MANAGEMENT'S DISCUSSION AND ANALYSIS

For the six months ended June 30, 2018

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MANAGEMENT’S DISCUSSION AND ANALYSIS

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 six months ended June 30, 2018 and 2017. This MD&A should be read in conjunction with the condensed unaudited interim financial statements of the Company and the related notes thereto for the six months ended June 30, 2018. This commentary is dated August 9, 2018. The financial statements have been prepared in accordance with International Accounting Standard 34, Interim Financial Statements and should be read in conjunction with the year-end December 31, 2017 audited financial statements. These documents, the Annual Information Form dated March 27, 2018, 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 the development of potash and magnesium operations in Saskatchewan. The Company's potash project in Wynyard, Saskatchewan (the **“Wynyard Potash Project”**) is a proposed 2.125 million tonnes per year (**“TPY”)** potash mine utilizing conventional solution mining methods for potash production. The Company proposes to develop the Wynyard Potash Project in three phases using a modular approach, with a first phase **(“Phase I”**) consisting of a potash production facility capable of producing 625,000 TPY of potash, increasing to 1,375,000 TPY of potash in the second phase, and ultimately to 2,125,000 TPY of potash in the third phase.

SECOND QUARTER UPDATE

Karnalyte has made significant progress in investigating the economic and technical viability of the Proteos Nitrogen Project during the second quarter of 2018. In addition to issuing an invitation for expressions of interest for the technical and economic aspects of the project, and initiating an independent market analysis, Karnalyte has undertaken due diligence on a number of potential project sites.

Mr. Frank Wheatley, President of Karnalyte commented that: “The technical assistance provided by Karnalyte’s strategic partner Gujarat State Fertilizers & Chemicals Limited (“GSFC”) from their five (5) decades experience in nitrogen fertilizer production has allowed Karnalyte to streamline some of the early phases of development, and we are grateful for their technical and commercial assistance as we continue to explore the Proteos Nitrogen Project.”

POTASH – WYNYARD POTASH PROJECT

While there have been some encouraging signs regarding the potash price environment, potash prices have not yet recovered to the point where the Wynyard Potash Project is economically viable and financeable. However, given the lead times necessary to prepare a major mining project for construction, and in order to ensure that it is developed in a timely fashion to take advantage of any future increase in potash prices, Karnalyte and GSFC intend to revisit the timing and sequence of the steps required to re-activate development of the project during the second half of 2018.

NITROGEN – PROTEOS NITROGEN PROJECT

Pre-Feasibility Study: Karnalyte has initiated several component parts of the pre-feasibility study on the Proteos Nitrogen Project, designed to explore the technical and economic viability of the proposed project, including an invitation for expressions of interest on the technical and economic aspects of the project, an independent market analysis, and due diligence on a number of potential project sites.

Expression of Interest: On July 30, 2018, Karnalyte issued, through its strategic partner GSFC, an invitation for expressions of interest ("EOI") from a select group of international technology providers and engineering, procurement and construction contractors, for developing the Proteos Nitrogen Project on a lump sum turn-key basis.

The scope of work covered by the EOI includes all phases of development, from basic engineering, through detailed engineering, procurement, construction, commissioning and satisfaction of all relevant performance and completion tests, including all ancillary facilities and infrastructure, together with an estimate of total capital costs for the project. Karnalyte / GSFC have requested that all EOIs be provided on or before the end of August 2018. After receipt, Karnalyte / GSFC will review the EOIs with a view to developing a short list of technology providers / contractors to receive a formal request for proposal, for EPC arrangements, for development of the Proteos Nitrogen Project.

Independent Market Analysis: Karnalyte has retained Integer Research Ltd. ("Integer Research") to undertake a first phase independent market study of the nitrogen fertilizer industry in North America, with particular focus on Central Canada. The purpose of the study is to validate Karnalyte's internal market analysis, and Karnalyte anticipates receiving the first phase report in September 2018. Subject to a positive outcome for the project in the first phase study, Karnalyte intends to retain Integer Research to undertake a second phase study in order to support discussions regarding project financing for the Proteos Nitrogen Project.

About Integer Research: Integer Research is an internationally recognized independent consultant to the fertilizers and chemicals industry that provides market studies, including supply/demand, trade and cost analysis and price forecasts. With respect to nitrogen, they offer capabilities across the nitrogen value chain, including analysis of ammonia, urea, UAN, and other nitrogen products. They produce market documentation for lenders and banks in support of project financing for greenfield and brownfield fertilizer projects. Through their offices in London, Beijing, and Tokyo, Integer Research offers consultancy services and industry intelligence to fertilizer and chemicals markets worldwide.

Project Site: Karnalyte is currently undertaking due diligence on a number of potential project sites located in Central Saskatchewan that match Karnalyte's project site selection criteria, which include adequate space for the initial development, as well as for potential future expansion, together with proximity to all requisite infrastructure, including natural gas, power, water, rail and highway.

Milestones:
Near term, indicative project development milestones include:

- Receipt of EOI — August 2018
- Receipt of Phase I independent market analysis — September 2018
- Project site – selection of preferred site — Second Half 2018
- Completion of pre-feasibility study: — Second Half 2018

As initial milestones are achieved, management will be in a better position to prepare a more detailed project development schedule and budget. All initial development activities for the first phase of investigation of this opportunity will be funded from working capital.

OUTLOOK FOR 2018

During the balance of 2018, the Company will continue to ensure that it is in a position to re-activate the development of the Wynyard Potash Project, if the improving potash price environment results in the Wynyard Potash Project becoming economically viable and financeable. In addition, the Company will continue to explore the technical and economic viability of developing the Proteos Nitrogen Project, with a view towards making an investment decision during the first half of 2019.

RESULTS OF OPERATIONS

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative (**"G&A"**) costs for the six month period ended June 30, 2018 amounted to $1,618,000 which is an increase of $6,000 from the comparative 2017 amount.

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

	G&A Expenditures (CAD $ thousands)			
	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Salaries, wages and benefits	246	358	471	822
Business development, investor relations, regulatory fees	161	20	196	71
Accounting and legal	323	188	405	270
Consulting	111	10	204	15
Directors Fees	70	87	138	110
Office and general	151	163	264	324
Total general and administrative	1,062	826	1,678	1,612

Salaries, wages and benefits for the six month period ended June 30, 2018 were $471,000 compared to $822,000 in 2017 which is a decrease of $351,000. Salaries, wages and benefits for the first two quarters of 2018 have decreased from the first two quarters of 2017 as the number of full time equivalent staff decreased from 10 in the first two quarters of 2017 to 5 in the first two quarters of 2018.

Business development, investor relations and regulatory fees for the six month period ended June 30, 2018 amounted to $196,000 compared to $71,000 in the 2017 comparative period, which is an increase of $125,000. The increase in this category in the first two quarters of 2018 compared to the first two quarters of 2017 was to respond to threats to the Company by three shareholders who actively tried to take control of Karnalyte and its Board of Directors.

Accounting and legal expenses for the six month period ended June 30, 2018 were $405,000 compared to $270,000 in the comparative period. The increase in expenses in this category is due to an increase in legal activities in response to threats to the Company by three shareholders who actively tried to take control of Karnalyte and its Board of Directors.

Consulting expenses for the six month period ended June 30, 2018 amounted to $204,000 compared to $15,000 in the comparative 2017 period, which is an increase of $189,000. Most of the increase is due the engagement of a financial advisor to assist the Company in assessing potential strategic alternatives for the Company. No such advisor was engaged in the first two quarters of 2017. Consulting expenses were also incurred in the first two quarters of 2018 for the engagement of an executive search firm to assist in recruiting the Company's President. The Company has also incurred some consulting expenses for the engagement of Integer Research to undertake a first phase independent market study of the nitrogen fertilizer industry in North America.

Director fees for the six month period ended June 30, 2018 amounted to $138,000 compared to $110,000 for the 2017 comparative period representing an increase of $28,000. The increase is due to a decrease to director fees rates applied to the first quarter of 2017 which was not applied in the first quarter of 2018.

Office and general expenses for the six month period ended June 30, 2018 amounted to $264,000 compared to $324,000 for the comparative period representing a decrease of $60,000. This decrease is mostly a result of fewer full time equivalent staff which resulted in an overall decrease in general expenses. The Company was also able to negotiate a reduction in rental rates at the Saskatoon office which resulted in savings in this category.

OTHER COSTS IMPACTING COMPREHENSIVE LOSS

Depreciation and amortization for the six month period ended June 30, 2018 was $33,000 compared to $143,000 in the 2017 comparative period. Depreciation decreased over the six month period as certain assets have become fully depreciated.

Stock-based compensation expense for the six month period ended June 30, 2018 was $109,000 compared to $5,000 in the 2017 comparative period. Stock based compensation expenses in the first quarter of 2017 related to the granting of stock options to officers and employees on January 12, 2016 when 90,000 stock options were granted. These options have since been fully expensed and so all the stock-based compensation expenses in the first two quarters of 2018 relate to the granting of stock options to officers and employees on December 15, 2017 when 530,000 stock options were granted and also to 1,150,000 options granted in June 2018. These expenses are all non-cash in nature and stock options are expensed over a two year vesting period.

Restructuring costs for the six month period ended June 30, 2018 were $10,000 compared to $840,000 in the 2017 comparative period. Part of the large expenses in the first two quarters of 2017 relates to severance paid to the Company's former Executive VP, Corporate Counsel in the first quarter of 2017. Following its annual general meeting on May 5th, 2017, the Company reviewed its strategy and restructured its operations. The restructuring resulted in the terminations and resignations of certain officers and employees. During the second quarter of 2017, the Company estimated and accrued $480,000 for costs of restructuring including $450,000 in severance paid to the Company's former President. The only restructuring expenses incurred in 2018 were in the first quarter when the Company reached a settlement with a former employee who filed a statement of claim at the Small Claims Court of Saskatchewan for alleged constructive dismissal.

Impairment expenses for the six month period ended June 30, 2018 were $198,000 compared to the period ending June 30, 2017 of $261,000. In 2014, previous management determined assets with a carrying amount of $63,165,000 were no longer recoverable. At June 30, 2018, the Company determined that those impairment indicators continue to impact recoverability. The Company and the industry as a whole continue to face significant headwinds including depressed pricing on international potash contracts. Therefore, incremental expenditures incurred on intangible and mine development assets during the first two quarters of 2018 of $198,000 were determined not to impact the previously determined recoverable amount. For additional information, refer to the notes to the financial statements dated December 31, 2015 available on SEDAR at www.sedar.com.

Net finance income for the six month period ended June 30, 2018 was $31,000 compared to net finance expense of $70,000 in the 2017 comparative period. The amounts recorded as net finance income are mostly the result of the amount of cash the Company is holding at a given time and the corresponding interest income the cash generates. Included in net finance income/expense in the interim statements of comprehensive loss for the six months ended June 30, 2017 was $136,000 recognized for the unrealized loss on a long-term investment entered into by the Company during the second quarter of 2017. This loss was recognized in order to record this long-term investment at its market value as at June 30, 2017. This investment was later cancelled in the fourth quarter of 2017 and so it did not exist at June 30, 2018 and thus no such loss was recognized during the first two quarters of 2018.

SUMMARY OF QUARTERLY RESULTS

The following table provides selected financial information of the Company for each of the last eight quarters ended at June 30, 2018:

	2018		2017				2016	
	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30
Total revenue	-	-	-	-	-	-	-	-
Comprehensive (loss)	(1,215)	(745)	(541)	(1,266)	(1,581)	(7)	(1,245)	(2,229)
Basic and diluted loss per share	(0.04)	(0.03)	(0.02)	(0.10)	(0.06)	-	(0.04)	(0.08)

Total current assets	10,880	12,010	12,757	8,552	9,685	15,724	17,156	19,276
Total assets	16,692	17,839	18,602	19,235	20,557	21,521	23,024	24,392
Total liabilities	788	790	846	946	1,003	388	1,886	2,014
Total shareholders' equity	15,904	17,049	17,756	18,289	19,554	21,133	21,138	22,378

*Expressed in thousands except loss per share

The comprehensive losses in all of the quarters were driven primarily by G&A expenses and particularly salaries and wages and office and general expenses.

The comprehensive loss in the second quarter of 2018 was negatively impacted by the legal and consulting expenses the Company incurred in order to respond to threats to the Company by three shareholders who actively tried to take control of Karnalyte and its Board of Directors

The comprehensive loss in the first quarter of 2017 was positively impacted by the recovery of a provision recorded in prior years that was recorded as a result of previous debt financing no longer being probable and previous financing contracts being cancelled by the Company. The Company disputed that this amount was owed but nonetheless, accrued a provision in order to conservatively account for the potential liability. The limitations period on the cancelled financing contracts to which this provision relates expired in the first quarter of 2017 and so the Company wrote-off the provision.

In 2017, the Company also estimated $1,238,000 in severance expenses due to some restructuring that took place in the first three quarters of 2017 and this had an impact on the comprehensive losses recorded in those quarters in 2017. The fourth quarter of 2017 was positively impacted by a gain of $255,000 recorded when the Bank of Montreal agreed to cancel the Company's prior investment into a Bank of Montreal S&P/TSX Composite Low Volatility Index Principal Protected Deposit Note which had been in a loss position when it was cancelled and a refund was received for the original amount invested of $5,000,000.

The comprehensive loss in the third quarter of 2016 was driven primarily by G&A expenses and particularly legal and consulting expenses relating to the evaluation of the Agreement in Principle, the Proposed Financing, and the Proposed Spin-out Transactions as discussed (and each as defined) in the MD&A dated May 12, 2016. 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 and the first quarter of 2017.

Current assets principally reflect activity in the cash account. Cash outlays vary over the quarters depending on the Company's activities. There was a decrease in cash during the second and third quarters of 2017 as the Company invested $5,000,000 into a Bank of Montreal S&P/TSX Composite Low Volatility Index Principal Protected Deposit Note which was classified as a long-term investment as it had a maturity date of May 10th, 2022. In October 2017, the Bank of Montreal agreed to cancel the Company's investment in this deposit note. Upon cancellation, the Company received a refund of $5,000,000 which was deposited into a high interest savings account thereby resulting in an increase in the cash account in the fourth quarter of 2017.

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 Potash Project forward. Total assets remained relatively constant for most 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 Potash Project to its current level. Balances have remained relatively consistent over the quarters presented with the exception of the first and second quarters of 2017 due to a consistent level of activity during most of those quarters. During the second and third quarters of 2016 activity relating to the planning, preparation and execution of the Optimization Program and the negotiation and evaluation of the Agreement in Principle, the Proposed Financing, and the Proposed Spin-out Transactions as discussed (and each as defined) in the MD&A dated May 12, 2016 and August 9, 2016 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 financing and the conclusion of the Optimization Program in that quarter. The decrease in the first quarter of 2017 is due to the write-off of the provision as discussed above and a decrease in overall activity compared to the other quarters presented. The increase in the second, third and fourth quarters of 2017 and the first and second quarters of 2018 is due to the accrual of an estimate of the costs of restructuring that took place during the quarters.

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 six month period ended June 30, 2018, $198,000 in additions to intangible assets were impaired. The net balances classified as intangible assets are as follows:

**Intangible Assets
(CAD $ thousands)**

	June 30, 2018	December 31, 2017
Mineral property		
Surface land	4,804	4,804
Drilling	240	240
Balance, end of period	5,044	5,044

CAPITAL ASSETS

The net balances classified as capital assets are as follows:

Capital Assets
(CAD $ thousands)

	June 30, 2018	December 31, 2017
Machinery and equipment	64	77
Buildings	156	162
Land	125	125
Land improvements	28	29
Vehicles	10	18
Furniture and equipment	-	5
Computer hardware	10	10
Assets under construction	-	-
Balance, end of period	393	426

There were no additions to capital assets in the first two quarters of 2018. The decrease in capital assets is a result of depreciation expenses of $33,000 recognized the first two quarters of 2018.

The Company's ability to secure adequate financing for the development of the Wynyard Potash Project on economic terms could result in a material difference from the Company's estimate of the recoverable asset.

SEGMENTATION REPORTING

The Company's operating segments have been identified as the Company's individual mineral 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, the Company would disclose a separate reporting segment.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2018, the Company had net working capital of $10.3 million compared to $8.8 million at June 30, 2017 including $10.2 million and $9.1 million, respectively, in cash.

As at June 30, 2018 and 2017, the Company also had $0.4 million in restricted cash that was set up as a requirement from the Government of Saskatchewan with respect to reclamation obligations regarding the Wynyard Potash Project. The Company is currently updating its reclamation program for the Wynyard Potash Project in accordance with Government of Saskatchewan regulations. This update may result in the requirement to increase the amount held as restricted cash in order to satisfy the financial assurance requirements of the Government of 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 existing development and ongoing corporate functions.

CONTRACTUAL OBLIGATIONS

The following table summarizes the commitments of the Company as at June 30, 2018:

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	603	603	-	-	-
Office lease	141	121	20	-	-
Leases on mineral property	6,601	132	738	738	4,993
Project contracts	89	89			
Total	7,434	945	758	738	4,993

Trade and other payables relate to operating and investing expenditures that were payable at the period ended June 30, 2018.

Office lease refers to the lease for the Saskatoon office location. The Saskatoon office is under a lease containing a monthly fee of $10,000 and will expire on August 31, 2019.

Leases on mineral property refer to the annual fees which are required to maintain the mineral leases related to the Wynyard Potash Project. The Wynyard Potash Project comprises 3 mineral leases. KLSA 010 has a term of 21 years and expires on September 7, 2031. KL246 and KL247A also have terms of 21 years and both expire on April 24, 2037. The Company is required to pay annual lease payments of $10.00 per hectare on any area held under lease for the term of the lease 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 POTASH PROJECT

Pursuant to the terms of the subscription agreement (the **"Subscription Agreement"**) and the offtake agreement (the **"Offtake Agreement"**) between the Company and Gujarat State Fertilizers & Chemicals Limited (**"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 Potash 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 Potash 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 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 Potash 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 Potash Project.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with International Financial Reporting Stands (**"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 Audit Committee and independent auditors. 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 Potash 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, 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 indicate that the carrying value may not be recoverable.

Upon indication that impairment may exist, carrying values of assets would be assessed for impairment. 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 June 30, 2018, the Company had cash totalling $10,176,000 (2017 – $9,112,000) to settle current liabilities of $543,000 (2017 - $691,000). As at June 30, 2018 and June 30, 2017, 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 June 30, 2018, 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 June 30, 2018, 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 six month period ended June 30, 2018, the Company earned interest income of $62,000 (2017 - $65,000) from its cash.

CHANGES IN ACCOUNTING POLICY

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

IFRS 9 "Financial instruments"

This standard includes revised guidance on the classification and measurement of financial assets. While it largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities, it eliminates the previous categories for financial assets of held to maturity, loans and receivables and available for sale. Upon adoption, the Company reclassified financial assets from loans and receivable to amortized cost. There was no impact on the measurement of any 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 a material impact on the financial statements.

IFRS 15 “Revenue”
This standard 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.

NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

IFRS 16 “Leases”
This standard 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. Earlier application is permitted. Karnalyte is currently evaluating the impact of adopting IFRS 16 on its financial statements.

IFRIC 23 “Uncertainty over Income Tax Treatments”
This standard 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.

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 Interim Chief Executive Officer 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 Interim Chief Executive Officer 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 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 and also to prevent and monitor the potential for management override. 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 1,950,000 stock options issued and outstanding.

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 Potash 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 Potash Project;
- expectations regarding the production capacity of the Wynyard Potash 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 Company's technical report filed on July 15, 2016 (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 Potash Project as currently anticipated;
- there are no adverse changes to the price of potash or magnesium that would adversely affect the prospects for developing and operating the Wynyard Potash 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 Potash 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 dated March 27, 2018 and the audited annual financial statements for the year ended December 31, 2017, which have been filed with Canadian provincial securities commissions and are available on SEDAR at www.sedar.com.