MANAGEMENT'S DISCUSSION AND ANALYSIS

For the six months ended June 30, 2020

KARNALYTE.COM
TSX: KRN

TABLE OF CONTENTS

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, 2020 and 2019. 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, 2020. This commentary is dated August 6, 2020. 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, 2019 audited financial statements. These documents, the Annual Information Form dated March 20, 2020 (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 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. Karnalyte is also exploring the development of a nitrogen fertilizer project (the "**Proteos Nitrogen Project**"), which is a proposed small-scale nitrogen fertilizer plant with a nameplate production capacity of approximately 700 metric tonnes per day ("**MTPD**") of ammonia and approximately 1,200 MTPD of urea, and a target customer market of independent fertilizer wholesalers in Central Saskatchewan.

SECOND QUARTER UPDATE

During the second quarter of 2020, the Company focused on the completion of the pre-feasibility study for the Proteos Nitrogen Project, on the engagement of a strategic consultant and on preparation for well workover development at its Wynyard Potash Project.

As previously announced, the Karnalyte Board of Directors (the "Board") has initiated a strategic review process to evaluate a broad range of potential strategic alternatives available to it including the evaluation of its existing and future projects, and the analysis of potential financing alternatives, with a focus on determining what is in the best interests of Karnalyte and maximizing value for all its shareholders. After thoroughly considering a number of proposals from national and global firms, the Company announced on July 27th that it has engaged MNP LLP ("**MNP**"), a leading Canadian accounting, tax and business consulting firm, as its strategic advisor. MNP has extensive experience in the potash and nitrogen industries, including in-depth knowledge of the Saskatchewan area. In addition to assisting with the evaluation of a range of strategic alternatives, MNP will provide an independent review of the pre-feasibility study Karnalyte recently completed on its Proteos Nitrogen Project.

POTASH – WYNYARD POTASH PROJECT

The short-term outlook for potash fertilizer continues to be bearish. More capacity coming onstream worldwide, weather issues in North America and the impact of the African swine flu in Asia have caused the potash market to remain at the bottom of the cycle. This is making the development of the Wynyard Potash Project very challenging. It is part of the reason that the Company is taking a look at its strategic options and considering what other opportunities might be available to it and any potential alternative arrangements that might make the financing of this project feasible.

NITROGEN – PROTEOS NITROGEN PROJECT

On July 21, 2020, the Company announced that it completed the prefeasibility study of its Proteos Nitrogen Project. While the results of the study were encouraging, the Company will continue to consider the project with discipline and caution. Some of the study's key conclusions include:

- The preliminary economic viability of the Proteos Nitrogen Project, with an internal rate of return and equity rate of return that approaches Company benchmarks, based on average pricing over the past four years for bulk urea and ammonia;
- Potential market growth in Saskatchewan to approximately 2.64 million tonnes, up from current demand estimates of approximately 1.2 million tonnes, based on Government of Saskatchewan information; and
- The project's implementation is expected to require three years following the preparation of a detailed project report and assuming a positive investment decision and commencement of construction by Karnalyte.

The Company has included the consideration of the Proteos Nitrogen Project in the scope of work required from MNP, Karnalyte's strategic consultant, who in the course of its full review of Karnalyte's strategic options, will independently review the prefeasibility study.

Encouraging for the development of the Proteos Nitrogen project was the Saskatchewan Government's launch on July 27th, 2020 of the Saskatchewan Chemical Fertilizer Incentive Program ("**SCFI**"). The SCFI program's goal is to help attract new capital investments in large-scale chemical fertilizer production facilities in Saskatchewan, while creating new construction and operational jobs in the province. The SCFI is a non-refundable, non-transferable 15% tax credit on capital expenditures valued at $10 million or more for newly constructed or expanded eligible chemical fertilizer production facilities in Saskatchewan. The Company is in the process of considering the impact of the SCFI program on the economics of the Proteos Nitrogen Project.

While Karnalyte is encouraged by the results of the prefeasibility study and the SCFI, the Company will continue to take a disciplined approach in its review and consideration of the Proteos Nitrogen project. The Proteos Nitrogen Project is sensitive to capital cost. The recent depression of nitrogen fertilizer prices due to an over supply in the market after wet weather conditions in North America in 2019 resulted in inventory stockpiles. Some analysts are predicting that these price declines will continue throughout the remainder of 2020. While the long-term fundamentals for nitrogen fertilizer may be strong, particularly in the Saskatchewan area where the agriculture industry thrives and there is predicted growth in the production of crops that are dependent on nitrogen fertilizer, Karnalyte will take a careful approach to evaluating this project before committing significant resources to its development.

APPOINTMENT OF INTERIM CHIEF FINANCIAL OFFICER

Karnalyte is pleased that effective July 27, 2020 Christie Gradin, CPA, CA has been appointed as Interim CFO. Ms. Gradin brings extensive expertise, business acumen and senior financial management experience and will provide important support as the Company navigates its strategic review process. Danielle Favreau, who until then was Karnalyte's CFO & Interim CEO, will continue in the role of Interim CEO while Christie Gradin will assume the CFO responsibilities. The Board determined that maintaining an Interim CEO position and an Interim CFO position was appropriate at this time until the strategic review process is completed and permanent appointments can be made based on the future needs of the Company.

SPECIAL SHAREHOLDER MEETING DATE SET

The Company received a requisition for a special meeting of shareholders from three shareholders together owning not less than 5% of the Company's issued and outstanding common shares. Such shareholders are asking Karnalyte shareholders to increase the Board size to six and appoint four of their nominees and two nominees from Gujarat State Fertilizers and Chemicals Limited ("**GSFC**"), Karnalyte's largest investor and strategic partner that holds approximately 38% of the Company's shares.

The Board has set the date for a special meeting of shareholders for December 15, 2020. At this time, the Company estimates that the special meeting will result in a minimum additional unexpected cost to the Company of $50,000. Shareholders should also expect an increase in legal and other costs as the Company addresses the various allegations made by those three shareholders. The Board has fixed November 10, 2020 as the record date to determine which shareholders will be entitled to vote at the meeting.

OUTLOOK FOR 2020

During the third quarter of 2020, the Company will continue its work with MNP to evaluate a broad range of potential strategic alternatives including the evaluation of existing and future projects and the analysis of potential financing alternatives.

RESULTS OF OPERATIONS

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative (**"G&A"**) costs for the six-month period ended June 30, 2020 amounted to $692,000 which is a decrease of $626,000 from the comparative 2019 amount.

G&A Expenditures (CAD $ thousands)				
	Three months ended June 30,		Six months ended June 30,	
	2020	2019	2020	2019
Salaries, wages and benefits	83	270	165	452
Business development, investor relations, regulatory fees	12	19	55	55
Accounting and legal	84	117	141	353
Consulting	29	12	66	50
Directors Fees	49	43	99	84
Office and general	83	185	166	324
Total general and administrative	340	646	692	1,318

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

Salaries, wages and benefits for the six-month period ended June 30, 2020 were $165,000 compared to $452,000 in 2019 which is a decrease of $287,000. Salaries, wages and benefits for the first two quarters of 2020 have decreased from the first two quarters of 2019 as the number of full-time equivalent staff went from 5 during the first quarter of 2019 to 3 for the duration of the first two quarters of 2020. The Company currently does not have plans to significantly increase the number of full-time equivalent staff.

Business development, investor relations and regulatory fees for the six month period ended June 30, 2020 amounted to $55,000 compared to $55,000 in the 2019 comparative period. As expected, expenses in this category in the first two quarters of 2020 are comparable to those incurred in the first two quarters of 2019.

Accounting and legal expenses for the six month period ended June 30, 2020 were $141,000 compared to $353,000 in the comparative period, which is a decrease of $212,000. The decrease in expenses in this category is due to a decrease in legal activities to respond to a potential attempt to take control of Karnalyte and its Board of Directors. In connection with these activities, the legal expenses were principally incurred by the Company during the year ended December 31, 2018 but continued through the first two quarters of 2019 relating to the preparation of final documentation and attendance at a court hearing in the second quarter of 2019. The Company does not anticipate any further significant legal expenses to be incurred in relation to that court application. However, subsequent to the end of the second quarter of 2020, the Company received a requisition for a special meeting of shareholders from a group of dissident shareholders who yet again are trying to take over the Company's board of directors. The Board has set a date for a special meeting for December 15, 2020. Shareholders should expect that there will be a significant increase in legal and other costs for the Company to hold an additional meeting this year and also to address the allegations of the dissident shareholders.

Consulting expenses for the six month period ended June 30, 2020 amounted to $66,000 compared to $50,000 in the comparative 2019 period, which is an increase of $16,000. During the first two quarters of 2019, consulting expenses mostly consisted of expenses incurred in relation to site selection for the Proteos

Nitrogen project. Expenses in this category incurred during the first two quarters of 2020 consisted mostly of consulting fees to former director Todd Rowan. This contract has been terminated since the end of the second quarter of 2020 and so no further expenses under this contract will be incurred. The Company has however, entered into a consulting contract with the interim CFO which will result in some additional consulting expenses to be incurred over the next several months until the Company has completed it's strategic review and makes a determination as to the permanent executive positions it wishes to fill.

Director fees for the six month period ended June 30, 2020 amounted to $99,000 compared to $84,000 for the 2019 comparative period representing an increase of $15,000. Expenses have increased slightly in the first two quarters of 2020 compared to the first two quarters of 2019 as the number of directors went from 3 during most of the first two quarters of 2019 to 4 for most of the first two quarters of 2020. As discussed in this MD&A, the Company in undertaking a strategic review the results of which may result in the addition of members to the board of directors. Also, discussed in the overview section of the MD&A, the Company has received a requisition for special meeting from a group of dissident shareholders who wish to elect 6 directors to the board. If they are successful at the special meeting, this will result in significant additional directors fees expenses.

Office and general expenses for the six month period ended June 30, 2020 amounted to $166,000 compared to $324,000 for the comparative period representing a decrease of $158,000. The decrease in this category is mostly due to a decrease in travel expenses during the comparative quarters. The application of IFRS 16 to the Company's office lease also resulted in a decrease in rent expense due to a portion of the lease being capitalized to the Company's balance sheet.

OTHER COSTS IMPACTING COMPREHENSIVE LOSS

Depreciation and amortization for the six month period ended June 30, 2020 was $33,000 compared to $21,000 in the 2019 comparative period. Depreciation increased in the first two quarters of 2020 as compared to the first two quarters of 2019 as the Company recorded a new asset in 2019 (right of use asset) after the application of IFRS 16 to the Company's office lease resulting in an increase in depreciation expenses due to the depreciation of the right of use asset.

Share-based compensation expense for the six month period ended June 30, 2020 was $6,000 compared to $75,000 in the 2019 comparative period. Share-based compensation expenses in the first two quarters of 2019 related to the granting of 530,000 stock options to officers and employees in December 2017 and to the granting of 1,150,000 stock options in June 2018. In the first two quarters of 2020, share-based compensation related only to the options granted in June 2018 as noted above. All of the other options have either expired, been forfeited, been cancelled or are fully amortized. 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, 2020 were $63,000 compared to $nil in the 2019 comparative period. In the fourth quarter of 2019, the Company received a statement of claim filed at the Court of Queen's Bench of Saskatchewan by Frank Wheatley, the Company's former Chief Executive Officer, in the amount of $450,000. Mr. Wheatley's claim is for an alleged breach of contract, wrongful dismissal, egregious conduct on termination, and defamation relating to the termination of his employment on September 11, 2019. The Company has denied Mr. Wheatley's allegations and filed a statement of defence and had recorded an estimate of all amounts payable to Mr. Wheatley under his contract. The

Company previously estimated and accrued $233,000 as owing to Mr. Wheatley of which approximately $15,000 has been paid. This estimate was revised during the quarter based on recent mediation discussions and an additional $63,000 accrued. Actual amounts may vary from amounts estimated.

Impairment expenses for the six month period ended June 30, 2020 were $468,000 compared to the period ending June 30, 2019 of $565,000. In 2014, previous management determined assets with a carrying amount of $63,165,000 were no longer recoverable. At June 30, 2020, 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 2020 of $468,000 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, 2020 was $21,000 compared to $88,000 in the 2019 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. Interest income included in net finance income decreased $67,000 in the first two quarters of 2020 compared to the first two quarters of 2019. This decrease is due to a decrease in the interest earned on the Company's cash due to a declining cash balance and also due to a decrease in interest rates.

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, 2020:

	2020		**2019**				**2018**	
	Jun 30	**Mar 31**	**Dec 31**	**Sep 30**	**Jun 30**	**Mar 31**	**Dec 31**	**Sep 30**
Total revenue	-	-	-	-	-	-	-	-
Comprehensive (loss)	(742)	(483)	(311)	(907)	(967)	(905)	(2,719)	(1,339)
Basic and diluted loss per share	(0.02)	(0.01)	(0.01)	(0.02)	(0.03)	(0.03)	(0.06)	(0.05)
Total current assets	6,944	7,647	8,064	8,690	9,318	10,068	11,136	10,089
Total assets	12,722	13,442	13,875	14,517	15,162	15,843	16,921	15,885
Total liabilities	2,615	2,595	2,549	2,892	2,646	2,383	901	1,217
Total shareholders' equity	10,107	10,847	11,326	11,625	12,516	13,460	14,313	14,668

*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 losses in the third and fourth quarters of 2018 and the first two quarters of 2019 were negatively impacted by the legal and consulting expenses the Company incurred. The restructuring costs estimated and accrued for in the third quarter of 2019 had a negative impact on the comprehensive loss recorded in this period. The fourth quarter of 2019 was positively impacted by a reduction in salaries, a reduction in legal expenses, a reduction in travel expenses, a reduction in restructuring expenses, the receipt of land rental income and the recovery recorded as a result of a change in estimate to the Company's decommissioning liability. The first two quarters of 2020 continued to be impacted by a reduction in salaries, legal expenses and travel expenses as compared to the comparative quarters; however, it was negatively impacted by the accrual of additional restructuring expenses, the timing of the recording of land rental income and a change in estimate to the Company's decommissioning liability resulting in a much less significant recovery as compared to the fourth quarter of 2019.

Past performance is not a guarantee of future performance and the information in this MD&A is not necessarily indicative of results for any future period. Factors expected to impact general and administrative expenses in future periods have been described throughout this MD&A.

Current assets principally reflect activity in the cash account. Cash outlays vary over the quarters depending on the Company's activities. There was an increase in current assets in the fourth quarter of 2018 as a result of an increase in cash due to the completion of the Company's rights offering as discussed in the "Total shareholders' equity" section below.

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 in all the quarters presented include the accrual of an estimate of the costs of restructuring that took place in the second and third quarters of 2017. The increase in the third quarter of 2018 is due to an increase in legal activities in response to threats to the Company by shareholders who actively tried to take control of Karnalyte and its Board of Directors. The increase in the fourth quarter of 2018 and all the quarters in 2019 is due to a significant increase in the decommissioning liability recorded due to a change in the estimate of this liability made during the fourth quarter of 2018. Also, the third and fourth quarters of 2019 and the first two quarters of 2020 include the accrual of the costs estimated for the restructuring of the Company's management that took place in the third quarter of 2019.

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, 2020, $386,000 in additions to intangible assets were impaired. The net balances classified as intangible assets are as follows:

Intangible Assets
(CAD $ thousands)

	June 30, 2020	December 31, 2019
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, 2020	December 31, 2019
Machinery and equipment	25	31
Buildings	135	140
Land	125	125
Land improvements	23	25
Vehicles	-	-
Furniture and equipment	-	-
Computer hardware	8	9
Right of use asset	43	62
Assets under construction	-	-
Balance, end of period	359	392

There were no additions to capital assets in the first two quarters of 2020. The decrease in capital assets is a result of depreciation expenses of $33,000 recognized the first two quarters of 2020.

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.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2020, the Company had net working capital of $6.1 million compared to $8.8 million at June 30, 2019 including $6.4 million and $8.6 million, respectively, in cash.

As at June 30, 2020 and 2019, 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, 2020:

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	819	819	-	-	-
Office lease	138	118	20		
Leases on mineral property	5,863	132	738	738	4,255
Project contracts	31	31			
Total	6,851	1,100	758	738	4,255

Trade and other payables relate to operating and investing expenditures that were payable at the period ended June 30, 2020.

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, 2021.

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.

RELATED PARTY CONTRACTS

The Company has a contract in place with GSFC, Karnalyte's largest shareholder and strategic partner, to assist with the evaluation and development of the Proteos Nitrogen Project and to further the Company's engineering activities respecting the Wynyard Potash Project. During the first two quarters of 2020, $nil expenses have been incurred under this agreement. There are no firm commitments of spending under the agreement and the agreement may be terminated by either party upon 30 days written notice. GSFC is a 38.7% shareholder of the Company.

There were no material changes to management compensation arrangements and no other related party transactions for the six month period ended June 30, 2020.

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 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 Standards (**"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, 2020, the Company had cash totalling $6,416,000 (2019 – $8,646,000) to settle current liabilities of $819,000 (2019 - $571,000). As at June 30, 2020 and June 30, 2019, the Company's trade and other receivables were all considered current and are subject to normal trade terms.

Management is aware of material uncertainties related to events and conditions that may cast significant doubt upon the Company's ability to continue as a going concern. The Company is in its pre-development phase and therefore there is no certainty that the Company will be able to raise additional funds to move forward to the production stage. In addition to operating expenses, the Company is committed to expenditures in 2020 on its mineral properties to keep the Company in good standing. The Company has sufficient cash to meet its short-term corporate operating and capital requirements but does not currently have adequate funds to proceed with full-scale development of the solution mining facility. The ability of the Company to continue as a going concern will require further equity issuances or other forms of financings. On March 11, 2020 the COVID-19 outbreak was declared a pandemic by the World Health Organization. The situation is dynamic and the ultimate duration and magnitude of the impact on the economy and capital markets is not known at this time. There is no assurance that the Company will be successful in obtaining required funding at an acceptable cost as and when needed or at all. Failure to obtain additional funding on a timely basis may cause the Company to postpone development plans, forfeit rights in its properties or reduce or terminate its operations.

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, 2020, 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, 2020, 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, 2020, the Company earned interest income of $40,000 (2019 - $107,000) from its cash.

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 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 42,174,847 Common Shares and 1,125,000 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 or the Proteos

Nitrogen 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 or the Proteos Nitrogen Project; expectations regarding the production capacity of the Wynyard Potash Project and the Proteos Nitrogen Project; expectations regarding markets for potash in North America and globally; expectations regarding markets for nitrogen fertilizer products; 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, nitrogen fertilizer products, 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, nitrogen fertilizer products, 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 nitrogen fertilizer products; 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 or the Proteos Nitrogen Project as currently anticipated; there are no adverse changes to the price of potash, nitrogen fertilizer products, or magnesium that would adversely affect the prospects for developing and operating the Wynyard Potash Project or the

Proteos Nitrogen 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, nitrogen fertilizers, 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 and the Proteos Nitrogen 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, 2019, which have been filed with Canadian provincial securities commissions and are available on SEDAR at www.sedar.com.