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 September 30, 2013 and the comparative 2012 period. 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 September 30, 2013. This commentary is dated November 11, 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

The quarter ended September 30, 2013 was characterized by two divergent themes. On a positive note, the Company continued to progress the Wynyard project by accomplishing key milestones geared towards preparation for full construction. During the three and nine months ended September 30, 2013, the Company spent a total of $3.8 million and $11.3 million respectively on Capital and Intangible Assets on this development. The key milestones accomplished during the third quarter included;

- Drilled and successfully tested a full production capacity disposal well ("Well 1");
- Drilled and successfully tested our second production size source water well ("Well 2");
- Received the main development permit, clear of all conditions, for the Wynyard project from the Saskatchewan Ministry of Environment (the "MOE") subsequent to these successful tests
- Continued work on detailed specifications for the evaporator and crystallizer equipment with our main equipment supplier (Whiting);
- Continued detailed engineering on plant (Foster Wheeler) and underground development (Ercosplan); and
- Continued preparing the plant site for construction upon further financing.

Achievement of these milestones constitutes the majority of capital spending related to preparing for plant construction. Expenditures related to these activities occurred throughout the third quarter and extended into the first half of the fourth quarter. As of the date of this MD&A, the Company does not expect to spend further material amounts on Capital or Intangible Assets until further financing is available.

The Company's achievements are important due to the other theme encountered during the third quarter that was negative to the entire potash market. On July 30, 2013 Uralkali announced that they were going to start marketing product outside of their marketing arrangement with Belaruskali through the Belarusian Potash Company ("BPC"). This announcement created significant market uncertainty which resulted in reduced prices and cautious purchasing behavior that has continued into the fourth quarter in the global potash market. As a result stock prices of most potash companies across the globe were negatively impacted with junior exploration and development companies being materially impacted. On the heels of this announcement, the potash industry has experienced delays in the execution of Chinese supply agreements which are likely to continue until Q1, 2014, significant impacts on the timing of delivery of product on Indian contracts and expects a slowdown of Brazilian potash imports due to a reduction in the

size of their second crop and elevated inventories. Global potash fundamentals remain challenging entering the fourth quarter of 2013. This weakness in the potash sector has caused further downward pressure on stock values and development prospects.

Management believes the potential exists for potash prices to remain at low levels for some time and accordingly is committed to maintain a strong cash position by minimizing spending. Karnalyte has a working capital balance at the end of the third quarter of $49.3 million which will allow the Company to sustain itself until construction of the Wynyard project becomes practical. With the work done on detailed engineering and site preparation to date, the Company can now minimize additional capital expenditures without impacting its ability to launch full construction upon further financing. The Company believes this strategy will allow it to maintain a significant cash balance and be in a position to capitalize on opportunities when the potash market rebounds.

In addition to focussing on cost control, the Company will continue to advance discussions with potential strategic partners and work with newly identified potential companies who view the current market conditions as an opportunity. Given the weakness in capital markets, the Company feels that a focus on securing additional strategic partners provides the best likelihood of financing success at this time.

RESULTS OF OPERATIONS

General and administrative expenses (G&A)

G&A costs for the three and nine months ended September 30, 2013 amounted to $1,349,865 and $3,735,725 which is an increase of $255,429 and $1,060,619 from the comparative 2012 amount.

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

G&A Expenditures				
	Three months ended Sept 30,		Nine months ended Sept 30,	
	2013	2012	2013	2012
Salary, wages and benefits	$ 385,899	$ 295,234	$ 1,187,043	$ 1,018,095
Accounting and legal	97,711	56,843	408,530	223,267
Rent	74,392	68,972	256,605	165,999
Directors Fees	69,598	64,750	246,598	191,250
Business development and investor relations	88,177	333,320	326,472	443,010
Consulting	59,144	117,091	261,203	183,340
Regulatory	-	-	54,391	67,011
Other	574,944	158,226	994,883	383,134
Total general and administrative	$ 1,349,865	$ 1,094,436	$ 3,735,725	$ 2,675,106

Salaries, wages and benefits for the three and nine month periods ended September 30, 2013 was $385,899 and $1,187,043 compared to $295,234 and $1,018,095 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 the Company began staffing the newly established Saskatoon office and has filled eight new full time positions including engineering, human resources, environmental administration and occupational health and safety personnel. The Company capitalized employee remuneration of $309,043 and $874,206 (2012 – $228,706 and $684,646) and share-based payments of $223,913 and $672,031(2012 – $300,655 and $560,902) during the period ended September 30, 2013 for employees who were working directly on the construction, engineering and product development.

Accounting and legal expenses for the three and nine month periods ended September 30, 2013 was $97,711 and $408,530 compared to $56,843 and $223,267 in the comparative periods. The increase in legal fees resulted from work done on the stock option plan, equipment leasing, purchasing terms and conditions and other initiatives throughout the quarter. There was also additional accounting fees incurred that related to work outside the scope of the quarter end filings. These services were related to taxation as well as other accounting queries.

Rent expense for the three and nine month periods ended September 30, 2013 amounted to $74,392 and $256,605 compared to $68,972 and $165,999 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 a new location in Okotoks that covers less square feet but is much better suited for head office operations. The new location will carry lower annual rental payments than the prior location but this saving was more than offset by the new office in Saskatoon. For the month of June both Okotoks locations were retained in order to allow time for new office renovations and reverting the old office back to the original structure also contributing to the increased cost in the current quarter.

Director fees for the three and nine month periods ended September 30, 2013 amounted to $69,598 and $246,598 compared to $64,750 and $191,250 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 nine month periods ended September 30, 2013 amounted to $88,177 and $326,472 compared to $333,320 and $443,010 in the 2012 comparative periods. The decrease in the three month period is due to an amount of $300,457 incurred in the 2012 comparative quarter that was related to pursuing potential investors that did not come to fruition. As a result, the related expenditures were reclassified from deferred expenses to business development. This amount was slightly offset by the Company increasing exposure to the retail markets by entering a contract with Stockhouse Publishing in the current quarter.

Consulting expenses for the three and nine month periods ended September 30, 2013 amounted to $59,144 and $261,203 compared to $117,091 and $183,340 in the comparative 2012 periods. The decrease in the three month comparative quarter is related to restructuring the IT department and securing a new IT consulting company that reduced overall costs. This has been offset with the addition of consultants retained to assist with marketing, financing and permitting requirements throughout the previous quarters. 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 nine month periods ending September 30, 2013 is relatively 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 nine month periods ended September 30, 2013 amounted to $574,944 and $994,883 compared to $158,226 and $383,134 for the comparative periods representing an increase of $416,718 and $611,749. In the quarter ended September 30, 2013 the Company was unable to fulfill a drilling contract which resulted in paying out the funds remaining on the agreement. The amount left in the drilling contract that was paid out was $391,727 and resulted in a large discrepancy in spending as compared to the comparative periods. In addition there have been additional costs incurred over the

comparative quarters due to costs related to maintaining a second office in Saskatoon and the additional employee related costs such as motor vehicle, telephone and travel expenses.

Other profit and loss (P&L) costs

Depreciation and amortization for the three and nine month periods ended September 30, 2013 was relatively consistent at $226,961 and $631,019 compared to $187,417 and $603,477 in the 2012 comparative period.

Share-based payments for the three and nine month periods ended September 30, 2013 was $583,759 and $1,692,441 compared to $751,671 and $1,446,583 in the 2012 comparative periods. Options were 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. Effective August 1, 2013 the plan was put on hold.

Restructuring expenditures for the three and nine month periods ended September 30, 2013 was $67,628 compared to $134,398 and $869,597 in the 2012 comparative periods. As the Company continues to evolve and move towards production it is expected many positions will be added and modified to fill the Company's needs.

Other income and expenses for the three and nine month periods ended September 30, 2013 was income of $17,682 and $21,314 compared to $50,114 and $181,018 in the 2012 comparative period. The variance between all periods is related to rental of drilling mats. The company purchased mats in 2010 and when they are not in use they are rented out to various vendors where possible. The variance in income is due to the availability of rental opportunities which depends heavily on weather and road conditions near the plant site in Wynyard Saskatchewan.

Net finance income for the three and nine month periods ended September 30, 2013 was $204,750 and $773,516 compared to $129,203 and $346,552 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.

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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.

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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 September 30, 2013:

Selected Quarterly Results								
	2013			2012				2011
	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31
Total revenue	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Comprehensive loss	(2,005,781)	(1,675,963)	(1,650,238)	(2,029,669)	(1,988,605)	(2,096,839)	(1,090,733)	(2,347,228)
Basic and diluted loss per share	(0.07)	(0.06)	(0.07)	(0.10)	(0.08)	(0.10)	(0.05)	(0.11)
Total current assets	51,771,842	57,671,813	63,162,528	26,313,146	29,703,131	32,271,738	32,644,537	35,166,003
Total assets	114,099,583	114,865,286	117,184,814	76,290,254	75,358,574	76,411,927	74,462,061	75,847,125
Total liabilities	2,621,638	2,182,854	3,783,272	4,145,975	1,844,825	1,961,900	1,435,257	2,558,416
Total shareholders' equity	111,477,945	112,682,432	113,401,542	72,144,279	73,513,749	74,450,027	73,026,804	73,288,709

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 December 2011, June 2012, September 2012 and September 2013 of $32,616, $111,276, $52,114 and $17,640 respectively. The loss in the quarter ended December 2011 is 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 along with increased stock based payments from higher stock option issuances.. The loss for the quarter ended September 30, 2013 contains $391,727 for costs associated with paying out a contract with a drilling contract that the company was unable to fulfill at this time.

Current assets trends principally reflect activity in the cash account that comprises the vast majority of current assets with relatively minor balances in prepaid expenses and miscellaneous receivables. In the quarter ending Dec 31, 2011 the funds that were raised through the Company's IPO were being used to continue work on the Project and the work continued through the quarter ending March 31, 2012 thereby

decreasing current assets as the cash was being spent on developing capital and intangible assets. In the quarter ended June 30, 2012, 309,053 broker warrants were exercised by various companies from the IPO syndicate for gross proceeds of $2,657,856 which offset expenditures for that period. In 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 September 30, 2013 the current assets decreased by $5,899,971 due to 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 due to timing of payments that are required on the work performed on bringing the Project to the current level. The large increase in the quarters ended 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 representing 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. 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 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.

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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 nine month period ended September 30, 2013, the Company capitalized $728,146 to intangible assets in the following areas:

Intangible Assets		
Period ended	September 30, 2013	December 31, 2012
Mineral property		
Drilling	$ 20,410,548	$ 19,998,422
Feasibility study	10,827,683	10,827,683
Geophysics	4,262,672	4,262,672
Environmental Study	3,417,249	3,240,208
Surface land	2,017,352	2,017,352
Engineering	2,008,905	1,994,300
Product Development	495,875	373,064
Permits	306,477	269,697
Process patent	120,347	104,144
Computer software	58,589	110,009
Balance, end of period	$ 43,925,697	$ 43,197,551

Drilling expenditures of $412,126 incurred throughout the period ended September 30, 2013 mainly related to storage tank rentals containing distillate fluid which will be used for drilling in the future.

Environmental expenditures of $177,041 incurred throughout the period ended September 30, 2013 relate to ongoing environmental monitoring and testing that is required to conform to regulatory requirements. The Company has also been working to attain permits for construction and preparing a permitting and reporting plan that will comply with regulations going forward.

Engineering expenditures in the amount of $14,605 incurred in the period ended September 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 $122,811 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 $36,780 for the period ended September 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 $16,203 were incurred as the Company continued to revise and update existing patents while applying for new patents in Canada and the United States. The expenditure was partially offset by depreciation of $5,034 for the nine months ending September 30, 2013.

Computer software decreased from a combination of limited expenditures being more than offset by depreciation of $78,330 for the nine months ending September 30, 2013.

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 nine month period ended September 30, 2013, the Company capitalized $10,086,319 to assets under construction, machinery and equipment, land improvements, leasehold improvements and equipment and furniture. Expenditures were capitalized to the following areas:

Capital Assets				
		September 30, 2013		December 31, 2012
Assets under construction	$	13,885,099	$	3,466,078
Machinery and equipment		1,875,206		2,291,533
Buildings		207,972		216,086
Leasehold improvements		166,700		27,467
Land		124,656		124,656
Vehicles		94,599		130,073
Furniture and equipment		86,572		88,367
Land improvements		50,072		60,297
Balance, end of period	$	16,490,876	$	6,404,557

Assets under construction increased by $10,419,021 during the nine month period ended September 30, 2013. This increase resulted from expenditures of $932,907 to continue site preparation on the proposed location of the production facility. An additional $5,015,845 was spent to continue detailed engineering required for plant construction. Expenditures of $4,197,611 were incurred for drilling a disposal well and preparing to drill a water well to test the permeability and porosity of the future disposal site. Finally costs of $219,565 were incurred to advance detailed engineering on the crystallizer and evaporator purchase and $53,093 to secure temporary utilities to the construction site. There has been no depreciation charges recorded for assets under construction.

Leasehold improvements increased by $139,233 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 September 30, 2013, the Company had net working capital of $49,319,830 compared to $22,317,127 at December 31, 2012 including $51,512,033 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 September 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	$ 2,452,012	$ 2,452,012	$ -	$ -	$ -
Office lease	$ 878,102	$ 265,238	$ 490,864	$ 122,000	$ -
Mineral lease and permit	$ 2,718,881	$ 49,483	$ 115,633	$ 340,502	$ 2,213,263
Project contracts	$ 2,314,229	$ 2,314,229	$ -	$ -	$ -
Total	$ 8,363,224	$ 5,080,962	$ 606,497	$ 462,502	$ 2,213,263

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. 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.

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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 the 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 September 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 September 30, 2013, the Company had cash totalling $51,512,033 to settle current liabilities of $2,452,012. As at September 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.

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. Management believes the foreign exchange risk derived from currency conversions is not significant and therefore does not hedge its foreign exchange risk. At September 30, 2013, the Company held the majority of its cash in CAD.

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 September 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 nine month period ended September 30, 2013 the Company earned interest income of $353,503 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 September 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.

OUTSTANDING SHARES

As of the date of this MD&A, the Company has 27,476,961 common shares and 2,126,500 stock options issued and outstanding.

OUTLOOK

Industry Outlook

Share prices 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. Shares prices of developing companies suffered a greater impact than share prices of producers during the period from this announcement until the date of this MD&A. The share prices of companies continue to be under significant pressure. 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. Other producers appear unwilling to concede market share with the result being a focus on volume over price, at least in the short term. As a result potash prices have suffered significant

decreases and buyers have reacted by sitting on the sideline and not entering into any major contracts. This has resulted in high inventory levels as everyone delays purchases in anticipation of further pricing decreases. Management believes that it is too soon to know the full impact on potash prices and production but the Company will continue to monitor new developments in the market.

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. Management believes that the heightened uncertainty facing the potash industry resulting from the recent Uralkali announcement will have a significant adverse impact on the ability of junior exploration and development companies such as Karnalyte to access the capital markets in the near term. The Company will need to ultimately access the capital markets further to enter into the full construction phase of the Project. The Company will continue to monitor the capital markets for any opportunities to access capital. With its current strong working capital position, the Company intends to continue to assess strategies and opportunities as they arise.

Company Outlook

The potential for potash prices to remain low for the medium to long term has caused management to formulate a strategy to maintain strong cost controls moving forward. With the work done on detailed engineering and site preparation to date, the Company can now minimize additional capital expenditures on the project for the near term without impacting its ability to launch full construction upon further financing. The Company will be implementing a strategy of cost control to conserve cash resources until the market sentiment improves. Expenditures on capital assets will only be made on clear value added items which provide further material advancement of the project, with the majority of spending to be deferred at this time. The Company believes this strategy will allow it to maintain a significant cash balance and be in a position to capitalize on opportunities when the potash market rebounds.

In addition to a primary focus on cost control, the Company will also focus on advancing existing discussions with potential strategic partners and working with newly identified potential companies who view the current market conditions as an opportunity. Given the weakness in capital markets the Company feels that a focus on securing additional strategic partners provides the best likelihood of financing success at this time.

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 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;
- 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 million;
- anticipated results of development and extraction activities and estimated future development, and
- the Company's ability to secure additional strategic partners and 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;
- estimates of the Company's mineral resources and mineral reserves are accurate, and
- the Company secures additional strategic partners and 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.