying amount of the assets. The gross carrying amount of a financial asset is written off when the Company has no reasonable expectations of recovering a financial asset it its entirety or a portion thereof.

3. Significant accounting policies (continued)

(g) Impairment (continued)

(ii) Non-financial assets

The non-financial assets of the Company consist of capital assets and exploration and evaluation and other assets. For the purpose of impairment testing, non-financial assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or cash generating units ("CGU's"). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell. An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount.

Upon the establishment of technical feasibility and at the time sufficient funding becomes available to proceed with plant construction, the related exploration and evaluation assets are transferred to development and production assets and are assessed for impairment at the time that the costs are transferred.

Non-financial assets are assessed for an indication of impairment at each financial reporting period or if facts and circumstances suggest that the carrying amount exceeds the recoverable amount. In determining the recoverable amount of the CGU cash generating unit the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Recoverable amount is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves and therefore is subject to the estimation of mineral reserves or the amount a market participant is willing to pay to acquire the assets of the CGU.

In respect of non-financial assets, impairment losses recognized in prior years are assessed at each reporting date for any indication that the fair value has recovered. An impairment loss is reversed if there has been a change in the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depletion and depreciation or amortization, if no impairment loss had been recognized.

(h) Stock-based compensation expense

The grant date fair value of options granted to employees is calculated using the Black-Scholes option pricing model and is recognized as compensation expense, within profit and loss, with a corresponding increase in contributed surplus over the vesting period. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

3. Significant accounting policies (continued)

(i) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Provisions are not recognized for future operating losses.

(j) Decommissioning obligations

The Company's activities give rise to dismantling, decommissioning and site disturbance re-mediation activities. Provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's best estimate of expenditure required to settle the present obligation at the reporting date. Subsequent to the initial measurement, the obligations are adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

(k) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in shareholders' equity. Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date. Deferred tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if they relate to income taxes levied by the same tax authority.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

3. Significant accounting policies (continued)

(l) Earnings per share

Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of dilutive instruments such as options granted to employees.

(m) New standards and interpretations not yet adopted:

The Company will be required to adopt the following new and revised International Financial Reporting Standards ("IFRS") that were issued by the International Accounting Standards Board ("IASB"):

i) IFRS 16 – Leases

IFRS 16 "Leases" introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term greater than 12 months, unless the underlying asset is of a low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease ability representing its obligation to make lease payments. IFRS 16 will replace IAS 17, Leases and is effective for annual periods beginning on or after January 1, 2019. Karnalyte is currently evaluating the impact of adopting IFRS 16 on its financial statements.

ii) IFRIC 23 – Uncertainty over Income Tax Treatments

IFRIC 23 provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments. IFRIC 23 is effective for periods beginning on or after January 1, 2019 with early adoption permitted. Karnalyte is currently evaluating the impact of adopting IFRIC 23 on its financial statements.

4. Restricted cash

The Company was required to submit three separate $125,000 irrevocable letters of credit to Saskatchewan Ministry of Environment towards any future environmental damage that could potentially be caused by the operation of its test facility near Wynyard, Saskatchewan. The letters of credit have been provided by the Company's bank on behalf of the Company and are secured by interest-bearing deposits that are not available to the Company for general use. Funds were renewed in June and August of 2014 and are invested in Guaranteed Investment Certificates which are redeemable on the 15th day of each month and are due for renewal in 2019.

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

5. Capital assets

	Land and Buildings	Vehicles	Processing and other Equipment	Assets Under Construction	Total
Cost:					
Balance at January 1, 2017	$ 497	$ 117	$ 3,707	$ 18,711	$ 23,032
Additions	-	-	-	-	-
Dispositions	-	-	(50)	-	(50)
Balance at December 31, 2017	497	117	3,657	18,711	22,982
Additions	-	-	-	-	-
Additions to decommissioning liability	-	-	-	1,175	1,175
Dispositions	-	-	-	-	-
Balance at December 31, 2018	$ 497	$ 117	$ 3,657	$ 19,886	$ 24,157
Accumulated depreciation:					
Balance at January 1, 2017	$ 169	$ 84	$ 3,358	$ 18,711	$ 22,322
Depreciation	13	15	256	-	284
Dispositions	-	-	(50)	-	(50)
Impairment	-	-	-	-	-
Balance at December 31, 2017	182	99	3,564	18,711	22,556
Depreciation	13	15	32	-	60
Dispositions	-	-	-	-	-
Impairment	-	-	-	1,175	1,175
Balance at December 31, 2018	$ 195	$ 114	$ 3,596	$ 19,886	$ 23,791
Carrying amounts:					
December 31, 2017	$ 315	$ 18	$ 93	$ -	$ 426
December 31, 2018	$ 302	$ 3	$ 61	$ -	$ 366

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

6. Exploration and evaluation assets and other assets

	Mineral Properties	Process Patents	Computer Software	Total
Cost:				
Balance at January 1, 2017	$ 48,004	$ 170	$ 277	$ 48,451
Additions	879	-	-	879
Sale of assets	(21)	-	-	(21)
Balance at December 31, 2017	48,862	170	277	49,309
Additions	535	15	-	550
Additions to decommissioning liability	354	-	-	354
Sale of Assets	-	-	-	-
Balance at December 31, 2018	$ 49,751	$ 185	$ 277	$ 50,213
Amortization and impairment losses:				
Balance at January 1, 2017	$ 43,221	$ 170	$ 277	$ 43,668
Amortization for the year	-	-	-	-
Impairment	597	-	-	597
Balance at December 31, 2017	43,818	170	277	44,265
Amortization for the period	-	-	-	-
Impairment	889	15	-	904
Balance at December 31, 2018	$ 44,707	$ 185	$ 277	$ 45,169
Carrying amounts:				
December 31, 2017	$ 5,044	$ -	$ -	$ 5,044
December 31, 2018	$ 5,044	$ -	$ -	$ 5,044

At December 31, 2018, the Company assessed whether there was any indication that previously recognized impairment losses required reversal. The Company determined that there were no indications that the asset values had increased significantly during the period. The Company has not obtained project financing and the Company's market capitalization continues to be depressed as does the market for potash. Therefore, in addition to the impairment losses recognized in prior years, the Company recorded an impairment loss of $904,000 during 2018 (2017 - $597,000) to impair additions to exploration and evaluation assets to their estimated recoverable amount.

Disclosure of sensitivities of the recoverable amount to changes in management estimates are not meaningful given the methodology described above in determining the fair value less cost to sell, however the identification of a buyer of the project in its entirety, or the Company's ability to secure adequate financing for the development of the mine on economic terms, could result in a material difference from the current estimate of the recoverable amount.

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

7. Provision

In 2017, a recovery was recorded relating to a provision recorded in prior years as a result of a previous debt financing arrangement. The limitations period to which this provision relates expired in 2017 and so the Company reversed the provision as it was no longer probable a loss would be incurred.

8. Decommissioning liability

December 31,		2018		2017
Beginning balance	$	155	$	136
Additions		1,529		-
Changes in estimate		20		15
Accretion		3		4
Ending balance	$	1,707	$	155

The undiscounted amount of estimated costs required to settle the obligations at December 31, 2018 is $2,553,000 (2017 - $212,000) which are expected to be incurred in 2038. The estimated costs have been inflated at 2.0 percent and discounted at a risk free rate of 2.07 percent (2017 - 2.16 percent) for the year ending December 31, 2018.

9. Share capital

(a) Authorized

As at December 31, 2018 and 2017 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 throughout the year ended December 31, 2018.

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

9. Share capital (continued)

(b) Earnings per share

Basic earnings per share were calculated as follows:

	2018	2017
Loss for the year ending December 31,	$ (6,018)	$ (3,395)
Weighted average number of common shares:		
Issued common shares at beginning of period	28,116	27,672
Common shares issued	385	444
Weighted average number of common shares	28,501	28,116
Basic loss per share	$ (0.21)	$ (0.12)

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 1,950,000 (2017 - 1,045,000) options as their effect would have been anti-dilutive.

(c) Rights offering

On December 21st, 2018, the Company completed a rights offering. Upon closing of the rights offering, the Company issued 14,058,282 common shares for gross proceeds of $2,389,908. Pursuant to the terms of the rights offering, each eligible holder of two (2) common shares was entitled to one (1) right. Each right entitled the holder thereof to subscribe to one common share at a price of $0.17. The Company paid $120,000 in legal, regulatory and printing costs in relation to the rights offering.

(d) 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.

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

9. Share capital (continued)

(d) Stock-based compensation expense (continued)

The number and weighted average exercise prices of share options are as follows:

	2018			2017		
	Number of options		Weighted average exercise price	Number of options		Weighted average exercise price
Outstanding at January 1,	1,045	$	0.98	2,018	$	0.87
Issued during the year	1,150		0.57	530		0.75
Expired during the year	(225)		1.81	-		-
Forfeited during the year	(20)		0.88	(1,503)		0.75
Outstanding at December 31,	1,950		0.65	1,045		0.98
Exercisable at December 31,	823	$	0.69	500	$	1.02

Number of Options Outstanding		Exercise Price	Remaining Life (yrs)	Vested Exercisable Options
210,000	$	0.75	1.54	210,000
60,000		0.75	3.95	60,000
530,000		0.75	5.96	265,000
200,000		0.75	5.96	50,000
100,000		0.75	5.96	25,000
850,000		0.51	4.44	213,000
1,950,000	$	0.65	4.64	823,000

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

9. Share capital (continued)

(d) Stock-based compensation expense (continued)

In June 2018, the Company granted stock options to employees, officers and directors in accordance with the Company's Stock Option Plan as approved by shareholders on August 26, 2016. The fair value of the options issued was estimated on the date of grant using the Black-Scholes option-pricing model. All of these options vest over two years and have a life of five years. The inputs used in the measurement of the fair values at grant date of these options were as follows:

	June 1, 2018	June 8, 2018	June 8, 2018
Number of options	200	100	850
Exercise price	$0.75	$0.75	$0.51
Dividend yield	nil	nil	nil
Interest rate	2.11%	2.15%	2.15%
Volatility rate	96.35%	96.35%	96.35%
Fair value per option	$0.38	$0.32	$0.31

Share based compensation of $305,000 (2017 - $13,000) was expensed during the year ended December 31, 2018. The forfeiture rate assumed in the calculation of all share based compensation expenses was 11%.

10. Nature of general and administrative expenses

The Company is required to present its financial performance by nature or by function. The Company has presented its 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 $971,000 (2017 - $1,211,000), accounting and legal of $1,381,000 (2017 - $540,000), consulting of $381,000 (2017 – 155,000) and office and sundry expense of $1,029,000 (2017 - $932,000) for the years ending December 31, 2018 and 2017.

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

11. Related party transactions

Transactions with key management personnel

The aggregate payroll expense of key management personnel and directors was as follows:

December 31,		2018		2017
Salaries and benefits	$	871	$	913
Severance payments		-		1,208
Share-based payments		190		7
	$	1,061	$	2,128

In 2018, Gujarat State Fertilizers and Chemicals (“GSFC”), a related party, acquired 10,288,697 common shares in the Company during the rights offering discussed in Note 9(c) to these financial statements. This brought GSFC’s ownership to 16,334,558 common shares representing approximately 38.7% of the issued and outstanding common shares of the Company.

In 2018, the Company entered into a consulting agreement with Gujarat State Fertilizers and Chemicals Limited, a related party, to assist with evaluation and development of the Proteous Nitrogen Project. During 2018, the Company incurred $95,000 in expenses under this agreement with a potential commitment of up to $33,000 remaining under the agreement. The potential commitment is included in the Project contracts line item in Note 15(c) to these financial statements.

12. Finance income and expenses

December 31,		2018		2017
Finance income:				
Interest income on bank deposits	$	(122)	$	(113)
Foreign exchange gain		-		(20)
		(122)		(133)
Financial expenses:				
Accretion of provisions		23		4
Change in estimate of decommissioning liability		-		15
Foreign exchange loss		5		-
		28		19
Net finance income recognized in comprehensive loss	$	(94)	$	(114)

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

13. Income tax expense

The provision for income taxes in the statement of loss reflects an effective tax rate which differs from the expected statutory rate. Differences are as follows:

	2018	2017
Loss before tax	$ (6,018)	$ (3,395)
Expected tax rate	27%	27%
Expected income tax	(1,625)	(916)
Non-deductible expenses	1	11
Stock-based compensation	82	4
Other	(46)	-
Change in unrecognized deferred tax assets	1,588	901
Total income tax expense	$ -	$ -

Unrecognized deferred tax assets

Deferred tax assets have not been recognized in respect of the following items:

	2018	2017
Capital assets	$ 1,787	$ 1,169
Share issue costs	26	-
Intangible assets (including E&E)	10,985	11,011
Assets under construction	4,774	4,774
Non-capital losses	15,062	14,092
Net deferred tax assets (liabilities)	$ 32,634	$ 31,046

The deferred tax assets have not been recognized at this time because it is not probable that future taxable profit will be available against which the Company can utilize the benefits.

The Company has Canadian non-capital losses for which no benefit has been recognized in the financial statements of approximately $55,787,000 (2017 - $52,193,000) which commence expiry in 2028.

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

14. Supplemental cash flow information

Changes in non-cash working capital are as follows:

December 31,	2018	2017
Accounts receivable	$ 5	$ (56)
Prepaid expenses	(158)	(43)
Accounts payable and accrued liabilities	210	256
	$ 57	$ 157
Relating to:		
Operating activities	$ 58	$ 157
Investing activities	(1)	-
	$ 57	$ 157

15. Financial risk management

(a) Overview

The Company's activities expose it to a variety of financial risks that arise as a result of its exploration, development, production and financing activities such as:

- credit risk;
- liquidity risk;
- market risk;
- currency risk; and
- interest rate risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements. The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. To date, no specific risk management tools have been put in place to mitigate these risks.

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

15. Financial risk management (continued)

(b) Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its obligation.

Cash consists of bank balances and short-term deposits that are redeemable at any time at the option of the Company. The Company manages the credit exposure related to short-term investments by depositing only with large Canadian financial institutions which management believes the risk of loss to be remote. The majority of the cash is currently held by one financial institution.

The carrying amounts of trade and other receivables, cash and restricted cash represent the maximum credit exposure.

(c) Liquidity risk and commitments

Liquidity risk is the risk that the Company will not be able to meet its obligations as they come due. The Company has adequate cash available to discharge all current liabilities.

The Company will need to obtain a substantial amount of funding in order to continue mine development and achieve commercial production. It is the intent of the Company to raise these funds through debt and equity financings.

The following are the commitments of the company as at December 31, 2018:

	Contractual cash flows	Less than one year	Two - three years	Four - five years	More than five years
Trade and other payables	$ 901	$ 901	$ -	$ -	$ -
Office lease	80	80	-	-	-
Lease on mineral property	6,232	248	738	738	4,508
Project contracts	85	85	-	-	-
	$ 7,298	$ 1,314	$ 738	$ 738	$ 4,508

The Company has entered into contracts for various engineering and consulting services.

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

15. Financial risk management (continued)

(d) Market risk

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates and interest rates will affect the Company's income or the value of the financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

The Company may use both financial derivatives and physical delivery sales contracts in the future to manage market risks. Should the Company reach commercial production a sales off-take contract exists where GSFC has committed to purchase 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. Pricing will be based on USD India cfr plus shipping costs.

(e) Currency risk

The following financial instruments were denominated in U.S. dollars:

December 31,		2018		2017
		USD		USD
Cash	$	66	$	25
Trade and other payables		3		15

The exchange rate on the period ending date December 31, 2018 was 1 Canadian dollar equals $0.7330 USD (2017 - $1 Canadian: $0.7971 USD). As of December 31, 2018, if the exchange rate would change by 1% it would have an impact of $3,000 on the reported comprehensive loss.

The USD cash balances throughout the year fluctuated depending on the amount of funds available and the prevailing foreign exchange rates at the time of the transactions and transfers between the USD and CAD accounts. The exchange rate fluctuated between $0.7330 USD to $0.8135 USD equaled to 1 Canadian dollar. The net foreign exchange differences are presented as finance income in the Statement of Comprehensive Loss.

15. Financial risk management (continued)

(f) Interest rate risk

Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in market interest rates. Interest income is generated through funds invested in regular and high interest savings accounts. Had the interest rate been 100 basis point higher (or lower) throughout the year ended December 31, 2018, comprehensive loss would have been lower (or higher) by approximately $100,000 (2017 - $133,000).

(g) Capital management

The Company views its working capital as its capital. The Company manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying potash assets. In order to maintain or adjust the capital structure, the Company may issue shares and adjust its capital spending based on available funding in the capital markets. To advance the Wynyard project, the Company will need to secure a significant amount of additional capital. 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 prepares annual capital expenditure budgets, which are updated as necessary depending on varying factors including current and forecast prices, successful capital deployment and general industry conditions. The annual and updated budgets are approved by the Board of Directors.

The Company is not subject to externally imposed capital requirements. There were no changes in the Company’s approach to capital management during the period.

16. Contingent liability

Since its annual general meeting on May 5, 2017, the Company has been reviewing its strategy and restructuring operations. The restructuring has included terminations and resignations of certain officers and employees.

In the fourth quarter of 2017, The Company received a statement of claim filed at the Court of Queen's Bench of Alberta by Mr. Siu Ma, the Company's former Executive Vice-president and Chief Operating Officer, in the amount of $728,750. Mr. Ma's claim is for an alleged breach of contract for the Company's failure to provide payments to Mr. Ma after he terminated the employment agreement alleging a change of control had occurred. The Company has denied Mr. Ma's allegations and filed a statement of defense and has recorded an estimate of all amounts payable to Mr. Ma under his contract. Actual amounts payable may vary from amounts estimated.