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, 2013 and 2012. 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, 2013. This commentary is dated August 6, 2013. The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). 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

On July 30, 2013 an announcement was made by Uralkali to exit the Belarusian Potash Company ("BPC") marketing agency and plans to significantly increase its operating rate in the future. This has added an unexpected and high level of uncertainty to the outlook for potash markets. More time will be needed to assess the implications of this development for the potash industry. In the short term, this uncertainty will likely have an adverse impact on our ability to access the capital required to proceed with the construction of our Wynyard project as currently planned. The Company is assessing various strategies and alternatives in response to this recent development.

The Company achieved the following key milestones during the period ended June 30, 2013 and the period up to the date of this MD&A including;

- 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 of up to US$300 million;
- Selected Whiting Equipment Canada Inc. ("Whiting") as its major equipment supplier and worked with Whiting to advance detailed engineering activities related to major equipment component specifications;
- Continued detailed engineering to advance the underground cavern design and planning;
- Continued site preparation activities at the future production facility site, and
- Tested the recently drilled disposal well and prepared for a second water source well, both of which will be used in production.

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RESULTS OF OPERATIONS

General and administrative expenses (G&A)

G&A costs for the three and six months ended June 30, 2013 amounted to $1,304,189 and $2,385,860 which is an increase of $521,826 and $805,190 from the comparative 2012 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,	
	2013	2012	2013	2012
Salary, wages and benefits	$ 394,392	$ 328,642	$ 801,145	$ 722,861
Accounting and legal	147,021	86,475	310,818	166,425
Rent	91,606	50,304	182,213	97,028
Directors Fees	87,500	65,750	177,000	126,500
Business development and investor relations	152,963	60,938	238,296	109,690
Consulting	146,741	49,003	202,059	66,246
Regulatory	-	2,000	54,391	67,011
Other	283,966	139,251	419,938	224,909
Total general and administrative	$ 1,304,189	$ 782,363	$ 2,385,860	$ 1,580,670

Salaries, wages and benefits for the three and six month periods ended June 30, 2013 was $394,392 and $801,145 compared to $328,642 and $722,861 in 2012. The Company restructured certain positions in May 2012 which resulted in five fewer full time and three fewer part time positions. In August 2012 staffing began for the newly established Saskatoon office. There has been eight new full time positions filled thus far in Saskatoon including engineering, human resources, environmental administration and occupational health and safety personnel. The Company capitalized employee remuneration of $292,992 and $547,367 (2012 – $234,487 and $455,941) and share-based payments of $278,405 and $448,118 (2012 – $227,937 and $260,246) during the period ended June 30, 2013 for employees who were working directly on the construction, engineering and product development.

Accounting and legal expenses for the three and six month periods ended June 30, 2013 was $147,021 and $310,818 compared to $86,475 and $166,425 in the comparative periods. The increase is associated to the legal fees incurred to set up the existing engineering, procurement and construction management (the “EPCM”) contract, a terms and conditions contract to be used for purchasing throughout the construction phase and assistance with setting up the employee share ownership plan that was implemented on June 1, 2013.

Rent expense for the three and six month periods ended June 30, 2013 amounted to $91,606 and $182,213 compared to $50,304 and $97,028 for the comparative periods. The rent has increased due to the addition of the Saskatoon office in August 2012 to accommodate the additional engineers required for construction of the plant facility. On June 1, 2013 the Company moved the head office to another location in Okotoks. For the month of June 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 current quarter.

Director fees for the three and six month periods ended June 30, 2013 amounted to $87,500 and $177,000 compared to $65,750 and $126,500 for the 2012 comparative periods. The increase is due to the addition

of a new director as well as changes to the pay structure to closer align the Company's Board with peer companies.

Business development and investor relations expenses for the three and six month periods ended June 30, 2013 amounted to $152,963 and $238,296 compared to $60,938 and $109,690 in the 2012 comparative periods. The increased travel in the current period related to the CEO and CFO continuing to seek out potential investors and give updates to existing shareholders through investor presentations and industry conferences throughout North America and Asian markets. The Company has also continued to increase exposure to the retail markets by entering a contract with Stockhouse Publishing. Throughout the quarter there were also fees incurred related to the annual general meeting and reserving options through the TSX.

Consulting expenses for the three and six month periods ended June 30, 2013 amounted to $146,741 and $202,059 compared to $49,003 and $66,246 in the comparative 2012 periods. The increase is related to fees paid to IT consultants that the Company has secured. These fees offset salary costs related to maintaining internal IT staff. There were also consultants retained to assist with marketing, financing and permitting requirements throughout the quarter. The Company has enlisted a firm to rejuvenate and update the website as well as revise a marketing video which will be used to explain the production process.

Regulatory expense for the three and six month periods ending June 30, 2013 is consistent to the comparative periods in 2012. The regulatory fee structure is related to market capitalization and therefore may fluctuate from year to year.

Other expenses for the three and six month periods ended June 30, 2013 amounted to $283,966 and $419,938 compared to $139,251 and $224,909 for the comparative periods representing an increase of $144,715 and $195,029. The increase in expenditures is mainly due to the costs related to maintaining a second office in Saskatoon and the additional employee related costs such as motor vehicle, telephone and travel expenses. In addition, costs were incurred to move offices in Okotoks and the continuation of advertising and promotional expenditures as the Company increases exposure to existing and potential investors.

Other P&L costs

Depreciation and amortization for the three and six month periods ended June 30, 2013 was relatively consistent at $197,442 and $404,058 compared to $222,714 and $416,059 in the 2012 comparative period.

Share-based payments for the three and six month periods ended June 30, 2013 was $684,396 and $1,108,682 compared to $564,391 and $694,912 in the 2012 comparative periods. The increase mainly relates to options granted to directors, officers and management on March 21, 2013 and June 24, 2013. The options are expensed over the two year vesting period. On June 1, 2013, the Company implemented an employee share purchase plan whereby the shares purchased by the Company are restricted for one year from the date of acquisition and the cost of the shares is recognized over a one year period as share based payment expense.

Other income and expenses for the three and six month periods ended June 30, 2013 was an expense of $8,563 and income of $3,632 compared to income of $105,226 and $130,904 in the 2012 comparative period. The expense in the current three month period is related to the loss incurred on the disposition of

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the leasehold improvements at the previously leased space in Okotoks. The income in the comparative period is related to land that the Company purchased for future production planning which is leased out to various farmers in the area until such time as it is needed by the Company. The rental of land has been consistent, however in the prior year there were also some drilling mats that were rented out. The lower income in the current period is because the Company did not rent out any mats in the six months ended June 30, 2013.

Net finance income for the three and six month periods ended June 30, 2013 was $518,627 and $568,766 compared to $102,602 and $217,348 in the 2012 comparative periods. The funds related to finance income are a direct result of the amount of cash the Company is holding at a given time and the corresponding interest income the cash generates. During the quarter ended March 31, 2012 the funds remaining from the Company's initial public offering (the "IPO") and over-allotment were allocated to high interest savings accounts. The closing of the GSFC financing deal in the first quarter of 2013 injected cash resulting in higher interest income than in the comparative quarter. A portion of the proceeds was converted to US funds and at the end of the current quarter an unrecognized gain of foreign exchange was represented in the net finance income.

PREVIOUSLY DISCLOSED USE OF PROCEEDS

Analysis of Prospectus Use of Proceeds				
	Current Expectation	Prospectus	Variance	Notes
Geological Analysis	$ 3,000,000	$ 3,000,000	$ -	
Feasibility Study Costs	9,000,000	17,000,000	(8,000,000)	a
Additional Exploration Seismic and Drilling	16,000,000	10,000,000	6,000,000	b
Environmental Impact Assessment	2,000,000	2,000,000	-	
Infrastructure Preparation and Equipment Deposits	5,000,000	9,400,000	(4,400,000)	c
Magnesium Pre-Feasibility Study	350,000	-	350,000	d
Contingencies	15,050,000	9,000,000	6,050,000	e
General, Administrative and Corporate Purposes	5,046,300	5,046,300	-	
Total	$ 55,446,300	$ 55,446,300	$ -	

Notes

a) Feasibility Study Costs estimated in the Company's 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 million for these holes in the $17 million feasibility study costs. In addition, the Company had included $2 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.

b) 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. This 3D is still being considered in 2013 and will be funded out of the proceeds of the IPO. As a result of the EIS, the Company is drilling 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 is expected to cost up to $3.5 million.

c) Given the results of the Company's technical report dated June 27, 2012 (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.

d) A contract has been completed with Lyntek Incorporated which resulted in a pre-feasibility study for magnesium compounds in the amount of $350,000.

e) 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 Technical Report. In addition the Company believes other sensitivities could arise in 2013 related to the key initiatives highlighted in the Prospectus and has therefore increased the expected contingencies by $6 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.

The amounts above exclude gross proceeds of $4,042,000 ($3,799,480 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.

SUMMARY OF QUARTERLY RESULTS

The following table provides selected financial information of the Company for each of the last eight quarters ended as at June 30, 2013:

Selected Quarterly Results								
	2013		2012				2011	
	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30
Total revenue	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Comprehensive loss	(1,675,963)	(1,650,238)	(2,029,669)	(1,988,605)	(2,096,839)	(1,090,733)	(2,347,228)	(549,778)
Basic and diluted loss per share	(0.06)	(0.07)	(0.10)	(0.08)	(0.10)	(0.05)	(0.11)	(0.03)
Total current assets	57,671,813	63,162,528	26,313,146	29,703,131	32,271,738	32,644,537	35,166,003	38,184,599
Total assets	114,865,286	117,184,814	76,290,254	75,358,574	76,411,927	74,462,061	75,847,125	75,436,477
Total liabilities	2,182,854	3,783,272	4,145,975	1,844,825	1,961,900	1,435,257	2,558,416	3,619,114
Total shareholders' equity	112,682,432	113,401,542	72,144,279	73,513,749	74,450,027	73,026,804	73,288,709	71,817,363

Comprehensive loss was driven primarily by G&A expenses incurred to fund the continued growth of the Company. These expenses were offset by rental income for drilling mat rentals in September 2011, June 2012 and September 2012 of $449,957, $111,276 and $52,114 respectively. The losses also reflect non-

cash components related to share based payment, depreciation expenses and unrealized gains and losses on foreign exchange. Share based payments range from $130,521 in March 2012 to $751,671 in September 2012. The quarter ended December 2011 increased significantly due to writing off financing expenses of $696,408 as a result of pulling the bought-deal financing and therefore not representative of a typical quarter. In the quarter ended June 2012, the Company experienced a significant step up in comprehensive loss primarily due to a major corporate restructuring in May 2012. Restructuring expenses amounting to $735,199 were incurred relating to third party consulting fees combined with severance costs. In the quarter ended September 2012, the comprehensive loss was consistent with the prior quarter but the severance costs were replaced with expensing costs related to the pursuit of strategic partner initiatives. The loss for the quarter ended June 30, 2013 also contains costs related to moving the Okotoks office and continuing to add new employees at the Saskatoon office. These additional costs were offset by increased interest income related to the additional cash on hand as well as an unrealized gain on the cash in the US cash account of $392,369.

Current assets trends principally reflect activity in the cash account. This account comprises the vast majority of current assets with relatively minor balances in prepaid expenses and miscellaneous receivables. Starting in the quarter ending Sept 30, 2011 the funds that were raised through the Company successfully completing its IPO were being used to continue work on the Project. During the quarter ending December 31, 2011 spending continued to increase and therefore current assets decreased as a result of expenditures related to the feasibility study and a seven well drilling program. The quarter ended June 30, 2012, 309,053 broker warrants were exercised by various companies who belonged to the IPO syndicate for gross proceeds of $2,657,856 which offset expenditures for that period. The quarter ended March 31, 2013 the currents assets increased dramatically as a result of closing a financing deal with GSFC for gross proceeds of $44,745,994 which was partially offset by share issue fees in the amount of $2,432,498. In the quarter ended June 30, 2013 the current assets decreased by $5,490,715. The decrease is due to significant spending on drilling a disposal well, continuing the EPCM for the plant construction, and additional work related to site preparation.

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 and cash injections as a result of options and broker warrants exercised as well as the closing of financing deals.

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 large increase in the quarters ended September 2011, December 2012 and March 2013 are a result of drilling projects, the feasibility study and site preparation activities which were in process over the quarter end dates and a large amount of payables and accruals were generated to account for the extra expenditures.

FINANCING

2011

The over-allotment related to the IPO was completed on January 14, 2011 where 470,000 common shares were issued at a price of $8.60 per share for total gross proceeds of $4,042,000. Share issue costs related to this offering were $325,472. The proceeds from the over-allotment will be used for general corporate

purposes. Along with the over-allotment, the Company granted 28,200 non-transferable broker warrants to the agents with an exercise price of $8.60 per warrant that will expire on or about July 13, 2012.

In December 2011 a bought-deal financing was pulled due to insufficient time to gather additional information to respond to securities commissions' comments that were raised on the Company's technical report.

During the year ended December 31, 2011, there were 50,000 stock options issued to new directors of the Company. There were 609,500 stock options exercised by employees, directors or consultants and 245,296 broker warrants exercised for gross proceeds to the Company of $4,567,999.

2012

On April 18, 2012, the Company granted 945,000 options to employees, directors and officers. The options have an exercise price of $10.05 per option and will expire on April 18, 2017.

During the year ended December 31, 2012, there were 617,325 stock options exercised by employees, directors or consultants for gross proceeds to the Company of $735,874 and 309,053 broker warrants exercised by various companies who belonged to the IPO syndicate for gross proceeds of $2,657,856.

During the year ended December 31, 2012, the Company filed a short form base shelf prospectus (the "Shelf Prospectus"), which subject to securities regulatory requirements, will allow the Company to make offerings of up to $350 million common shares, units, preferred shares and notes or other types of unsecured debt securities during the 25 month period the Shelf Prospectus remains effective. The Company may determine the price and terms of any securities offered under the Shelf Prospectus at the time of sale to be set forth in a prospectus supplement.

During the year ended December 31, 2012, 253,875 stock options expired or were forfeited and 59,475 broker warrants expired.

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 $44,745,994 which represents a 19.98% ownership stake in the Company. Share issue costs related to this financing amounted to $2,432,492 for net proceeds of $42,313,502. 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 options 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 million. The purpose of the Facility is to fund the construction and commissioning of the Wynyard Carnallite Project (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.

On June 24, 2013, the Company granted 15,000 options to a new employee as a component of the compensation package for that employee. The options have an exercise price of $6.73 and will expire on June 24, 2018.

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.

Expenditures to date were focused on the completion of the Company's technical reports, including the Technical Report, finalizing the Company's Environmental Impact Statement ("EIS"), confirming the resources and reserves on the initial focus area and preparing the Company for construction.

Intangible assets

During the six month period ended June 30, 2013, the Company capitalized $512,928 to intangible assets in the following areas:

Intangible Assets		
Period ended	June 30, 2013	December 31, 2012
Mineral property		
Drilling	$ 20,281,533	$ 19,998,422
Feasibility study	10,827,683	10,827,683
Geophysics	4,262,672	4,262,672
Environmental Study	3,352,536	3,240,208
Surface land	2,017,352	2,017,352
Engineering	2,008,905	1,994,300
Product Development	455,672	373,064
Permits	295,557	269,697
Process patent	117,069	104,144
Computer software	91,500	110,009
Balance, end of period	$ 43,710,479	$ 43,197,551

Drilling expenditures of $283,111 incurred throughout the period ended June 30, 2013 mainly related to storage tank rentals containing distillate fluid which will be used for drilling in the future.

Environmental expenditures of $112,328 incurred throughout the period ended June 30, 2013 relate to ongoing environmental monitoring and testing that is required to conform to regulatory requirements.

Engineering expenditures in the amount of $14,605 incurred in the period ended June 30, 2013 related to engineering consulting work while the company hires the remaining engineering staff required for construction.

Product development expenditures in the amount of $82,608 relate mainly to the capitalization of salaries, benefits, bonuses and stock based compensation for employees who are analysing specific characteristics of our brine and products to facilitate construction and development of the cavern design and processing facility.
Permit expenditures of $25,860 for the period ended June 30, 2013 are the annual fees payable in order for the Company to maintain their current permit and lease areas.

Patent expenditures in the amount of $12,925 were incurred as the Company continue to revise and update existing patents while applying for new patents in Canada and the United States where applicable. The expenditure was partially offset with depreciation of $3,219 for the six months ending June 30, 2013.

Computer software decreased as a result of very little expenditures which were offset with depreciation of $45,421 for the six months ending June 30, 2013.

Deferred financing

Deferred financing costs were incurred as a result of the Company continuing 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 six month period ended June 30, 2013, the Company capitalized $6,703,437 to assets under construction, machinery and equipment, vehicles, land improvements, leasehold improvements and equipment and furniture. Expenditures were capitalized to the following areas:

Capital Assets	June 30, 2013	December 31, 2012
Assets under construction	$ 10,299,892	$ 3,466,078
Machinery and equipment	2,030,542	2,291,533
Buildings	210,787	216,086
Vehicles	107,679	130,073
Land	124,656	124,656
Furniture and equipment	80,778	88,367
Land improvements	53,205	60,297
Leasehold improvements	200,455	27,467
Balance, end of period	$ 13,107,994	$ 6,404,557

Assets under construction increased by $6,833,814 during the six month period ended June 30, 2013. This increase is a result of expenditures of $711,281 for the Company to continue site preparation on the location of the production facility. An additional $2,788,108 has been spent to continue of detailed engineering required for plant construction. There has also been expenditures of $3,244,187 incurred drilling a disposal well and preparing to drill a water well to test the permeability and porosity of the future disposal site. Finally the Company has incurred a cost of $90,238 to secure detailed engineering

related to the crystallizer and evaporator purchase. There has been no depreciation charges recorded for assets under construction.

Leasehold improvements increased by $172,988 related to the construction of a new office space for the Okotoks office. The existing lease for the Okotoks office expired at the previous location and since the lab has been moved to the Saskatoon office space, the Company secured a smaller more suitable space for the head office.

All other capital assets decreased this quarter as a result of limited expenditures and the offsetting depreciation.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2013, the Company had net working capital of $55,654,140 compared to $22,317,127 at December 31, 2012 including $56,224,956 and $25,114,959, respectively, in cash. 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. No investments are made in commercial paper instruments.

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, 2013:

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	$ 2,017,673	$ 2,017,673	$ -	$ -	$ -
Office lease	$ 931,369	$ 265,238	$ 520,573	$ 145,558	$ -
Mineral lease and permit	$ 684,113	$ 41,983	$ 122,300	$ 73,967	$ 445,863
Project contracts	$ 2,376,885	$ 2,376,885	$ -	$ -	$ -
Total	$ 6,010,040	$ 4,701,779	$ 642,873	$ 219,525	$ 445,863

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 and its independent auditors. 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

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estimates of total depleted reserves and useful lives and the calculation of share-based payments. See note 2 to the December 31, 2012 financial statements.

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 the Project.

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

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

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 depleted 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, 2013 and 2012, the Company had GST receivables from the Canadian Government 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, 2013, the Company had cash totalling $56,224,956 to settle current liabilities of $2,017,673. As at June 30, 2013 and 2012 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 will be exposed to price risk with respect to North American and international potash prices. A significant decrease in the price of potash could cause the continued exploration and future development of the Company's properties to be uneconomical. On July 30, 2013 an announcement was made by Uralkali to exit the BPC marketing agency and to significantly increase its operating rate in the future, which has added an unexpected and high level of uncertainty to the outlook for potash markets. More time will be needed to assess the implications of this development for the potash industry.

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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. As the Company moves into full construction the currency risk will be heightened as most of the major equipment components will be based in US dollars. In the quarter ended June 30, 2013 the company moved $30 million CAD to a high interest US dollar savings account in an effort to mitigate risk of foreign exchange fluctuations.

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, 2013, 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 period ended June 30, 2013 the Company earned interest income of $128,218 from its cash.

RECENT ACCOUNTING PRONOUNCEMENTS

During the first quarter of 2013, the Company adopted the following standards:

- IFRS 11 "Joint arrangements" outlines the accounting treatment for joint arrangements, notable joint operations and joint ventures, to be applied retrospectively. This new standard became effective on January 1, 2013. There was no impact to the Company on adoption of this standard.
- IFRS 13 "Fair value measurement" defines fair value, provides guidance on measuring fair value and outlines disclosure requirements for fair value measurements. This standard applies when another IFRS standard requires fair value measurements or disclosures, with some exceptions including IFRS 2 "Share based payments" and IAS 17 "Leases". This new standard became effective and was applied prospectively on January 1, 2013. There was no measurement impact to the Company on adoption of this standard. Refer to note 12 for the additional disclosure required.

INTERNAL CONTROLS OVER FINANCIAL REPORTING (ICFR)

The Company has designed and implemented disclosure controls and procedures and internal controls over financial reporting. In the section titled "Disclosure Controls & Procedures and Internal Control over Financial Reporting" of its annual Management's Discussion & Analysis dated December 31, 2012, the Company reported certain material weaknesses in internal controls over financial reporting as at December 31, 2012. There have been no changes during the period ended June 30, 2013 that have a material effect on the disclosure controls and procedures or the internal controls over financial reporting.

OFF BALANCE SHEET ARRANGEMENTS

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

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OUTSTANDING SHARES

As of the date of this MD&A, the Company has 27,478,082 common shares and 2,249,500 stock options issued and outstanding.

OUTLOOK

Industry Outlook

Shares of major North American potash producers and developers fell sharply on July 30, 2013 after Uralkali announced that it was pulling out of the BPC marketing agency which has added an unexpected and high level of uncertainty to the outlook for potash markets. Uralkali has announced they intend to now sell more potash to China, which buys about one fifth of the world's supply of the fertilizer. It is too soon to know the potential impact of the announcement by Uralkali on potash prices and production.

Capital Market Outlook

Access to the capital markets is crucial for all developing companies. The current weakness in the capital markets for resource companies presents challenges to all developing companies. The heightened uncertainty facing the potash industry resulting from the recent Uralkali announcement makes access to capital markets for companies like Karnalyte extremely difficult in the short term and perhaps longer. The Company has a strong working capital position at the end of the quarter of $55.7 million with a manageable cash burn rate and capital programs. This working capital will provide some protection for a period of time, however the Company will need to access the capital markets further to enter into the full construction phase of the Project.

Company Outlook

The Company achieved a tremendous amount of key milestones throughout the prior year and the first half of 2013. The Company is in the pre-development stage and therefore access to capital markets is critical to continue to progress. The recently introduced uncertainty facing the potash industry, as described above, will likely have an adverse impact on our ability to access the capital requirements Management is assessing various strategies and alternatives in response to this recent development. Management believes that our relatively strong financial position, with over $50 million in working capital, will enable us to weather this storm.

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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:

- 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;
- 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 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 million;
- 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 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;
- 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.