MANAGEMENT'S DISCUSSION AND ANALYSIS
For the year ended December 31, 2016

This Management's Discussion and Analysis ("**MD&A**") is intended to provide a summary of the operational and financial results of Karnalyte Resources Inc. ("**Karnalyte**" or the "**Company**") for the year ended December 31, 2016 and 2015. This MD&A should be read in conjunction with the audited financial statements of the Company and the related notes thereto for the year ended December 31, 2016. This commentary is dated March 14, 2017. The financial statements have been prepared in accordance with International Financial Reporting Standards ("**IFRS**"). These documents, the Annual Information Form, and additional information about the Company are available on SEDAR at www.sedar.com. Some of the statements made herein contain forward-looking information and accordingly please refer to the "Forward-Looking Information" section at the end of the MD&A.

OVERVIEW

General Overview

Karnalyte was incorporated under the *Business Corporations Act* (Alberta) on November 16, 2007 and is a Saskatchewan-headquartered company focused on exploration and development of potash and magnesium in Saskatchewan. The Company intends to develop and extract a carnallite-sylvite mineral deposit through a solution mining process, at competitive cost and with minimal environmental impact. Using a staged approach to potash and magnesium plant construction, the Company plans to operate the initial facility at Wynyard, Saskatchewan to produce 625,000 tonnes per year ("**TPY**") of potash, increasing to 1,375,000 and 2,125,000 TPY of potash in subsequent phases of the project (the "**Wynyard Carnallite Project**").

Proposed Financing and Spin-Out Transactions

On March 14, 2016 the Company announced that it had entered into an agreement in principle (the "**Agreement in Principle**") with Gujarat State Fertilizers and Chemicals Limited ("**GSFC**") to finance construction of the first phase of Karnalyte's 625,000 TPY potash mine at Wynyard, Saskatchewan ("**Phase I**"). The Agreement in Principle contemplated a transaction that included senior secured debt, subordinated unsecured debt, and an equity infusion to be backstopped by GSFC, and the spin-out of Karnalyte's secondary mineral assets and unexplored lands into one or more separate entities (the "**Transactions**").

The Company further announced that in order to facilitate the completion of the Transactions, Karnalyte, GSFC and Robin L. Phinney have entered into an agreement (the "**Framework Agreement**"), effective February 24, 2016, which contains, among other things, an agreement with respect to the composition of the board of directors of Karnalyte (the "**Board**" or "**Board of Directors**"), voting support and solicitation.

On August 2, 2016 the Company announced the cessation of negotiations with GSFC in respect of the Transactions. Karnalyte and GSFC were unable to reach an agreement on certain fundamental terms of the Transactions, including with respect to governance matters and the terms upon which Karnalyte's secondary minerals would be developed in a separate entity.

As the Transactions were not consummated, the Framework Agreement terminated automatically effective September 30, 2016 in accordance with its terms, provided that certain obligations under the Framework Agreement survived such termination, as further described in the material change report the Company filed on October 7, 2016 on SEDAR at www.sedar.com. As a result of the termination of the Framework Agreement, GSFC was required to cause one of its nominee directors to resign, and Mr. Mukund Purohit resigned as a director of Karnalyte effective September 30, 2016.

Updated Technical Report

On July 14, 2016 the Company announced the release of an updated technical report entitled *KCl and MgCl2 Reserve and Resource Estimate for the Wynyard Carnallite Project, Subsurface Mineral Leases KL 246, KL 247 and KLSA 010, Saskatchewan, Canada* with an effective date June 23, 2016 (the "**2016 Technical Report**"). The 2016 Technical Report contains a comprehensive overview of Karnalyte's property, geology, mining and recovery methods, required infrastructure, mineral resource and mineral reserves estimates, and all other aspects of the Wynyard Carnallite Project, with an effective date of June 23, 2016. The 2016 Technical Report was prepared for Karnalyte by industry leading solution mining and engineering firms, ERCOSPLAN Ingenieurgesellschaft Geotechnik und Bergbau mbH ("**ERCOSPLAN**"), Amec Foster Wheeler Canada Ltd., and North Rim Exploration Ltd.

Optimization Program

In December of 2016, the Company completed the previously announced program to optimize the potash production process and reduce projected operating and capital costs (the "**Optimization Program**"). The Optimization Program provided information about KCl brine concentrations that can be achieved at particular flow rates in a controlled cavern operation. Karnalyte retained ERCOSPLAN to design, monitor and independently verify the results of the Optimization Program. The goal of the Optimization Program was to show that controlled carnallitite solution mining of the Belle Plaine Member is technically feasible and to obtain data to calibrate the thermal model for the cavern.

ERCOSPLAN has submitted a report on the Optimization Program which expands on previous laboratory dissolution tests and computer modelling previously conducted by the Company. ERCOSPLAN's report on the Optimization Program indicates that during the hot production leaching stage, inflow rates of 15-20 m^3/h and solvent temperature of 85°C can heat the cavern to temperatures of 70-75°C. These observations suggest that the cavern brine temperatures previously estimated to be between 50-60°C during production leaching are too low and that achieving higher temperatures is possible. This would also suggest that the 116 g/l KCl concentration brine in the Company's prior estimates is conservative, and that higher KCl concentration in the production brine could be achieved with higher production brine temperature. This will require further testing to confirm the extent of the increased KCl concentration in the production brine.

The Optimization Program allowed Karnalyte's technical and engineering teams to gather beneficial information which Karnalyte intends to incorporate into the design and operation of the full scale potash production facility. ERCOSPLAN's report indicates that a full scale double well production cavern with 70m well spacing and 50m well radius as previously planned for brine production is not required for test work, as the necessary information to calibrate the modelling program can be obtained from a smaller diameter single well cavern.

SELECTED ANNUAL INFORMATION

The information has been summarised from the Company's audited financial statements.

Selected Annual Results (CAD $ thousands)			
	Year ended December 31		
	2016	2015	2014
Total revenue	$ -	$ -	$ -
Interest and other income	296	160	680
Net and comprehensive loss	(8,852)	(14,536)	(67,581)
Basic and diluted per share	(0.32)	(0.53)	(2.46)
Total current assets	17,156	28,067	41,026
Total assets	23,024	31,962	45,417
Total current liabilities	1,750	1,883	1,525
Total liabilities	1,886	2,064	1,689
Total shareholders' equity	21,138	29,898	43,728

During the year ended December 31, 2016, the Company's focus was on negotiating the terms of the Agreement in Principle and the Transactions, as discussed in the "Overview" section. The Company was also focused on updating the 2016 Technical Report and carrying out the Optimization Program, as discussed in the "Overview" section.

During the comparative year ended December 31, 2015, the Company spent the first part of the year heavily focused on a proxy contest which saw the Company expend a significant amount of legal and consulting fees in order to resolve these matters. Furthermore, during the first quarter of 2015, management made a decision to suspend all activity in relation to the Wynyard Carnallite Project, other than the minimum required to maintain title to the Wynyard Carnallite Project. This decision resulted in some major restructuring which saw 18 employees terminated including senior officers of the Company. As a result of this restructuring, $3,451,000 of restructuring expenses were incurred during the first two quarters of 2015. Subsequent to the reconstitution of the Board of Directors in May 2015, the Company re-hired its engineering and technical teams to carry out the Optimization Program. Shortly thereafter, the Company announced that it was restarting its operations at Wynyard, Saskatchewan to develop its Wynyard Carnallite Project. In addition to this focus during the second half of 2015, the Company was also focused on the negotiation of the terms of the Agreement in Principle with GSFC.

RESULTS OF OPERATIONS

General and administrative expenses ("G&A")

G&A costs for the year ended December 31, 2016 amounted to $6,986,000, which is a decrease of $1,809,000 from the comparative 2015 amount.

The key components of the G&A costs are as follows:

G&A Expenditures (CAD $ thousands)		
	Year ended December 31,	
	2016	2015
Salary, wages and benefits	$ 2,129	$ 1,283
Business development, investor relations, regulatory fees	385	821
Accounting and legal	2,659	3,282
Consulting	496	1,741
Rent	158	235
Directors Fees	273	595
Other	886	838
Total general and administrative	$ 6,986	$ 8,795

Salaries, wages and benefits for the year ended December 31, 2016 was $2,129,000 compared to $1,283,000 in 2015 which is an increase of $846,000. The increase from the prior year is due in part to the fact that during the first half of 2015 there was a significant headcount reduction related to the corporate restructuring that took place. This restructuring resulted in the termination or resignation of 18 people which reduced salaries and wages significantly during the first two quarters of 2015. During the last half of 2015 as operations resumed 9 permanent employees were hired bringing the total headcount to 10. Permanent staffing levels remained at 10 permanent employees throughout 2016 resulting in an increase overall in salaries and wages compared to 2015. Also, the Company hired 10 additional temporary staff to assist with the Optimization Program.

Business development, investor relations and regulatory fees for the year ended December 31, 2016 amounted to $385,000 compared to $821,000 in the 2015 comparative period, which is a decrease of $436,000. During the first half of 2015, a significant portion of expenditures incurred in this area related to the proxy contest. Since no such event took place in 2016 there was a significant decrease in expenses.

Accounting and legal expenses for the year ended December 31, 2016 were $2,659,000 compared to $3,282,000 in the 2015 comparative period, which is a decrease of $623,000. During the first and second quarters of 2015, significant legal expenses were incurred relative to the proxy contest. Since no such event took place during the first and second quarters of 2016, there was a decrease in expenses. However this decrease was offset by significant legal expenses incurred during the first, second and third quarters of 2016 as the Company was negotiating the Agreement in Principle and the Transactions as discussed in the “Overview” section. The fourth quarter of 2016 the Company experienced a significant decrease in accounting and legal expenses due to the cessation of negotiations with GSFC during the third quarter of 2016.

Consulting expenses for the year ended December 31, 2016 amounted to $496,000 compared to $1,741,000 in the 2015 comparative period, which is a decrease of $1,245,000. The decrease is due to the higher number of consultants engaged during the first and second quarters of 2015 relating to the proxy contest and consulting fees paid to senior officers of the Company during the first, second and third quarters of 2015. No such expenses were incurred in 2016. Consulting expenses incurred in 2016 primarily related to the evaluation of the Agreement in Principle and the Transactions.

Rent expense for the year ended December 31, 2016 amounted to $158,000 compared to $235,000 for the 2015 comparative period, which is a decrease of $77,000. Rent has decreased due to the change in location of the Company's offices from Calgary to Saskatoon in September of 2015 which reduced the number of offices leased from 2 to 1.

Director fees for the year ended December 31, 2016 amounted to $273,000 compared to $595,000 for the 2015 comparative period representing a decrease of $322,000. The decrease is due to an overall decrease in the number of meetings held in 2016 compared to 2015. A higher number of meetings were held in the first six months of 2015 as a result of the proxy contest.

Other expenses for the year ended December 31, 2016 amounted to $886,000 compared to $838,000 for the 2015 comparative period representing an increase of $48,000. Overall other expenses have remained consistent from 2015 to 2016. There was an increase in travel expenses of $177,000 mostly due to travel expenses incurred in relation to the negotiation of the Agreement in Principal and the Transactions as well as the reimbursement to some of the executive officers for travel from Alberta to the Company's headquarters in Saskatoon. This increase is offset by a decrease in telephone and small equipment expenses due to the elimination of the Calgary office and also due to a decrease in courier and shipping expenses resulting from a large payment made in 2015 for the termination of a drilling contract entered into by previous management requiring the payment of shipping charges to move the contractors equipment offsite.

Other costs impacting comprehensive loss

Depreciation and amortization for the year ended December 31, 2016 was $340,000 compared to $642,000 in the 2015 comparative period. Depreciation decreased over the year as certain assets have become fully depreciated.

Share-based compensation expense for the year ended December 31, 2016 was $30,000 compared to $706,000 in the 2015 comparative period. The decrease in share based compensation expense from 2015 to 2016 is due to the granting of options to directors, officers and management on July 14, 2015 which vested immediately resulting in the recognition of stock based compensation expense on that date of $732,000. The expense was offset by the reversal of previous stock based compensation expenses on non-vested options forfeited during that period. In 2016, activity affecting stock-based compensation expense mostly consisted of stock options granted on January 12, 2016, when 90,000 stock options were granted to employees. Stock based compensation expenses recorded in 2015 and 2016 are all non-cash in nature. With the exception of the options granted on July 14, 2015, all options are expensed over a two year vesting period.

Restructuring costs for the year ended December 31, 2016 were $nil compared to the period ended December 31, 2015 of $3,451,000. In 2015, these expenses related to the severance and contract termination penalty charges for senior officers and employees of the Company terminated during the first and second quarters of 2015. During the first half of 2015 nineteen employees were either terminated or resigned. No such expenses were incurred in 2016.

Impairment expenses for the year ended December 31, 2016 were $1,980,000 compared to the year ending December 31, 2015 of $1,125,000. In 2014, previous management determined assets with a carrying amount of $63,165,000 were no longer recoverable. At December 31, 2016 the Company assessed whether there was any indication that this previously recognized impairment loss required reversal. The Company achieved a significant milestone in renewing its 2016 Technical Report on the Wynyard Carnallite Project in 2016. Nevertheless, the Company and the industry as a whole face significant headwinds including depressed pricing on international potash contracts (the lowest in a decade), leading to Canadian potash mine shut-ins and production curtailments. Management continues to monitor these factors closely for potential indicators of impairment reversal. Therefore, incremental expenditures incurred on intangible and mine development assets during the year of $1,980,000 were determined not to impact the previously determined recoverable amount. We believe the Company will be required to assess its assets for reversal of past impairment if the Company successfully secures committed financing. For additional information, refer to the notes to the financial statements dated December 31, 2015 available on SEDAR at www.sedar.com.

Gain on sale of asset for the year ended December 31, 2016 was $88,000 compared to $nil in the 2015 comparative period. During the year, the Company sold several swamp mats that were no longer required. These assets were fully depreciated and so proceeds on their sale resulted in a gain of $62,000. Also in 2016, one of the Company's vehicles was involved in an accident resulting in the insurance provider deeming the damages to be a total loss for which $26,000 in proceeds was received. This vehicle was fully depreciated and so these proceeds resulted in a gain.

Other income and expenses for the year ended December 31, 2016 amounted to $100,000 of income compared to $33,000 of income in the 2015 comparative period. The increase from 2015 to 2016 is due in part to an increase in rental income from the leasing out of farm land. In 2016, Karnalyte purchased 17 parcels of land covering a significant portion of the initial stages of the Wynyard Carnallite Project site. Since the land holdings increased in 2016, land rental income also increased. The Company was also able to earn some income by leasing out some of its swamp mats that were not being used.

Net finance income for the year ended December 31, 2016 was $296,000 compared to $150,000 in the 2015 comparative period. The amounts recorded as net finance income are a direct result of the amount of cash the Company is holding at a given time and the corresponding interest income the cash generates. Interest income included in net finance income decreased $147,000 in 2016 compared to 2015. This decrease is due to the decrease in cash. This decrease was offset by a foreign exchange gain recorded due to the improvement of the Canadian dollar relative to the US dollar in 2016. This is compared to a foreign exchange loss recorded during the same period in 2015 and hence the increase overall in net finance income.

SUMMARY OF QUARTERLY RESULTS

The following table provides selected financial information of the Company for each of the last eight quarters ended at December 31, 2016:

Selected Quarterly Results
(CAD $ thousands)

	2016				2015			
	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Total revenue	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Comprehensive loss	(1,245)	(2,229)	(3,221)	(2,157)	(2,369)	(2,961)	(6,824)	(2,816)
Basic and diluted loss per share	(0.04)	(0.08)	(0.12)	(0.08)	(0.09)	(0.11)	(0.25)	(0.10)
Total current assets	17,156	19,276	22,361	26,260	28,067	29,973	32,268	38,736
Total assets	23,024	24,392	26,594	30,046	31,962	33,853	36,276	42,935
Total liabilities	1,886	2,014	1,992	2,295	2,064	2,022	2,219	1,913
Total shareholders' equity	21,138	22,378	24,602	27,751	29,898	31,831	34,057	41,022

The comprehensive losses in the first, second and third quarters of 2016 were driven primarily by G&A expenses and particularly legal and consulting expenses relating to the Agreement in Principle and the Transactions as discussed in the "Overview" section above. Since the negotiations ceased in August of 2016, these activities did not take place in the fourth quarter of 2016 thereby resulting in a decrease in comprehensive loss in the fourth quarter of 2016. The comprehensive loss in fourth quarter of 2015 was also driven by legal and consulting expenses related to the negotiation and evaluation of the Agreement in Principle and the Transactions. The second quarter of 2015 saw an increase in the comprehensive loss relative to other quarters due to restructuring expenses of $2,553,000 in relation to severance packages paid to senior officers and employees of the Company as well as contract termination penalties related to the consulting agreements of the Company's senior officers. There were also legal expenses incurred of $1,850,000 related to the proxy contest.

Another significant component of the comprehensive losses recognized in the quarters presented is the impairment expenses recorded each quarter. At the December 31, 2014 year-end, management made a determination that there was an indication of impairment related to the Company's potash cash generating unit. As a result, the fair value less cost to sell was determined based on the Company's estimate of the amount it would receive for the resale value of individual assets. At that time, the Company recognized an impairment loss of $59,149,000 to impair the assets to their estimated recoverable amount. At each period end since this determination was made, the Company assessed whether there was any indication that this previously recognized impairment loss required reversal. The Company determined that there were no indications that the recoverable amount of the assets had increased during the period. Therefore, incremental expenditures incurred on intangible and mine development assets throughout 2015 and 2016 were determined not to impact the previously determined recoverable amount, which was based on the salvage value of tangible equipment and land, and were impaired as incurred. Impairment expenses incurred over the quarters range from zero in the first two quarters of 2015 to $840,034 in the second quarter of 2016.

Finally, another main component of the quarterly losses relates to non-cash stock based compensation expenses for amortizing stock option costs. Stock based compensation expenditures over the quarters presented range from a high of an expense of $735,000 in the third quarter ending September 30, 2015 to a reversal of $143,000 in June 2015 as a result of forfeited options from employees, consultants and directors no longer with the Company.

Current assets principally reflect activity in the cash account. Cash outlays vary over the quarters depending on the Company's activities. During the first and second quarters of 2015 severance amounts of $899,000 and $2,553,000 respectively were paid which had a demonstrated impact on current assets during those quarters.

Total assets on a quarterly basis reflect two main components, cash from financings still available to the Company and capitalized expenditures on capital assets and mineral properties for moving the Wynyard Carnallite Project forward. Total assets remained relatively constant for the majority of the periods above.

Total liabilities for the periods relate primarily to trade and other payables. These balances vary in the analysis due to the timing of the payments required relative to the work performed in bringing the Wynyard Carnallite Project its current level. Balances have remained relatively consistent over the quarters presented due to a consistent level of activity during all of those quarters. During the first part of 2015 activities mostly related to the proxy contest and during the last half of 2015 activity related to the planning and preparation of the Optimization Program planned for 2016. During the first three quarters of

2016 activity relating to the planning, preparation and execution of the Optimization Program and the negotiation and evaluation activities related to the Agreement in Principle and the Transactions which overall resulted in consistent levels of total liabilities. The decrease in the fourth quarter of 2016 is due to the conclusion of the negotiations related to the Agreement in Principle and the Transactions and the conclusion of the Optimization Program in that quarter.

STOCK OPTIONS

2016

On January 12, 2016, the Company granted 90,000 stock options to employees. The options have an exercise price of $0.75 per option and will expire on June 12, 2021, December 12, 2021, June 12, 2022 and December 12, 2022. There were 82,000 stock options exercised in 2016 for gross proceeds of $61,500.

2015

On July 14, 2015, the Company granted 1,930,000 stock options to employees, directors and officers. The options vested upon issuance, have an exercise price of $0.75 per option and will expire on July 14, 2020.

INVESTING

The Company capitalizes costs that are determined to provide future benefits and charges other costs to comprehensive loss including salaries, support and office costs, community relations programs and other administrative related expenditures. Costs directly related to capital assets are capitalized to appropriate categories and depreciated over their useful lives.

Expenditures to date were focused on the completion of the Company's resource reports, including updating the Company's prior technical reports, and 2013 environmental impact statement, confirming the resources and reserves through drilling wells on the initial focus area and preparing the Company for construction by advancing detailed engineering and completing initial site preparation.

Intangible assets

During the year ended December 31, 2016, $1,980,000 in additions to intangible assets were impaired. $2,255,000 in additions were capitalized and they relate to the purchase of lands related to the Wynyard Carnallite Project. The net balances classified as intangible assets are as follows:

Intangible Assets (CAD $ thousands)		
	Year ended December 31,	
	2016	2015
Mineral property		
Surface land	$ 4,543	$ 2,288
Drilling	240	240
Balance, end of period	$ 4,783	$ 2,528

In 2016, the Company purchased 17 parcels of land near Wynyard for $2,255,000. All categories of intangible assets have been recognized with a $nil value with the exception of land and drilling for the years ended December 31, 2016 and 2015 as a result of the impairment losses. The identification of a potential buyer of the Wynyard Carnallite 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 asset. Such a situation would require the Company to review the impairment in future periods and could result in recovering a portion or all of this impairment.

Capital assets

The net balances classified as capital assets are as follows:

Capital Assets (CAD $ thousands)		
	Year ended December 31, 2016	2015
Machinery and equipment	$ 331	$ 641
Buildings	173	183
Land	125	125
Land improvements	31	33
Vehicles	32	-
Furniture and equipment	7	10
Computer hardware	11	
Assets under construction	-	-
Balance, end of period	$ 710	$ 992

There was $58,000 in additions to capital assets in 2016. Included in this amount were purchases of two vehicles and a small purchase of computer equipment. These increases were offset by depreciation expenses recorded in 2016 of $340,000 resulting in an overall decrease in capital assets.

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 Company’s estimate of the recoverable asset.

Decommissioning obligations

The Company's decommissioning obligations are based on the Company's ownership in wells and facilities. Management estimates the costs to abandon and reclaim the wells and the facilities and the estimated time period during which these costs will be incurred in the future. The majority of these costs are expected to be incurred over the next 30 years. The undiscounted amount of estimated costs required to settle the obligations at December 31, 2016 is $212,000 (2015 – $212,000). The estimated costs have been inflated at 2.0 percent and discounted at a risk free rate of 1.43 percent (1.84 percent – 2015) for the year ending December 31, 2016.

Segmentation Reporting

The Company's operating segments have been identified as the Company's individual mineral reserve streams. The Company has currently identified two operating segments, potash and magnesium, however due to materiality they are currently grouped as one segment for financial reporting purposes. If magnesium reserves were advanced to a material stage, costs would be allocated to separate reporting segments.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2016, the Company had net working capital of $15.4 million compared to $26.2 million at December 31, 2015 including $16.8 million and $27.7 million, respectively, in cash. As at December 31, 2016 and 2015, the Company also had $0.4 million in restricted cash that was set up as a requirement from the Government of Saskatchewan in order to operate the test plant in Saskatchewan. The Company maintains cash in bank accounts for day to day operations and invests the excess in overnight financial instruments in high interest saving accounts that are highly liquid.

The Company has sufficient cash to meet its short-term corporate costs and existing capital plans and has sufficient funds to finance development and ongoing corporate functions. There is no certainty, however, that the Company will be able to raise additional funds to obtain the necessary capital to move the Wynyard Carnallite Project forward to the production stage. See "Risk Factors" in the Annual Information Form.

CONTRACTUAL OBLIGATIONS

The following table summarizes the commitments of the Company as at December 31, 2016:

Contractual Obligations (CAD $ thousands)					
	Payments due by period				
	Total	Less than one year	Two - three years	Four - five years	More than five years
Trade and other payables	$ 406	$ 406	$ -	$ -	$ -
Provisions	1,344	$ 1,344			
Office lease	61	61	-	-	-
Leases on mineral property	6,991	390	738	738	5,125
Project contracts	95	95	-	-	-
Total	$ 8,897	$ 2,296	$ 738	$ 738	$ 5,125

Trade and other payables relate to operating, investing and financing expenditures that were payable at the year ended December 31, 2016.

Office lease refers to the lease for the Saskatoon office location. The Saskatoon office is under a lease containing a monthly fee of $12,000 and will expire on August 31, 2017.

Leases on mineral property refer to the annual fees which are required to maintain the mineral leases related to the Wynyard Carnallite Project. On March 12, 2016, the Company applied to the Saskatchewan Ministry of the Economy to convert the lands subject to Permit KP 360A to one or more leases. As part of its applications to the Saskatchewan Ministry of the Economy, the Company submitted application fees, deposits, and the estimated first year's rent payments for the leases. Permit KP 360A has been converted to two new subsurface mineral leases: KL 246 and KL 247A. These leases have a term of 21 years and both expire on April 24, 2037. In addition to these new leases, the Company also has obligations under subsurface mineral lease KLSA 010 which expires September 7, 2031. The Company is required to pay annual lease payments of $10.00 per hectare on any area held under lease for a term of twenty-one years for a total cost of $368,900 per year. The Company is also required to expend not less than $3,000,000 for work during the first three years of the term of the lease. Expenditures made to date on the property have satisfied this requirement.

Project contracts are in place for various engineering and consulting services.

Restrictions on Disposition of the Wynyard Carnallite Project

Pursuant to the terms of the subscription agreement (the "**Subscription Agreement**") and the offtake agreement (the "**Offtake Agreement**") between the Company and GSFC, each dated January 10, 2013, the Company must not divest, sell, assign, transfer or otherwise dispose of any part of its interests in the Wynyard Carnallite Project without the prior written consent of GSFC until the third anniversary of the date on which the first shipment for delivery of products is dispatched by the Company in accordance with the terms of the Offtake Agreement (the "**Project Lock In Period**"). After the expiry of the Project Lock In Period, a person may acquire an interest in the Wynyard Carnallite Project subject to GSFC's right to terminate the Offtake Agreement at that time. The Subscription Agreement provides that, subject to certain conditions, the above-described restrictions on disposition do not apply to a creation or grant of a security interest to a lender providing financing for the Wynyard Carnallite Project (including for an expansion thereof). The Offtake Agreement provides that following the expiry of the Project Lock In Period, the Company may dispose of any part of the Wynyard Carnallite Project that is not part of the Company's subsurface mineral lease KLSA 010 or that is not intended or reasonably required for the three phases of the Wynyard Carnallite Project.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amount of assets, liabilities and expenses. The Company evaluates the estimates periodically. In making judgments about the carrying values, the Company uses estimates based on historical experience and various assumptions that are considered reasonable in the circumstances. Actual results may differ from those reported. The Company reviews significant areas subject to estimation with the Company's Audit Committee. Significant areas requiring estimation include the assessment of impairment indicators and any subsequent determination of impairment over mineral properties and capital assets, including the estimates of total depleted reserves and the calculation of share-based payments.

Stage of development

The Company is in the development stage of its history and at this stage of the Company's growth, it is subject to the risks associated with early stage companies, including uncertainty of future revenues, developing acceptable markets and growth into established markets, profitability and the need to raise additional financing to continue to progress its Wynyard Carnallite Project.

Continued exploration and development of the property is dependent on Karnalyte's ability to obtain necessary financing. As the Company is not currently producing from its property, it will be necessary for the Company to seek additional equity or debt to finance its programs.

Intangible assets and Property, Plant and Equipment

The Company's expenditures relating to the acquisition of mineral properties, leases, permits and the exploration and development thereon are recorded at cost and include direct and indirect acquisition and exploration costs associated with specific mineral properties. These costs are capitalized on the basis of the potential realization from the underlying asset. Amortization of these amounts will be recognized using the unit-of-production method over the shorter of estimates of reserves or service life following the commencement of production or written off, if the properties are sold or abandoned.

Assets under construction, machinery and equipment, buildings, vehicles, furniture, land improvements and leasehold improvements are recorded at cost, less accumulated depreciation. Capital assets are depreciated using the straight-line method over three to seven years. Leasehold improvements are amortized on a straight line basis over the terms of the respective leases. Assets under construction will start being depreciated when the assets are available for use for their intended purpose and will be calculated on a unit of production basis. The Company also reviews capitalized amounts for impairment whenever events or changes in internal or external circumstances indicated that the carrying value may not be recoverable.

Upon indication that impairment may exist, carrying values of assets would be adjusted. Impairment conditions may result from any of the following items, but not limited to: cessation of exploration activities; exploration results are not promising such that exploration will not be planned for the foreseeable future; permit or lease ownership rights expire; sufficient funding is not expected to be available to complete the exploration program; an exploration property is deemed to have no material economic value to the Company's business plan or future development of the property becomes uneconomical.

The Company reviews capitalized amounts for impairment whenever events or changes in circumstances indicate its carrying amount may not be recoverable. The carrying value of assets is assessed for indications that the carrying amounts recorded may not be recoverable from estimated current and future cash flows. Estimating future cash flows requires assumptions about future business conditions and other developments. Significant, unanticipated changes to these assumptions could require a provision for impairment in the future.

Share-based payments

The Company has share-based payments expenses for stock option awards to employee, directors, officers and consultants, as explained in the Company's financial statements. IFRS requires that all share-based awards be accounted for using the fair value method. Under this method, the Black-Scholes option pricing model requires estimates of the expected life of the option, forfeiture rates, stock volatility and the risk-free interest rate expected over the life of the option. A change in these assumptions could materially change the amount of share-based payments expenses recorded.

Income taxes

The Company accounts for income taxes in accordance with the asset and liability method. Under this method, deferred income tax assets and liabilities are recognized for differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of a change in income tax rates is recognized in the period that includes the date of substantive enactment. A deferred income tax asset is recognized only when it is more likely than not that the income tax asset will be realized.

FINANCIAL RISK FACTORS

Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its commercial obligations. The Company has no significant concentration of credit risk arising from operations. The Company's cash and restricted cash is held with large Canadian financial institutions and management believes the risk of loss to be remote.

Liquidity risk

The Company manages liquidity risk by maintaining sufficient cash balances to meet liabilities when due. As at December 31, 2016, the Company had cash totalling $16,752,000 (2015 – 27,733,000) to settle current liabilities of $1,750,000 (2015 - $1,883,000). As at December 31, 2016 and December 31, 2015, the Company's trade and other receivables were all considered current and are subject to normal trade terms.

Market risk

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market. The Company's future potash sales are exposed to price risk with respect to North American and international potash prices.

Currency risk

The Company's functional currency is the Canadian dollar with the majority of transactions denominated in Canadian dollars. At this time management believes the foreign exchange risk derived from currency conversions is not significant and therefore does not hedge its foreign exchange risk. At December 31, 2016, the Company held the majority of its cash in Canadian dollars.

Interest rate risk

The Company's trade and other payables are non-interest bearing and have contractual maturities of less than 45 days. As at December 31, 2016, the Company's only interest bearing asset is cash in high interest saving accounts and a small amount of cash held in Guaranteed Investment Certificates. Cash earns interest at prevailing short-term interest rates. During the year ended December 31, 2016, the Company earned interest income of $0.2 million (2015 - $0.4 million) from its cash. Had the interest rate been 100 basis point higher (or lower) throughout the year ended December 31, 2016, comprehensive loss would have been lower (or higher) by approximately $0.2 million (2015 - $0.3 million).

NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

IFRS 9 "*Financial Instruments*" – The standard is the first step in the process to replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 introduces new requirements for classifying and measuring financial assets and liabilities and carries over from the requirements of IAS 39. Financial instruments: recognition and measurement derecognition of financial assets and financial liabilities. The extent of the impact of adoption of these standards has not yet been determined.

IFRS 15 "*Revenue*" – On May 28, 2014, the IAS board issued IFRS 15 "Revenue", which specifies how and when to recognize revenue as well as requiring entities to provide users of financial statements with more disclosure. The standard supersedes IAS 18 "Revenue", IAS 11 "Construction contracts", and related interpretations. IFRS 15 will be effective for annual periods beginning on or after January 1, 2017. Application of the standard is mandatory and early adoption is permitted. Karnalyte is currently evaluating the impact of adopting IFRS 15 on its financial statements.

IFRS 16 "Leases" – On January 13, 2016 the IASB issued IFRS 16 "*Leases*". The new standard is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted for entities that apply IFRS 15 *Revenue from Contracts with Customers* at or before the date of initial adoption of IFRS 16. IFRS 16 will replace IAS 17 *Leases*. Karnalyte is currently evaluating the impact of adopting IFRS 16 on its financial statements.

Amendments to IAS 7 – In January 2016, the IASB issued amendments to IAS 7 "Statements of Cash Flows" as part of its "Disclosure Initiative". These amendments are required to be applied prospectively and are effective for annual periods beginning on or after January 1, 2017. Earlier application is permitted. The amendments are intended to clarify IAS 7 to improve information provided to users of financial statements about an entity's financing activities. Karnalyte does not expect the amendments to have a material impact on its financial statements.

INTERNAL CONTROLS

Disclosure Controls and Procedures

The Company has established disclosure controls and procedures for the timely and accurate preparation of financial and other reports. Such disclosure controls and procedures are designed to provide reasonable assurance that material information required to be disclosed is recorded, processed, summarized and reported within the periods specified by applicable securities regulations. In addition, the disclosure controls ensure that information required to be disclosed is accumulated and communicated to the appropriate members of management and properly reflected in the Company's continuous disclosure filings.

As with most small or developing companies and consistent with the concept of reasonable assurance, the Company recognizes that the relative cost of maintaining these disclosure controls and procedures should not exceed their expected benefits. As a result, the Company's disclosure controls and procedures can only provide reasonable assurance, and not absolute assurance, that the objectives of such controls and procedures are met.

The President and Chief Financial Officer are responsible to evaluate the disclosure controls and procedures. They have concluded that the design and operation of these disclosure controls and procedures were not effective due to the existence of material weaknesses in the internal controls over financial reporting noted in the following section.

The Company mitigates these weaknesses by using external consultants as appropriate; however, such mitigating procedures do not constitute compensating controls for the purposes of National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* ("**NI 52-109**").

Internal Controls over Financial Reporting (ICFR)

The President and Chief Financial Officer of the Company are responsible for designing and ensuring the operating effectiveness of internal controls over financial reporting. They are also responsible for causing the internal controls to be designed and operated effectively under their supervision. They are intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. It is management's belief that any control system, no matter how well conceived or operated, can provide only reasonable, but not absolute, assurance that the objectives of the control system are met. An internal control system cannot prevent all errors or fraud.

The majority of the current directors and officers of the Company were appointed subsequent to a settlement following the proxy contest by the Concerned Shareholder Group. As a result, and due to a lack of continuity of personnel and business process, there is a material risk that current officers and directors of the Company are not aware of possible contractual arrangements, commitments, vendor invoices or other obligations to which the Company may have been committed by the former officers and directors. As a result, there is a risk that any such arrangements, commitments, vendor invoices or other obligations are not recorded or disclosed in the condensed interim financial statements. Management has undertaken a review of the accounting records, vendor invoices, minutes of meetings of the Board of Directors and its committees, among other records of the Company, to partly mitigate the aforementioned risk.

The Company does not have adequate in-house personnel to properly implement segregation of duties with respect to complex accounting and non-routine transactions that may arise. It is not deemed economically feasible at this time to have such personnel. The volume of transactions and reporting requirements puts significant strain on the limited accounting personnel such that the Company relies on external experts and assistance to complete these activities on time.

These material weaknesses may increase the risk of material misstatements in the financial statements; the Company mitigates these weaknesses by using external consultants as appropriate; however, such mitigating procedures do not constitute compensating controls for the purposes of NI 52-109.

OFF BALANCE SHEET ARRANGEMENTS

The Company has no off balance sheet arrangements at the time of this MD&A.

OUTSTANDING SHARES

As of the date of this MD&A, the Company has 28,116,565 Common Shares and 2,018,000 stock options issued and outstanding.

In 2016, 82,000 common shares were issued upon the exercise of 82,000 stock options. The Company also issued 555,555 common shares to GSFC on October 1, 2016. These shares were issued in order to satisfy a contractual obligation that arose as a result of the subscription agreement that the Company entered into with GSFC on March 7, 2013. Under the terms of the subscription agreement, the Company was obligated to issue an additional 555,555 common shares to GSFC if commercial production had not yet commenced on or before October 1, 2016. Since commercial production had not yet commenced on October 1, 2016, the additional 555,555 common shares were issued on that date. This issuance brought GSFC's total ownership stake in the Company from 19.98% to 21.5%.

LEGAL PROCEEDINGS AND REGULATORY ACTIONS

In the fourth quarter of 2015, Karnalyte was made aware of an action filed against Karnalyte, its directors and certain of its officers by Ishan Holdings and Development Corporation and Betty Hayer-Dusange in the Supreme Court of British Columbia, New Westminster Registry claiming damages in an unspecified amount (the "**British Columbia Proceeding**"). Subsequent thereto Karnalyte was made aware of an action based on similar allegations filed by the same persons against Karnalyte, its directors and certain its officers in the United States District Court for the District of South Carolina claiming damages in the amount of $9.5 million (the "**South Carolina Proceeding**", and collectively with the British Columbia Proceeding, the "**Proceedings**").

The Proceedings allege, among other things, breaches of contracts, fraud and deceit, civil conspiracy, racketeering and unfair business practices. Karnalyte and the Company's directors and officers consider the Proceedings to be frivolous, vexatious and without merit and have filed responses to such effect in connection with the Proceedings.

Subsequent to December 31, 2016 the plaintiffs filed a Notice of Discontinuance in the British Columbia Proceeding.

Subsequent to December 31, 2016 an order was made by the United States District Court for the District of South Carolina, Charleston Division, dismissing the claim of the plaintiff Ishan Holdings and Development Corporation in the South Carolina Proceeding.

Karnalyte is not aware of any other legal proceedings to which the Company is or was a party, or of which any of its property is or was the subject, during the financial year ended December 31, 2016. The Company is not aware of any contemplated proceedings.

During the financial year ended December 31, 2016, management is not aware of any penalties or sanctions imposed against the Company by a court relating to provincial and territorial securities legislation or by a securities regulatory authority, nor any other penalties or sanctions imposed by a court or regulatory body against the Company. During the financial year ended December 31, 2016 the Company did not enter into any settlement agreements before a court relating to provincial and territorial securities legislation or with a securities regulatory authority.

FORWARD-LOOKING INFORMATION

Certain statements in this MD&A may constitute "forward-looking" statements which involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking information is often, but not always, identified by the use of words such as "anticipate", "believe", "could", "estimate", "expect", "plan", "intend", "forecast", "future", "guidance", "may", "predict", "project", "should", "strategy", "target", "will" or the negative or similar words or phrases suggesting future outcomes or language suggesting an outlook.

Forward-looking statements may include, but are not limited to, management's expectations, intentions, and beliefs concerning:

- the development and operation of the Wynyard Carnallite Project;
- future extraction and exploitation of mineral deposits;
- capital expenditure requirements;
- future commodity prices;
- expectations regarding prices and costs;
- expectations regarding the Company's ability to obtain additional financing necessary to develop the Wynyard Carnallite Project;
- expectations regarding the production capacity of the Wynyard Carnallite Project;
- expectations regarding markets for potash in North America and globally;
- expectations regarding the distinction between standard-grade and high-grade potash;
- expectations regarding markets for magnesium;
- the effectiveness of the Company's anticipated solution mining methods;
- expenditures to be made by the Company to meet certain work commitments;
- work plans to be conducted by the Company;
- reclamation and rehabilitation obligation and liabilities;
- treatment under governmental regulatory regimes with respect to environmental matters;
- treatment under governmental taxation regimes;
- impact of foreign governments and regulation on the Company's operations;
- future development of infrastructure;
- government regulation of mining operations;
- dependence on key personnel; and
- competitive conditions.

Forward-looking statements in this MD&A include statements regarding:

- the Company's ability to commence and increase production from 625,000 TPY, to 1.375 million TPY, and thereafter to 2.125 million TPY of potash;
- the production of potash or magnesium;

- the costs related to the operation of the plant and facilities will be consistent with other solution mining operations subject to differences in the Company's mineral body and processing;
- the implementation and ongoing use of solution mining process;
- further seismic exploration and drilling;
- global fertilizer demand and consumption;
- Capital expenditure and operational expenditure estimates;
- anticipated results of development and extraction activities and estimated future developments;
- the Company's ability to produce sufficient potash to meet its obligations under the Offtake Agreement;
- the Company's ability to obtain additional financing on satisfactory terms;
- the market prices for potash and magnesium;
- the Company's ability to pump the waste underground to eliminate surface salt tail piles;
- the Company's ability to economically extract and process mineralized material into potash; and
- the improvements that the Company has developed for the solution mining process are as effective as expected by the Company.

Such forward-looking statements are based on a number of material factors and assumptions, including:

- the stabilization of the global potash industry and market;
- the Company obtains additional financing in the future;
- the Company executes its project development plans in a manner consistent with the 2016 Technical Report;
- the Company executes its discounted cash flow model assumptions as described in the 2016 Technical Report;
- estimates of mineral resources and mineral reserves in the 2016 Technical Report are accurate;
- full potash production is reached;
- that the Company continues to have rights to the property subject to subsurface mineral leases KL 246, KL 247A and KLSA 010, and such rights are not challenged or impacted in any material manner;
- that the Company is able to obtain required approvals, licences and permits, in a timely manner;
- the Company is able to successfully develop and market magnesium products;
- the Company's key senior management continue in their respective roles with the Company;
- the Company's intellectual property is not challenged;
- the Company does not become subject to litigation;
- the Company's ability to meet its obligations under the Offtake Agreement;
- environmental and other applicable law and other regulations are not amended, repealed or applied in a manner that impacts the development and operation of the Wynyard Carnallite Project as currently anticipated;
- there are no adverse changes to price of potash or magnesium that would adversely affect the prospects for developing and operating the Wynyard Carnallite Project, or making it inadvisable or uneconomic to proceed with development;

- the future mining operations operate as anticipated;
- the Company's ability to maintain and develop positive relationships with foreign governments and future business partners;
- the Company is able to develop and maintain the infrastructure required to export, store and transport its potash or magnesium production;
- there are no comparable mining companies targeting carnallite in North America; and
- the continued existence and operation of the primary potash production facility.

Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not such results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under "Financial Risk Factors" elsewhere in this MD&A and the following factors, which are discussed in greater detail under the "Risk Factors" section of the Annual Information Form:

- exploration, development and operation risks related to the Wynyard Carnallite Project;
- the ability to secure adequate financing to implement the Company's strategic and development objectives;
- the ability to maintain adequate capital to meet the Company's financial commitments;
- the successful execution of the Company's project plans;
- the uncertainty regarding the estimation of mineral resources and mineral reserves in the 2016 Technical Report;
- the lack of current revenues and uncertainty about future revenues;
- the risks associated with the limited operating history of the Company;
- the lack of developed markets for the Company's magnesium products;
- the unproven nature of solution mining of carnallite in Saskatchewan;
- no assurance of titles, leases, or maintenance of existing permits;
- permit and licensing requirements related to exploration and development activities;
- the Company's ability to satisfy its material agreements, including the Offtake Agreement;
- the risks associated with the enforcement of the Company's material agreements, including the Offtake Agreement;
- the potential loss of key employees, technical experts or key suppliers;
- the potential for a volatile market for the Common Shares of the Company;
- the potential dilution of shareholders through future financings;
- failure to protect the Company's intellectual property rights;
- litigation and tax matters;
- adequacy of the Company's insurance coverage;
- adequacy of the Company's internal controls over financial reporting;
- environmental and regulatory risks;
- the volatility of potash and magnesium prices;
- the cyclical nature of the potash and magnesium industries;
- availability and cost of labour and materials required for the construction of Phase I;

- competition; and
- currency exchange rate fluctuations.

Although the forward-looking statements contained in this MD&A are based upon what management of the Company believes are reasonable assumptions, the Company cannot assure investors that actual results will be consistent with these forward-looking statements. These forward-looking statements are made as of the date of this MD&A and are expressly qualified in their entirety by this cautionary statement. Subject to applicable securities laws, the Company assumes no obligation to update or revise them to reflect new events or circumstances.

Further information about the factors affecting forward-looking statements is available in Karnalyte's Annual Information Form and the audited annual financial statements for the year ended December 31, 2016, which have been filed with Canadian provincial securities commissions and are available on SEDAR at www.sedar.com.