Karnalyte RESOURCES

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 period ended June 30, 2014 and 2013. This MD&A should be read in conjunction with the unaudited financial statements of the Company and the related notes thereto for the period ended June 30, 2014. This commentary is dated August 12, 2014. 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, 2013 financial statements. These documents, including 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 Statements" section at the end of the MD&A.

OVERVIEW

The second quarter of 2014 saw the potash market begin to stabilize with prices beginning to strengthen from the lows experienced in late Q4 2013 and Q1 2014. However, management expects that the overall capital market response to the industry will remain challenging until the industry experiences a more sustained and incremental price recovery. The outlook has improved recently, led by events such as Uralkali advising the market that their strategy moving ahead would involve being "industry responsible" in terms of pricing and volumes. In addition, PCS reiterated their strategy will not waiver and they will still focus on a price over volume strategy.

Recent results from some major producers have indicated that global volumes have recovered slightly better that previously expected pushing full year guidance upwards to approximately 58 million tonnes. Inventory levels will be challenging for August and September with most producers sold out for this period. It is still to be seen whether the second half of 2014 will be entered into or if buyers will utilize their optional tonnages in existing contracts.

Even with the volume increases, pricing, particularly in Asian markets, remains challenging. Recent tenders in Malaysia and Indonesia have concluded in approximately the same ranges as contracts in early 2014 illustrating stagnant Asian pricing. Markets such as China and India usually do not show any price improvement (up or down) until the next contract is entered into. North American pricing is seeing a reasonable resurgence with prices in the US Midwest exceeding US $380 per short ton (approximately $418/metric tonne). This divergence in pricing illustrates the difference between standard and granular pricing. Granular potash prices in Europe, Brazil and North America are up 11% on average to the end of the second quarter of 2014 while standard-grade regions like SE Asia remained relatively flat over the same period. Adding to the positive news is the Brazilian market that has seen potash purchases increase almost 25% in the first six months of 2014. This increase is very encouraging in one of the most important potash markets worldwide.

The Company believes that prices will continue their gradual recovery in all markets, particularly given the recent announcements from major producers confirming widespread belief that a price over volume strategy is the best for the industry and will be adhered to. Karnalyte's strategy continues to be to only produce granulated potash with no standard grade production at all.

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On May 13, 2014 the Company announced that Thomas S. Drolet has taken over the President and Chief Executive Officer ("CEO") duties from Robin Phinney. In the initial release, the Company announced Mr. Drolet was appointed as acting President and CEO for an initial six to twelve month period. The Board of Directors have appointed Mr. Drolet as the permanent President and CEO. Subsequent to his appointment Mr. Drolet has made significant advances with the Company's strategic plan and is working to position the Company to begin construction. The Board has given Mr. Drolet the responsibility to aggressively pursue the financing required to build the Wynyard Carnallite Project 625,000 tonnes/annum potash facility. The Company is continuing to develop a new strategic plan for the future success of the Company that includes:

- Aggressively pursuing additional strategic partners and other finance alternative
- Continuing to advance the detailed engineering for full construction
- Developing, progressing and pursuing markets and product development for magnesium co-products

Overall the industry response to the change has been positive.

RESULTS OF OPERATIONS

General and administrative expenses (G&A)

G&A costs for the three and six months ended June 30, 2014 amounted to $1,459,000 and $2,403,000 which is an increase of $155,000 and $17,000 from the comparative 2013 amount.

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

G&A Expenditures				
	Three months ended June 30,		Six months ended June 30,	
	2014	2013	2014	2013
Salary, wages and benefits	$ 830	$ 394	$ 1,246	$ 801
Business development and investor relations	180	153	249	238
Accounting and legal	96	147	168	311
Rent	70	92	144	183
Consulting	60	147	125	202
Directors Fees	55	87	132	177
Regulatory	13	-	58	54
Other	155	284	281	420
Total general and administrative	$ 1,459	$ 1,304	$ 2,403	$ 2,386

*Expressed in thousands

Salaries, wages and benefits for the three and six month periods ended June 30, 2014 was $830,000 and $1,246,000 compared to $394,000 and $801,000 in 2013. The increase is related a restructuring event including the addition of an interim CEO and the related severance expenses. This increase is slightly offset due to fewer employees in the current period than in the comparative quarter. The Company capitalized employee remuneration of $313,000 and $644,000 (2013 – $313,000 and 565,000) and share-based payments of $63,000 and $188,000 (2013 – $278,000 and $448,000) during the periods ended June

30, 2014 and 2013 for employees who were working directly on engineering, construction and product development.

Business development and investor relations expenses for the three and six month periods ended June 30, 2014 amounted to $180,000 and $249,000 compared to $153,000 and 238,000 in the 2013 comparative periods. The increase is due the Company enlisting the services of investment companies to assist in securing financing to move the Project forward. The Company is actively seeking additional partners and funding and as a result investor relations and business development will continue to be a significant portion of expenses moving forward.

Accounting and legal expenses for the three and six month periods ended June 30, 2013 was $96,000 and $168,000 compared to $147,000 and $311,000 in the comparative periods. The decrease resulted from legal fees incurred to set up and review an equipment contract as well as revisions to the stock option plan executed in the second quarter of 2013 which is reflected in higher comparative quarter expenditures.

Rent expense for the three and six month periods ended June 30, 2014 amounted to $70,000 and $144,000 compared to $92,000 and $182,000 for the comparative periods. The rent has decreased due to the change in location of the head office in Okotoks. On June 1, 2013 the office moved to a new location in Okotoks that covers less square feet resulting in cost savings and is better suited for head office operations. For the month of June 2013, both Okotoks locations were retained in order to allow time for renovations to be completed at the new office and revert the old office back to the original structure which also contributed to the increased cost in the prior quarter.

Consulting expenses for the three and six month periods ended June 30, 2014 amounted to $60,000 and $125,000 compared to $147,000 and $202,000 for the comparative 2013 periods. The higher amount in the comparative quarter was due to an environmental company that was secured to assist with environmental permitting and reporting requirements. In addition in the current quarter there were savings recognized with minimizing information technology consulting hours.

Director fees for the three and six month periods ended June 30, 2014 amounted to $55,000 and $132,000 compared to $87,000 and $177,000 for the 2013 comparative periods. The decrease is due to a fewer number of board members than in the comparative period.

Regulatory expense for the three and six month periods ending June 30, 2014 is $13,000 and $58,000 compared to $nil and $54,000 for the comparative period. The regulatory expenses are related to the annual TSX listing fees as well as fees incurred for public filing requirements on SEDAR. The year to date amounts is consistent with only slight changes in the quarters due to timing.

Other expenses for the three and six month periods ended June 30, 2013 amounted to $155,000 and $281,000 compared to $284,000 and $420,000 for the comparative period representing a decrease of $129,000 and $139,000 respectively. The primary factor for the decreased spending was advertising in business magazines that were not continued in the current period. As well, three employees and the Okotoks office were relocated in the second quarter of 2013 resulting in higher expenditures in the comparative quarter. In addition there were decreases in office and employee related spending including couriers, subscriptions and travel.

Depreciation and amortization for the three and six month periods ended June 30, 2014 was consistent at $192,000 and $409,000 compared to $197,000 and $404,000 in the 2013 comparative period.

Share-based compensation expense for the three and six month periods ended June 30, 2014 was a credit of $128,000 and expense of $184,000 compared to $684,000 and $1,109,000 in the 2013 comparative periods. Share based payments are all non-cash in nature. Due to company restructuring in the current quarter including both director resignations and employee layoffs there were a number of options forfeited and cancelled resulting in a credit. Options were granted to directors, officers and management on March 21, 2013 and June 24, 2013. The options are expensed over a two year vesting period. No new options were issued in the current period.

Other income and expenses for the three and six month periods ended June 30, 2014 amounted to income of $14,000 and $45,000 compared to and expense of $9,000 and income of $4,000 in the 2013 comparative periods. There were drilling mats rented during the current quarter resulting in income earned for the company. The year to date increase is resulting from mat rentals as well as a gain related to the disposal of one of the company trucks.

Net finance income for the three and six month periods ended June 30, 2014 was $162,000 and $350,000 compared to $519,000 and $569,000 in the 2013 comparative period. The majority of the amounts included as finance income are generated by cash accounts earning interest income. In addition, there was a portion of the financing deal early in 2013 that was invested in US funds and converted back to CAD during the second quarter of 2013 at a favourable rate. This resulted in a realized gain on foreign currency, also contributing to the variance in the comparative quarters.

PREVIOUSLY DISCLOSED USE OF PROCEEDS

Analysis of Prospectus Use of Proceeds				
	Current Expectation	Prospectus	Variance	Notes
Geological Analysis	$ 1,100	$ 3,000	$ (1,900)	a
Feasibility Study Costs	10,900	17,000	(6,100)	b
Additional Exploration Seismic and Drilling	16,000	10,000	6,000	c
Environmental Impact Assessment	2,000	2,000	-	
Infrastructure Preparation and Equipment Deposits	5,000	9,400	(4,400)	d
Magnesium Pre-Feasibility Study	350	-	350	e
Contingencies	12,000	9,000	3,000	f
General, Administrative and Corporate Purposes	8,096	5,046	3,050	g
Total	$ 55,446	$ 55,446	$ -	

*Expressed in thousands

Notes

a) Further geological analysis of the Company's property has been postponed at the current time due to the status of the Company and the strategic plan formed by management. Further geological analysis of the property will continue to be assessed as the Company moves to a more advanced stage.

b) Feasibility Study Costs estimated in the Prospectus, dated December 6, 2010 (the "Prospectus"), were based on expectations of at least four additional drill cores being required to fully understand the rock mechanical properties and geological structure related to constructing the processing facility and preparing the solution mine area. Upon further review of existing information and considering the results of the two drill hole geological analysis drilling program

conducted, the co-authors of the feasibility study determined the additional drill holes would not be required. The Company included an estimate of approximately $6.0 million for these holes in the $17.0 million feasibility study costs. In addition, the Company had included $2.0 million in additional contingencies for the surface facility and other portions of the feasibility study that are not required based on the proposals received and accepted.

c) The Company decided subsequent to the Prospectus to increase the drilling and exploration program. No additional 3D seismic activity was planned in the Prospectus but has since been determined to be important to gaining a better understanding of up to one-half of the total permit area under control, estimated at $2.5 million. As a result of the EIS, the Company has drilled a disposal well and a water well to test the injectivity of the disposal well and the productivity of the water wells. This drilling and testing program cost approximately $3.5 million.

d) Given the results of the Technical Report and the recommendations contained therein, the expenditures allocated to infrastructure preparation and equipment deposits have been decreased. Significant expenditures on equipment deposits cannot be made until detailed engineering is progressed further. The funds have now been allocated to contingencies until such time that decisions are made on where the funds are required.

e) A contract has been completed with Lyntek Incorporated which resulted in the Technical Report which includes a pre-feasibility study for magnesium compounds in the amount of $0.4 million.

f) The Company incurred some unanticipated expenditures including a failed financing that resulted in recognition of significant offering expenses together with expenditures made to support the October 2011 Technical Report. In addition the Company believes other sensitivities could arise in 2014 related to the key initiatives highlighted in the Prospectus and has therefore increased the expected contingencies by $6.0 million to arrive at the same total as projected in the Prospectus. Expenditures against this contingency will be considered provided they allow for the Company to protect its ultimate timeline as much as possible.

g) At the time the Prospectus was generated in December of 2010, management estimated that the use of proceeds funds generated from the IPO would be used over a two year period at which time the plant would be fully constructed and production would have begun. As a result only two years of G&A costs were included in the use of proceeds estimates. Due largely to circumstances outside of managements control, construction has been delayed and therefore more of the funds than originally anticipated has been used for general, administrative and corporate expenditures.

The amounts above exclude gross proceeds of $4.0 million ($3.8 million net of commissions) related to the closing of the over-allotment option on January 13, 2011. These proceeds will be allocated to general, administrative and corporate purposes.

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SUMMARY OF QUARTERLY RESULTS

The following table provides selected financial information of the Company for each of the last eight quarters ended June 30, 2014:

Selected Quarterly Results								
	2014		2013				2012	
	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30
Total revenue	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Comprehensive loss	(1,347)	(1,254)	(1,410)	(2,006)	(1,676)	(1,650)	(2,030)	(1,989)
Basic and diluted loss per share	(0.05)	(0.05)	(0.05)	(0.07)	(0.06)	(0.07)	(0.10)	(0.08)
Total current assets	44,827	46,209	47,780	51,772	57,672	63,163	26,313	29,703
Total assets	109,109	110,220	111,457	114,100	114,865	117,185	76,290	75,359
Total liabilities	762	460	881	2,622	2,183	3,783	4,146	1,845
Total shareholders' equity	108,347	109,760	110,576	111,478	112,682	113,402	72,144	73,514

*Expressed in thousands except loss per share

Comprehensive loss was driven primarily by G&A expenses incurred to fund the continued growth of the Company. Typically a main component of the quarterly losses relates to non-cash share based payment expenses for amortizing stock option costs. Stock based compensation expenditures range from a high of $752,000 in September 2012 to a low of $312,000 in March 2014. During the current quarter however, the stock based compensation is in a credit position of $128,000 due to restructuring including both employees and directors. The resulting forfeiture and cancellation of options related to those individuals offset the expense incurred during the current quarter. In the current quarter ended June 30, 2014 the restructuring amount of $410,000 also significantly impacted the comprehensive loss incurred in the period. In the quarter ended September 2012, the comprehensive loss was consistent with the prior quarter but the pursuit of a strategic partner along with increased stock based payments from option issuances contributed to a higher than typical comprehensive loss. The loss for the quarter ended December 2012 also contains costs related to legal, consulting, accounting and travel costs related to strategic partner initiatives that would not be considered recurring costs moving forward. The loss for the quarter ended September 2013 is inflated due to the inclusion of $392,000 for costs associated with a termination payment of a contract with a drilling company. Interest income throughout the quarters ranged from a high of $192,000 in the period ending March 31, 2014 to a low of $77,000 in March 2013 with the current period reflecting $182,000 of interest income.

Current assets trends principally reflect activity in the cash account. Cash comprises the majority of current asses with relatively minor balances in prepaid expenses and miscellaneous receivables. The quarter ended March 2013 represented a substantial increase due to the receipt of funds related to the Company obtaining a strategic partner and the related issuance of common shares. In the quarters ended June, September and December 2013, expenditures were incurred as the Company completed source water and disposal well testing. The decrease in the current quarter is almost entirely related to expenditures related to general and administrative expenditures.

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 Project forward. Total assets remained relatively constant for the majority of the periods above. The quarterly fluctuations generally reflect cash expended on G&A expenses.

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Total liabilities for the periods illustrated relate primarily to trade and other payables. These balances vary in the analysis due to timing of payments that are required on the various work performed on bringing the Project to the current level. The increase in the quarter ended December 31, 2012 and March 2013 are a result of drilling projects and site preparation activities which were in process over the quarter ends and a large amount of payables and accruals were generated as a result. The Company is not currently working on any projects requiring large cash outlays; therefore the liabilities are much lower than in comparative quarters.

FINANCING

2013

On March 7, 2013, the Company closed a non-brokered private placement financing with GSFC with 5,490,306 common shares being issued at a price of $8.15 per share for total gross proceeds of $44.7 million representing a 19.98% ownership stake in the Company. Share issue costs related to this financing amounted to $2.4 million for net proceeds of $42.3 million. The Company is obligated to issue an additional 555,555 common shares to GSFC if commercial production has not commenced on or before October 1, 2016.

On March 21, 2013 the Company granted 1,014,000 stock options to employees, directors and officers. The options have an exercise price of $7.95 per option and will expire on March 21, 2018. On June 14, 2013, the Company announced that it has entered into an engagement letter pursuant to which it has engaged BNP Paribas and Natixis, New York Branch, on an exclusive basis, to act as lead arrangers (the "Lead Arrangers") for a senior secured project finance facility (the "Facility") of up to US$300.0 million. The purpose of the Facility is to fund the construction and commissioning of the Project.

The Facility is expected to be structured on an underwritten basis whereby each Lead Arranger will underwrite 50% of the Facility subject to credit approval, due diligence and satisfactory legal documentation. Progress towards formal commitment and ultimately to closing will be carefully monitored and managed to ensure timing matches that of other financing initiatives and opportunities.

On June 24, 2013, the Company granted 15,000 options to employees. The options have an exercise price of $6.73 and will expire on June 24, 2018.

2014

On June 27, 2014, the first shares were issued from the employee share ownership plan ("ESOP"). There were 928 common shares granted to employees at a cost of $6,000. The ESOP was initiated in June 2013 and suspended in August 2013.

INVESTING

The Company capitalizes costs incurred on projects that are determined to provide future benefit and charges other costs to operations including administrative 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. Costs of personnel related entirely to preparation of mineral properties on the Company's permit areas and for the future construction of facilities or product development are capitalized as part of the mineral properties or of the processing facilities.

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Expenditures to date were focused on the completion of the Company's resource reports, including the Technical Report and EIS, 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 period ended June 30, 2014, the Company capitalized $58,000 to intangible assets in the following areas:

Intangible Assets				
	June 30, 2014		December 31, 2013	
Mineral property				
Drilling	$	19,340	$	19,374
Feasibility study		10,828		10,828
Geophysics		4,268		4,268
Environmental Study		3,457		3,438
Surface land		2,017		2,017
Engineering		2,009		2,009
Product Development		611		538
Permits		341		317
Process patent		125		116
Computer software		13		46
Balance, end of period	$	43,009	$	42,951

*Expressed in thousands

Drilling expenditures decreased by $34,000 as a result of expenditures incurred for reclamation of the tank storage facility that the Company no longer holds. These expenditures were more than offset by the receipt of a refund related to Provincial Sales Tax for the distillate fluid that was sold at the end of the previous quarter. Drilling has been postponed and therefore the Company has chosen to sell the fluid and discontinue the tank rentals until such time as it is needed.

Environmental expenditures of $19,000 incurred throughout the six month period ended June 30, 2014 relate to groundwater monitoring which is required to comply with government regulations.

Product development increase of $73,000 relate mainly to the capitalization of salaries, benefits and stock based compensation for employees who are analysing specific characteristics of the brine and products to facilitate construction and development of the cavern design and processing facility.

Permit expenditures of $24,000 for the six month period ended June 30, 2014 are the annual fees payable in order for the Company to maintain their current permit and lease areas.

Process patent expenditures of $9,000 were incurred as the Company continues to revise and update existing patents while applying for new patents in Canada and the United States where applicable.

Computer software decreased as a result of depreciation of $33,000 recognized during the period.

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Decommissioning obligations

The Company's decommissioning obligations are based on the Company's ownership in wells and facilities. Management estimates the costs to abandon and reclaim the wells and the facilities and the estimated time period during which these costs will be incurred in the future. The majority of these costs are expected to be incurred over the next 30 years. The undiscounted amount of estimated costs required to settle the obligations at June 30, 2014 is $212,000 (2013 – $212,000). The estimated costs have been inflated at 2.0 percent and discounted at a risk free rate of 2.60 percent (2013 – 2.73 percent) for the period ending June 30, 2014.

Deferred financing

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

Capital assets

During the period ended June 30, 2014, the Company capitalized $481,000 to assets under construction, machinery and equipment, vehicles, land improvements, leasehold improvements and equipment and furniture. The net balances classified as capital assets are as follows:

Capital Assets	June 30, 2014	December 31, 2013
Assets under construction	$ 16,970	$ 16,088
Machinery and equipment	1,657	1,969
Buildings	200	205
Vehicles	42	85
Land	125	125
Furniture and equipment	71	79
Land improvements	39	46
Leasehold improvements	122	148
Balance, end of period	$ 19,226	$ 18,745

*Expressed in thousands

Assets under construction increased by $882,000 during the six month period ended June 30, 2014. This increase resulted from expenditures of $62,000 to continue detailed engineering for equipment and underground infrastructure with the remainder being primarily salaries, benefits and stock based compensation for capitalized employees. There has been no depreciation charges recorded for assets under construction.

All other categories have decrease due to limited spending and the offsetting depreciation in each of the accounts.

Segmentation Reporting

The Company's operating segments have been identified as the Company's individual mineral reserve streams. The Company has currently identified two operating segments, potash and magnesium, however due to materiality they are currently grouped as one segment for financial reporting purposes. As

magnesium reserves are advanced to a material stage, costs will be allocated to separate reporting segments.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2014, the Company had net working capital of $44.2 million compared to $55.7 million at June 30, 2013 including $44.4 million and $56.2 million, respectively, in cash. As at June 30, 2014, the Company also had $375,000 in restricted cash that was set up as a requirement from the Government of Saskatchewan in order to operate the test plant in Saskatchewan. The Company maintains cash in bank accounts for day to day operations and invests the excess in overnight financial instruments in high interest saving accounts that are highly liquid.

The Company has sufficient cash to meet its short-term corporate costs and existing capital plans and has sufficient funds to finance exploration and ongoing corporate functions. There is no certainty, however, that the Company will be able to raise additional funds to obtain the necessary capital to move the Project forward to the production stage.

CONTRACTUAL OBLIGATIONS

The following table summarizes the commitments of the Company as at June 30, 2014:

Contractual Obligations					
	Payments due by period				
	Total	Less than 1 year	2-3 years	4-5 years	More than 5 years
Trade and other payables	$ 615	$ 615	$ -	$ -	$ -
Office lease	$ 679	$ 265	$ 402	$ 12	$ -
Mineral lease and permit	$ 2,680	$ 60	$ 208	$ 341	$ 2,071
Project contracts	$ 1,610	$ 1,610	$ -	$ -	$ -
Total	$ 5,584	$ 2,550	$ 610	$ 353	$ 2,071

*Expressed in thousands

Trade and other payables relate to operating, investing and financing expenditures that were payable at the period ended June 30, 2014.

Office leases are in place for both the Okotoks and Saskatoon office locations. The Okotoks space is under a lease containing a monthly fee of $10,000 and will expire on June 1, 2016. The Saskatoon office is under a lease containing a monthly fee of $12,000 and will expire on August 31, 2017.

Mineral lease and permit obligations refer to the annual fees which are required to maintain the permit and lease areas the Company currently owns. There are two annual extension periods available to the Company, March 2014 to February 2016 at a cost of $20,000 and $40,000 respectively. At the end of the extension periods the Company will need to convert the area to a lease in order to maintain the mineral rights for the property. All the required exploration on the property has been completed and no further spending will be required until such time as the property is converted to a lease.
The Company is required to pay an annual lease of $2.00 per acre on any area held under lease for a term of twenty-one years for a total cost of $34,000 per year. The Company is required to expend not less than

$3.0 million for work during the first three years of the term of the lease. The Company has met all expenditures as required under the subsurface mineral regulations.

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

CRITICAL ACCOUNTING ESTIMATES

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

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

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

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

developments. Significant, unanticipated changes to these assumptions could require a provision for impairment in the future.

Capital assets

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.

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. As at June 30, 2014 and 2013, the Company had receivables with a public insurance company, corporate banks and a limited number of customers who rent mats on a short-term basis such that management believes that the credit risk with respect to receivables is low.

Liquidity risk

The Company manages liquidity risk by maintaining sufficient cash balances to meet liabilities when due. As at June 30, 2014 the Company had cash totalling $44.4 million to settle current liabilities of $0.6

million. As at June 30, 2014 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 is exposed to price risk with respect to North American and international potash prices. A sustained decrease in the price of potash could cause the continued exploration and future development of the Company's properties to be uneconomical.

Currency risk

The Company's functional currency is the Canadian dollar with the majority of transactions denominated in Canadian dollars. The Company has engaged third party experts to perform various reports on the future potential of its mineral properties where such contracts are denominated in United States dollars and Euros. 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, 2014 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, 2014, 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, 2014 the Company earned interest income of $0.4 million (2013 - $0.1 million) from its cash.

RECENT ACCOUNTING PRONOUNCEMENTS

During the first quarter of 2014, the Company adopted the following standards:

IAS 32 "*Financial Instruments: Presentation*" - The amendments to IAS 32 pertain to the application guidance on the offsetting of financial assets and financial liabilities. The changes require that the Company have the current right to offset amounts with counterparties to recognize on a net basis in the financial statements. There was no impact to the Company on adoption of this standard.

IFRIC 21 "*Levies*" – The interpretation provided guidance on accounting for levies in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets. IFRIC 21 defines a levy as an outflow from an entity imposed by a government in accordance with legislation and confirms that an entity recognizes a liability for a levy only when the triggering event specified in the legislation occurs. The Company's current accounting treatment for levies is consistent with the requirements of IFRIC 21, such that the adoption of IFRIC 21 has had no impact on the financial reporting.

NEW STANDARDS NOT YET ADOPTED

IFRS 9 "*Financial Instruments*" – The standard is the first step in the process to replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 introduces new requirements for

classifying and measuring financial assets and liabilities and carries over from the requirements of IAS 39. Financial instruments: recognition and measurement derecognition of financial assets and financial liabilities. The extent of the impact of adoption of these standards has not yet been determined.

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

Internal Controls over Financial Reporting (ICFR)

The 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 them 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. The Company's management has assessed the design and operating effectiveness of internal controls over financial reporting. 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 below. An internal control system cannot prevent all errors and fraud. It is management's belief that any control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

During the design and operating effectiveness assessment a material weaknesses in internal controls over financial reporting was identified. The weakness related to the company not having full-time in-house personnel to address complex accounting and non-routine transactions that may arise. It is not deemed as economically feasible at this time to have such personnel. When faced with unusual or non-routine issues, the Company relies on external experts for review and advice.

The Company mitigates these weaknesses through 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.

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 27,477,045 common shares and 1,959,500 stock options issued and outstanding.

OUTLOOK

Industry Outlook

Global volumes seem to have recovered slightly better through the first half of 2014 than previously expected, pushing full year guidance upwards to approximately 58 million tonnes. Inventory levels will be challenging for August and September with most producers sold out for this period. It is unclear whether contracts for the second half of 2014 will be entered into or whether buyers will utilize their optional tonnages in existing contracts.

Even with the volume increases, pricing, particularly in Asian markets, remains challenging. Recent tenders in Malaysia and Indonesia have concluded in approximately the same ranges as contracts in early 2014 illustrating stagnant Asian pricing. Markets such as China and India usually do not show any price improvement (up or down) until the next contract is entered into. On the positive side, North American pricing is seeing a reasonable resurgence with prices in the US Midwest exceeding US $380 per short ton (approximately $418/metric tonne). This divergence in pricing illustrates the difference between standard and granular potash pricing. Granular potash prices in Europe, Brazil and North America are up 11% on average to the end of the second quarter in 2014 while standard-grade regions like SE Asia remained relatively flat over the same period. Adding to the positive news is the Brazilian market that has seen potash purchases increase almost 25% in the first six months of 2014. This increase is very encouraging in one of the most important potash markets worldwide.

The Company believes that prices will continue their gradual recovery, particularly given the recent announcements from major producers confirming widespread belief that a price over volume strategy is the best for the industry and will be adhered to. Karnalyte's strategy continues to be to only produce granulated potash with no standard grade production at all.

Capital Market Outlook

Access to the capital markets is crucial for all developing companies. The general weakness in the Canadian capital markets related to potash investment remained a challenge for all companies during the second quarter. There have been indications that a more stabilized market may be on the horizon but the question remains when the market will improve enough to allow for junior companies to access much needed capital to progress projects. For Karnalyte, access to the capital markets will be important but the total funding required will be comprised of various components with the capital markets being one component. In light of the current state of the capital markets, the Company continues to focus on advancing existing discussions with potential strategic partners and work with newly identified companies who may determine that the current weakness in the market reflects opportunities to invest. The Company believes that with success in this area the capital markets will then become more open and positive than it is today.

Company Outlook

Subsequent to the Company`s Board of Directors appointment of Mr. Thomas Drolet as the permanent President and CEO, Mr. Drolet has made significant advances with the Company's strategic plan and is working to position the Company to begin construction. The Board has given Mr. Drolet the responsibility to aggressively pursue the financing required to build the Wynyard Carnallite Project 625,000 tonnes/annum potash facility. The Company believes that financing of the project is likely to be comprised of an integrated, holistic financing model. This model will contain capital market financing, private equity, sub/mezzanine financing and additional strategic partner financing. The current focus is on attracting a second strategic partner along with the existing partner (GSFC) that the Company believes will enhance the other avenue of finance. The financing is a central component of the Company's new strategic plan. The Company is continuing to develop a new strategic plan for future success of the Company that includes:

- Aggressively pursuing additional strategic partners and other finance alternative
- Continuing to advance the detailed engineering for full construction
- Developing, progressing and pursuing markets and product development for magnesium co-products

Overall the industry response to the change has been positive.

FORWARD-LOOKING INFORMATION

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 statements may include, but are not limited to, statements regarding:

- expectations regarding the state of the global potash and magnesium industry;
- expectations regarding the Company's ability to finance the project;
- future extraction and exploitation of mineral deposits;
- capital expenditure requirements;
- expectations regarding prices and costs;

- development of mineral reserves and mineral extraction processes;
- the Company spending the funds available to it as stated in this MD&A;
- expectations regarding the Company's ability to subsequently raise capital;
- expenditures to be made by the Company to meet certain work commitments;
- expectations regarding the Company's strategic plan;
- discussions with potential strategic partners;
- work plans to be conducted by the Company, and
- reclamation and rehabilitation obligations and liabilities.

In certain cases, forward-looking statements can be identified by the use of such words as "may", "would", "could", "will", "intend", "expect", "believe", "plan", "anticipate", "estimate" and other similar terminology. These statements reflect the Company's current expectations regarding future events and operating performance and speak only as of the date of this MD&A.

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

- the future stability of potash prices and the cyclical nature of potash prices;
- the potential renewed partnerships in global potash marketing;
- the Company's ability to maintain a strong working capital position in the near term;
- the Company's ability to commence production at 625,000 tonnes per year, and ramp up to production of 2.125 million tonnes per year;
- further seismic exploration and drilling;
- time to completion of plant construction of 18 to 24 months following receipt of satisfactory financing and regulatory approvals;
- brine field preparation taking between 24 and 30 months;
- production run rates achieving 625,000 tonnes per year within 10 months following the completion of the processing plant;
- total capital expenditure for a 625,000 tonne mine of $593.0 million;
- the ability of the Company's strategic plan to position the Company for future success;
- anticipated results of development and extraction activities and estimated future development, and
- the Company's ability to obtain additional financing on satisfactory terms.

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

- the global potash market stabilizes and the stock prices of potash companies rebound above the current depressed market;
- the Company is able to manage its working capital position and is able to act on appropriate strategies and opportunities to access the capital markets as they arise;
- the Company executes its project development plans in a manner consistent with its budgets, planning and its Technical Report;
- there is no adverse change to the price of potash that would adversely affect the prospects for developing the Project, or make it uneconomic to proceed;
- the Company's ability to execute its strategic plan;
- estimates of the Company's mineral resources and mineral reserves are accurate, and
- the Company obtains additional financing in the future.

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 under "Risk Factors" in the Company's Annual Information Form. 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.