MANAGEMENT'S DISCUSSION AND ANALYSIS

For the six months ended June 30, 2021

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MANAGEMENT’S DISCUSSION AND ANALYSIS

This Management’s Discussion and Analysis (**“MD&A”**) is intended to provide a summary of the operational and financial results of Karnalyte Resources Inc. (**“Karnalyte”** or the **“Company”**) for the six months ended June 30, 2021 and 2020. This MD&A should be read in conjunction with the condensed unaudited interim financial statements of the Company and the related notes thereto for the six months ended June 30, 2021. This commentary is dated August 12, 2021. The financial statements have been prepared in accordance with International Accounting Standard 34, Interim Financial Statements and should be read in conjunction with the year-end December 31, 2020 audited financial statements. These documents, the Annual Information Form dated March 19, 2021 (the “**Annual Information Form**”), and additional information about the Company are available on SEDAR at www.sedar.com. Some of the statements made herein contain forward-looking information and accordingly please refer to the “Forward-Looking Information” section at the end of the MD&A.

OVERVIEW

GENERAL OVERVIEW

Karnalyte was incorporated under the Business Corporations Act (Alberta) on November 16, 2007 and is a Saskatchewan-headquartered company focused on the development of potash and magnesium operations in Saskatchewan. The Company’s potash project in Wynyard, Saskatchewan (the **“Potash Project”**) is a proposed 2.125 million tonnes per year (**“TPY”)** potash mine utilizing conventional solution mining methods for potash production. The Company proposes to develop the Potash Project in three phases using a modular approach, with a first phase **(“Phase I”**) consisting of a potash production facility capable of producing 625,000 TPY of potash, increasing to 1,375,000 TPY of potash in the second phase, and ultimately to 2,125,000 TPY of potash in the third phase.

SECOND QUARTER UPDATE

During the second quarter of 2021, the Company continued to focus on activities surrounding the corporate strategic review that was prepared by MNP LLP (the “**Strategic Review Report**” or **“Report**”). As previously announced, Karnalyte’s Board of Directors (the “**Board**”) initiated the strategic review process to evaluate a broad range of potential strategic alternatives available to the Company, including evaluation of its existing and future projects, with a focus on determining what is in the best interests of Karnalyte and maximizing value for its shareholders. An update on this review was provided during the second quarter including commentary on the specific matters addressed in the Strategic Review Report. This update included a review and analysis of the Company’s proposed nitrogen fertilizer project, a review and analysis of market sounding activities for the Potash Project and suggestions for improving Karnalyte’s financial position.

NITROGEN PROJECT

In the Strategic Review Report, the opportunity of building a regional nitrogen production facility near Saskatoon, Saskatchewan (the “**Nitrogen Project**”) was analyzed as one of the options to maximize value for Karnalyte’s shareholders.

The Report concluded that the Nitrogen Project could be a profitable venture, with an estimated average annual cash flow of US$52 million per year, an IRR of 9.06% and a payback period of under 10 years if all product produced is sold at expected market values within the production period. These projections were predicated on the market price of nitrogen fertilizer, the capital cost of the facilities, labour costs, costs of raw materials (including natural gas), transportation and other costs of production all falling within the levels assumed in the Report. Management notes that there can be no assurance that such estimates and assumptions will prove to be accurate. Accordingly, readers should not place undue reliance on such estimates and assumptions.

While MNP noted that the economics of this project could be positive, the Report concluded that, given current market and competitive conditions, the Nitrogen Project is high-risk without both an offtake agreement and a joint or independent capital investment. Management and the Board are considering the various challenges identified in the Report including market risk and capital risk and are continuing discussions with multiple prospective partners to assess interest in an offtake agreement and capital investment. Further updates will be provided when appropriate or required as discussions continue.

Gujarat State Fertilizers and Chemicals Limited ("**GSFC**"), a 38.7% shareholder of Karnalyte, has indicated that, if requested by the Company, they would support the Nitrogen Project by bringing GSFC's significant experience operating nitrogen fertilizer production facilities to the project but only as technical advisor at the planning, design, and construction phases and as initial operator of the Nitrogen Project facility. However, GSFC has emphasized that Karnalyte will require a strategic partner to support the Nitrogen Project, as GSFC is not in a position to act as lead partner for the Nitrogen Project.

POTASH PROJECT

As further development of the Company's Potash Project is dependent on improved potash prices, financing, and other matters, the Strategic Review Report provides a future economic outlook on the global potash industry and identifies how a Karnalyte potash facility would compare in the industry.

While the Strategic Review Report noted that the price of potash has increased in 2021 and that potash demand is expected to grow linearly year over year through to 2030, the market is expected to be in a prolonged state of oversupply. This expectation is in part derived from speculation in the market surrounding new mines coming online in Belarus, Russia and Canada (BHP Jansen). An oversupply in the market creates an ongoing structural problem between supply and demand that will have a less predictable impact on the price of potash. That said, management is of the view that recent positive developments in the industry could result in a shift in this demand supply balance such that upward pressure on the price will be realized. The market has been showing signs of tightening over the past several months and continues at the writing of this MD&A, with potash prices in North America showing significant increases from 60 to 100%. Increases globally year over year are near 20% but expected to be higher during the second half of 2021. Developments include recent production curtailments as a result of the early closure by (The) Mosaic Company of its K1 and K2 shafts at Esterhazy, Saskatchewan, and sanctions imposed on potash exports from Belarus that were implemented in the European Union at the end of June 2021 and further sanctions just announced by the United States on imports of potash from Belarus. If current demand rates continue and further sanctions result in a decrease in potash exports from Belarus, this could result in further upward pressure on global potash prices.

The Strategic Review Report noted that the Potash Project would have a number of advantages that would make the project potentially attractive to a strategic industry player despite current conditions:

- **Environmental**: The mine would not produce tailing piles or ponds, would require a limited use of fresh water, would result in minimal surface impact and has the possibility of a secondary, marketable magnesium product.
- **Pre-Work & Investment**: There has been a significant amount invested in pre-work and permitting, allowing for shorter lead time to initiate construction.
- **Strategic Partner**: Karnalyte has an agreement with its strategic partner, GSFC, for approximately a 56% off-take over 20 years of the expected production in phase 1 of the Potash Project.
- **Product Quality**: The potash at the mine is a high-quality product that would be produced in a desirable granular form with the ability to upgrade quality to industrial-use standards to attract additional demand at a higher margin in the premium potash market.

The market sounding activities conducted to date have indicated industry partner interest based on the above factors and others. Although interest is limited in terms of number of players, it is indicative that there is additional potential with an aggressive and well-structured marketing effort.

Offsetting the strategic advantages noted above are the current unfavorable market conditions including current potash prices, low interest level from financial institutions, and limited capacity from the current shareholder group and the majority shareholder of Karnalyte to finance the Potash Project. Such unfavourable conditions could be overcome by attracting another strategic partner with a strong presence in the industry and a long-term development vision.

The Board and management are actively assessing the recommendations in the Report to continue efforts to seek out and attract a major industry partner with a sound financial position and long-term strategic vision to produce and deliver this high-quality potash product to North American and global markets. These partnership options could include any or a combination of an equity offering with which to build out the Potash Project, royalty financing, debt financing, long-term off-take arrangement or other strategies. Discussions with a number of potential partners continue.

IMPROVING KARNALYTE'S FINANCIAL POSITION

The Strategic Review Report also recommended that the Board and management transition Karnalyte to a low-cost operation by developing and implementing a minimum cash flow budget to preserve available cash for investment in seeking out a strategic industry partner. Specifically, the report recommended that Karnalyte investigate alternative sources of funding to extend the operational runway, monetize existing assets to preserve a financial and liquidity foundation and maintain the minimum requirements to sustain an exchange listing.

In response to these recommendations, management intends to investigate alternative sources of funding, divest certain assets not essential to the Potash Project, reduce general and administrative expenses and potentially move Karnalyte to the TSX Venture Exchange to reduce the higher regulatory and cost burdens on the TSX. During the second quarter of 2021, some restructuring was implemented in order to reduce general and administrative expenses. During the third quarter, the Company intends to downsize its office space requirements at its corporate headquarters by moving to a virtual corporate office model in order to maximize cost savings.

CORPORATE & GOVERNANCE MATTERS

The Board remains committed to good governance practices. In light of the opportunities and risks facing the Company, and in the interests of strengthening the Board and improving its independence, the Board decided to expand its composition to a board of five (5) directors. In doing so, the Board assessed the competencies, skills and personal qualities it requires in directors in order to provide the Board with the best opportunity to advance Karnalyte's projects to the next stage of development. After an extensive recruiting process, management nominated two additional directors in the Company's information circular dated May 31, 2021. At Karnalyte's annual general meeting on June 29, 2021, the shareholders elected these additional directors to the Board.

Derek Hoffman is a corporate/commercial lawyer with the Hoffman Group advising public and private entities in a range of industries including mining, energy, agriculture and technology. Derek brings significant mining experience to the board having previously served as a Partner and Leader of the Mining Group at Miller Thompson LLP, a leading Canadian law firm, and also as in-house counsel for the global mining company BHP where he advised on a broad range of matters involving mineral exploration, strategic transactions and mine and associated infrastructure development and construction.

Dilip V. Pathakjee, nominee of GSFC, is the Senior Vice President of Materials Management at GSFC. Mr. Pathakjee has over 30 years of experience in operations research and development, finance, marketing, materials management, and management of foreign projects. During the past 5 years Mr. Pathakjee has held other senior roles at GSFC including Vice President (Finance) and Senior Vice President (Finance). Mr. Pathakjee holds a master's degree in chemical engineering, a master's degree in business administration, a post-graduate diploma in treasury and risk management and a diploma in industrial psychology.

OUTLOOK FOR 2021

During the third quarter of 2021, the Company will continue discussions with potential strategic partners for both the Potash Project and the Nitrogen Project. The Company will continue to assess the analysis and recommendations of the Strategic Review Report and will continue to implement cost saving measures in order to preserve the Company's available cash.

RESULTS OF OPERATIONS

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative (**"G&A"**) costs for the six-month period ended June 30, 2021 amounted to $1,070,000 which is an increase of $378,000 from the comparative 2020 amount.

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

	G&A Expenditures (CAD $ thousands)			
	Three months ended June 30,		**Six months ended June 30,**	
	2021	**2020**	**2021**	**2020**
Salaries, wages and benefits	85	83	170	165
Business development, investor relations, regulatory fees	18	12	54	55
Accounting and legal	98	84	326	141
Consulting	90	29	194	66
Directors Fees	57	49	98	99
Office and general	131	83	228	166
Total general and administrative	479	340	1,070	692

Salaries, wages and benefits for the six-month period ended June 30, 2021 were $170,000 compared to $165,000 in 2020 which is an increase of $5,000. Salaries, wages and benefits slightly increased as one employee transitioned from part time to full time in the fall of 2020 and another employee transitioned from full time to part time in January 2021. At the end of the second quarter of 2021, the Company implemented some restructuring, the resulting cost savings of which will be reflected in future quarters.

Business development, investor relations and regulatory fees for the six-month period ended June 30, 2021 amounted to $54,000 compared to $55,000 in the 2020 comparative period, which is a decrease of $1,000. As expected, expenses in this category in the first two quarters of 2021 are comparable to those incurred in the first two quarters of 2020.

Accounting and legal expenses for the six-month period ended June 30, 2021 were $326,000 compared to $141,000 in the comparative period which is an increase of $185,000. Accounting and legal expenses increased significantly due to an increase in legal activities related to the receipt of an originating application and a statement of claim in the first quarter of 2021.

In the first quarter of 2021, the Company received an originating application filed by Messrs. Peter Matson and Gregory George Szabo against the Company. The applicants are seeking a declaration that the Company oppressed its shareholders; the removal of all current directors; fixing the size of the Company's board at six; appointing Messrs. Joe Vidal, Neil Yelland, Joe Clavelle, Todd Rowan, and two GSFC nominees; reimbursing all costs incurred by the applicants and Mr. Mark Zachanowich in connection with requisitioning the special meeting of shareholders held on December 15, 2020; and damages in the amount of $3.25 million. The Company has filed a claim for insurance coverage under its directors and officers insurance policy for this matter, which is subject to certain limits and a $50,000 deductible per claim. The Company is working with its legal counsel and insurer to respond to the application.

In the first quarter of 2021, the Company received a statement of claim filed by Mr. Dan Brown against the Company, Frank Wheatley, Mark Zachanowich, Peter Matson, Todd Rowan, Gregory Szabo, Sanjeev Varma and Vishvesh Nanavaty. Mr. Brown is seeking a declaration that certain statements made by the Defendants' about the Plaintiff are false and defamatory; a written apology; a declaration that the defendants have harassed, intimidated, and threatened the Plaintiff; damages in the amount of $180,000 for breach of contract; general damages of $500,000; punitive, exemplary and aggravated damages of $200,000; that the defendants pay Mr. Brown for those monies paid by Mr. Brown for his shares in the Company; and an award of special damages, past and future loss of income, and cost of future care. The Company has filed a claim for insurance coverage under its directors and officers insurance policy for this matter, which is subject to certain limits and a $50,000 deductible per claim. The Company is working with its legal counsel and insurer to defend the claim.

Consulting expenses for the six-month period ended June 30, 2021 amounted to $194,000 compared to $66,000 in the 2020 comparative period, which is an increase of $128,000. In the first two quarters of 2020, consulting expenses mostly related to consulting fees paid to former director Todd Rowan. In 2021, the expenses in this category related to the strategic review initiated with MNP. Further expenses are expected to be incurred in relation to this project in 2021. The Company has entered into a consulting contract with the interim CFO, resulting in additional consulting expenses in this category when compared to the same period in the prior year.

Director fees for the six-month period ended June 30, 2021 amounted to $98,000 compared to $99,000 for the 2020 comparative period. As discussed in this MD&A, the directors have been expanded from three in the first two quarters of 2021 to five effective June 29, 2021 in order to strengthen the Board's independence and assist with the opportunities and risks facing the Company. The addition of two directors will increase future expenditures in this category.

Office and general expenses for the six-month period ended June 30, 2021 amounted to $228,000 compared to $166,000 for the comparative period representing an increase of $62,000. The majority of this increase is due to a significant increase in premiums for the Company's directors and officers insurance policy.

OTHER COSTS IMPACTING COMPREHENSIVE LOSS

Depreciation for the six-month period ended June 30, 2021 was $33,000 compared to $33,000 in the 2020 comparative period. Expenses in this category were comparable to the prior period as expected.

Share-based compensation expense for the six-month period ended June 30, 2021 was $16,000 compared to $6,000 in the 2020 comparative period. Share-based compensation expenses in the first two quarters of 2020 related to the granting of 850,000 stock options to officers and employees in June 2018. In the first two quarters of 2021, share-based compensation expenses related to the 460,000 stock options granted in July 2020. All of the other options have either expired, been forfeited, been cancelled or are fully amortized. These expenses are all non-cash in nature and stock options are expensed over a two-year vesting period using a declining balance method.

Restructuring costs for the six-month period ended June 30, 2021 were $124,000 compared to $63,000 in the 2020 comparative period representing an increase of $61,000. In the second quarter of 2021, an accrual of $124,000 was made to account for the costs of restructuring that took place during the quarter. The expenses recorded in the second quarter of 2020 related to the revised estimate for restructuring that took place in 2019. In the fourth quarter of 2019, the Company received a statement of claim filed at the Court of Queen's Bench of Saskatchewan by Frank Wheatley, the Company's former Chief Executive Officer, in the amount of $450,000. Mr. Wheatley's claim is for an alleged breach of contract, wrongful dismissal, egregious conduct on termination, and defamation relating to the termination of his employment on September 11, 2019. The Company has denied Mr. Wheatley's allegations and filed a statement of defence and had recorded an estimate of all amounts payable to Mr. Wheatley under his contract. In 2019, the Company estimated and accrued $233,000 as owing to Mr. Wheatley of which approximately $15,000 has been paid. In the second quarter of 2020, this estimate was revised based on mediation discussions and an additional $63,000 was accrued. Actual amounts may vary from amounts estimated.

Impairment expenses for the six-month period ended June 30, 2021 were $315,000 compared to the period ending June 30, 2020 of $468,000. In 2014, previous management determined assets with a carrying amount of $63,165,000 were no longer recoverable. At June 30, 2021, the Company determined that those impairment indicators continue to impact recoverability. The Company and the industry as a whole continue to face significant headwinds including depressed pricing on international potash contracts. Therefore, incremental expenditures of $315,000 incurred on intangible and mine development assets in the first two quarters of 2021 were determined not to impact the previously determined recoverable amount. For additional information, refer to the notes to the financial statements dated December 31, 2015 available on SEDAR at www.sedar.com.

Net finance income for the six-month period ended June 30, 2021 was $nil compared to $21,000 in the 2020 comparative period. The amounts recorded as net finance income are mostly the result of the amount of cash and cash equivalents that the Company is holding at a given time and the corresponding interest income the cash and cash equivalents generate. Interest income decreased by $28,000 in the first two quarters of 2021 compared to the first two quarters of 2020 as a result of the Company's declining cash balance and lower interest rates. This interest income decrease was slightly offset by a $7,000 decrease in foreign exchange loss relating to the Canadian dollar relative to the US dollar.

SUMMARY OF QUARTERLY RESULTS

The following table provides selected financial information of the Company for each of the last eight quarters ended at June 30, 2021:

Selected Quarterly Results

	2021		2020				2019	
	Jun 30	**Mar 31**	**Dec 31**	**Sep 30**	**Jun 30**	**Mar 31**	**Dec 31**	**Sep 30**
Total revenue	-	-	-	-	-	-	-	-
Comprehensive (loss)	(839)	(577)	(1,290)	(914)	(742)	(483)	(312)	(907)
Basic and diluted loss per share	(0.02)	(0.01)	(0.03)	(0.02)	(0.02)	(0.01)	(0.01)	(0.02)
Total current assets	3,388	4,177	5,291	6,444	6,944	7,647	8,064	8,690
Total assets	9,305	10,110	11,241	12,198	12,722	13,442	13,875	14,517
Total liabilities	2,774	2,748	3,311	2,992	2,615	2,595	2,549	2,892
Total shareholders' equity	6,531	7,362	7,930	9,206	10,107	10,847	11,326	11,625

*Expressed in thousands except loss per share

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

The restructuring costs estimated and accrued for in the third quarter of 2019 had a negative impact on the comprehensive loss recorded in this period. The fourth quarter of 2019 was positively impacted by a reduction in salaries, a reduction in legal expenses, a reduction in travel expenses, a reduction in restructuring expenses, the receipt of land rental income and the recovery recorded as a result of a change in estimate to the Company's decommissioning liability. The first two quarters of 2020 were positively impacted by a reduction in salaries, legal expenses and travel expenses as compared to the comparative quarters of 2019; however, they were negatively impacted by the accrual of additional restructuring expenses in the second quarter of 2020, the timing of the receipt of land rental income and a change in estimate to the Company's decommissioning liability resulting in a much less significant recovery as compared to the fourth quarter of 2019. In the third quarter of 2020, a continued reduction of salaries and travel expenses as compared to the comparative prior year quarters was offset by increased legal expenses and consulting expenses, as compared to the first two quarters of 2020. The fourth quarter of 2020 was negatively impacted by an increase in legal expenses, investor relations and consulting fees largely due to the December 15, 2020 special meeting, as well as increased accounting fees relating to the year end audit. These negative impacts were slightly offset by the receipt of land rental income in the fourth quarter of 2020. The first quarter of 2021 was negatively impacted by legal, accounting and consulting expenses as compared to the first quarter of 2020. In the second quarter of 2021, consulting, office and general and restructuring expenses negatively impacted comprehensive loss as compared to the second quarter of 2020.

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

Current assets principally reflect activity in the cash and cash equivalents account. Cash outlays vary over the quarters depending on the Company's activities.

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 Potash Project forward. Total assets remained relatively constant for most of the periods above.

Total liabilities for the periods relate primarily to trade and other payables. These balances vary in the analysis due to the timing of the payments required relative to the work performed in bringing the Potash Project to its current level. Balances in all the quarters presented include the accrual of an estimate of the costs of restructuring that took place in the second and third quarters of 2017. The second and third quarters of 2019 were impacted by a significant increase in the decommissioning liability recorded due to a change in the estimate of this liability made during the fourth quarter of 2018. Also, the third and fourth quarters of 2019 and the first two quarters of 2020 include the accrual of the costs estimated for the restructuring that took place in the third quarter of 2019. The increase in the third quarter of 2020 relates to consulting fees for the strategic review initiated with MNP, as well as, in the third and fourth quarters of 2020 increased legal, consulting and investor relation activities in response to the receipt of the requisition of a special meeting by the dissident shareholder group. Balances in the first quarter of 2021 decreased as compared to the fourth quarter of 2020 as the 2018 originating application was fully resolved and awarded costs were paid, which was partially offset with increased liabilities resulting from the 2021 originating application and statement of claim filed against the Company. Balances in the second quarter of 2021 increased slightly due to the restructuring that took place during the quarter.

Total shareholders' equity is impacted by the quarterly comprehensive losses and the share-based compensation expense as the number of shares outstanding remains unchanged.

INVESTING

The Company capitalizes costs that are determined to provide future benefits and charges other costs to comprehensive loss including salaries, support and office costs, community relations programs and other administrative related expenditures. Costs directly related to capital assets are capitalized to appropriate categories and depreciated over their useful lives.

Expenditures to date were focused on the completion of the Company's resource reports, including updating the Company's prior technical reports, and 2013 environmental impact statement, confirming the resources and reserves through drilling wells on the initial focus area and preparing the Company for construction by advancing detailed engineering and completing initial site preparation.

INTANGIBLE ASSETS

During the six-month period ended June 30, 2021, $315,000 in additions to intangible assets were impaired. The additions to intangible assets all related to the Potash Project. The net balances classified as intangible assets are as follows:

Intangible Assets
(CAD $ thousands)

	June 30, 2021	December 31, 2020
Mineral property		
Surface land	4,804	4,804
Drilling	453	453
Balance, end of period	5,257	5,257

CAPITAL ASSETS

The net balances classified as capital assets are as follows:

Capital Assets
(CAD $ thousands)

	June 30, 2021	December 31, 2020
Machinery and equipment	8	15
Buildings	124	129
Land	125	125
Land improvements	22	23
Vehicles	-	-
Furniture and equipment	-	-
Computer hardware	-	1
Right of use asset	6	25
Assets under construction	-	-
Balance, end of period	285	318

There were no additions to capital assets in the first two quarters of 2021. The decrease in capital assets is a result of depreciation expenses of $33,000 recognized during the first two quarters of 2021.

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

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2021, the Company had net working capital of $2.3 million compared to $6.1 million at June 30, 2020 including $2.8 million and $6.4 million, respectively, in cash and cash equivalents.

As at June 30, 2021 and 2020, the Company also had $0.4 million in restricted cash that was set up as a requirement from the Government of Saskatchewan with respect to reclamation obligations regarding the Potash Project. The Company has updated its reclamation program for the Potash Project in accordance with Government of Saskatchewan regulations. This update may result in the requirement to increase the amount held as restricted cash in order to satisfy the financial assurance requirements of the Government of Saskatchewan in future periods.

The Company maintains cash in bank accounts for day to day operations and invests the excess in overnight financial instruments in high interest saving accounts that are highly liquid.

The Company expects to have adequate cash to meet its existing commitments as well as to meet short-term operating and capital requirements but does not currently have adequate funds to proceed with full-scale development of the solution mining facility. The Company is pursuing the sale of non-strategic assets and considering strategic alternatives as the ability of the Company to continue as a going concern will require further equity issuances or other forms of financings.

CONTRACTUAL OBLIGATIONS

The following table summarizes the commitments of the Company as at June 30, 2021:

Contractual Obligations
(CAD $ thousands)

	Payments due by period				
	Total	**Less than one year**	**Two - three years**	**Four - five years**	**More than five years**
Trade and other payables	1,068	1,068	-	-	-
Leases on mineral property	5,170	68	735	735	3,632
Project contracts	23	23	-	-	-
Total	6,261	1,159	735	735	3,632

Trade and other payables relate to operating and investing expenditures that were payable at the period ended June 30, 2021.

Leases on mineral property refer to the annual fees which are required to maintain the mineral leases related to the Potash Project. The Potash Project comprises three mineral leases. KLSA 010 has a term of 21 years and expires on September 7, 2031. KL246 and KL247A also have terms of 21 years and both expire on April 24, 2037. The Company is required to pay annual lease payments of $10.00 per hectare on any area held under lease for the term of the lease for a total cost of $368,900 per year. The Company is also required to expend not less than $3,000,000 for work during the first three years of the term of the lease. Expenditures made to date on the property have satisfied this requirement.

Project contracts are in place for various investor relations and consulting services.

RELATED PARTY TRANSACTIONS

The Company entered into a consulting agreement with GSFC, the Company's largest shareholder and strategic partner, to assist with the evaluation of the Nitrogen Project and to further the Company's engineering activities respecting the Potash Project. During the first two quarters of 2021, $nil expenses were incurred under this agreement. There are no firm commitments of spending under the agreement. GSFC is a 38.7% shareholder of the Company.

There were no material changes to management compensation arrangements and no other related party transactions for the six months ended June 30, 2021.

RESTRICTIONS ON DISPOSITION OF THE POTASH PROJECT

Pursuant to the terms of the subscription agreement (the **"Subscription Agreement"**) and the offtake agreement (the **"Offtake Agreement"**) between the Company and GSFC, each dated January 10, 2013, the Company must not divest, sell, assign, transfer or otherwise dispose of any part of its interests in the Potash Project without the prior written consent of GSFC until the third anniversary of the date on which the first shipment for delivery of products is dispatched by the Company in accordance with the terms of the Offtake Agreement (the "**Project Lock In Period**"). After the expiry of the Project Lock In Period, a person may acquire an interest in the Potash Project subject to GSFC's right to terminate the Offtake Agreement at that time. The Subscription Agreement provides that, subject to certain conditions, the above-described restrictions on disposition do not apply to a creation or grant of a security interest to a lender providing financing for the Potash Project (including for an expansion thereof). The Offtake Agreement provides that following the expiry of the Project Lock In Period, the Company may dispose of any part of the Potash Project that is not part of the Company's subsurface mineral lease KLSA 010 or that is not intended or reasonably required for the three phases of the Potash Project.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with International Financial Reporting Standards **("IFRS")** requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amount of assets, liabilities, income and expenses. The Company evaluates judgments and estimates periodically 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 judgment and estimation with the Audit Committee and independent auditors. Significant areas requiring judgment and estimates include:

STAGE OF DEVELOPMENT

The Company is in the development stage of its history and at this stage of the Company's growth, it is subject to the risks associated with early stage companies, including uncertainty of future revenues, developing acceptable markets and growth into established markets, profitability and the need to raise additional financing to continue to progress its Potash Project.

Continued exploration and development of the property is dependent on the Company's ability to obtain necessary financing. As the Company is not currently producing from its property, it will be necessary for the Company to seek additional equity or debt to finance its programs.

INTANGIBLE ASSETS AND PROPERTY, PLANT AND EQUIPMENT

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

Assets under construction, machinery and equipment, buildings, vehicles, furniture, land improvements and leasehold improvements are recorded at cost. Capital assets are depreciated over their estimated useful lives.

The Company reviews exploration and evaluation assets, capital assets and other non-financial assets for indicators of impairment at each reporting period. Impairment indicators are used to determine whether carrying values of assets should be assessed for impairment or whether a reversal of impairment may be required.

Internal and external indicators of impairment for capital and other non-financial assets are considered, including significant changes in the extent or manner in which an asset is expected to be used. The use of a significant portion of the Company's capital assets is related to exploration and evaluation activity.

Indicators of impairment for exploration and evaluation assets include the period for which the Company has the right to explore, expected renewals of exploration rights, whether substantive exploration and evaluation expenditures on mineral properties are budgeted, and results of exploration and evaluation activities on the exploration and evaluation assets. Management also considers whether sufficient data exists to indicate that the carrying amount of capital assets and exploration and evaluation and other assets is unlikely to be recovered in full from successful development or by sale.

In measuring impairment, estimates of future cash flows require assumptions about future business conditions and other developments. Significant, unanticipated changes to these assumptions could require a provision for impairment in the future.

DECOMMISSIONING PROVISIONS

Amounts are recorded for decommissioning provisions that will be incurred by the Company at the end of the operating life of the facilities and properties, and upon retirement of its mining assets. Estimates of these costs are subject to uncertainty associated with the method, timing and extent of future decommissioning activities. The provision and related asset and expense are impacted by estimates with respect to the costs and timing of decommissioning.

SHARE-BASED PAYMENTS

The Company has share-based payments expenses for stock option awards to employees, 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.

CONTINGENT LIABILITIES

Contingent liabilities are reviewed continuously to assess whether an outflow of cash has become probable. If the recognition criteria are met, then a provision is recorded in the period in which the change in probability occurs. Assessing whether a contingent liability is probable requires the Company to make judgments about the existence of past events and the application of applicable laws, contractual or constructive obligations.

FINANCIAL RISK FACTORS

CREDIT RISK

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its commercial obligations. The Company has no significant concentration of credit risk arising from operations. The Company's cash and restricted cash is held with large Canadian financial institutions and management believes the risk of loss to be remote.

LIQUIDITY RISK AND GOING CONCERN

The Company manages liquidity risk by maintaining sufficient cash balances to meet liabilities when due. As at June 30, 2021, the Company had cash totalling $2,764,000 (2020 – $6,416,000) to settle current liabilities of $1,080,000 (2020 - $819,000). As at June 30, 2021 and June 30, 2020, the Company's trade and other receivables were all considered current and are subject to normal trade terms.

Management is aware of material uncertainties related to events and conditions that may cast significant doubt upon the Company's ability to continue as a going concern. The Company is in its pre-development phase and therefore there is no certainty that the Company will be able to raise additional funds to move forward to the production phase. There is also uncertainty with respect to various legal matters. In addition to operating expenses, the Company is committed to expenditures in 2021 on its mineral properties to keep the Company in good standing. The Company expects to have adequate cash to meet its existing commitments as well as to meet short-term operating and capital requirements but does not currently have adequate funds to proceed with full-scale development of the solution mining facility. The Company is pursuing the sale of non-strategic assets and considering strategic alternatives as the ability of the Company to continue as a going concern will require further equity issuances or other forms of financings. On March 11, 2020 the COVID-19 outbreak was declared a pandemic by the World Health Organization. The situation is dynamic and the ultimate duration and magnitude of the impact on the economy and capital markets is not known at this time. There is no assurance that the Company will be successful in obtaining required funding at an acceptable cost as and when needed or at all. Failure to obtain additional funding on a timely basis may cause the Company to postpone development plans, forfeit rights in its properties or reduce or terminate its operations.

The financial statements do not include any adjustments to carrying values of asset amounts and liabilities, or reported expenses that may be necessary if the going concern assumption were not appropriate.

MARKET RISK

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market. The Company's future potash sales are exposed to price risk with respect to North American and international potash prices.

CURRENCY RISK

The Company's functional currency is the Canadian dollar with the majority of transactions denominated in Canadian dollars. At this time management believes the foreign exchange risk derived from currency conversions is not significant and therefore does not hedge its foreign exchange risk. At June 30, 2021, the Company held the majority of its cash in Canadian dollars.

INTEREST RATE RISK

The Company's trade and other payables are non-interest bearing and have contractual maturities of less than 45 days. As at June 30, 2021, the Company's only interest bearing asset is cash in high interest saving accounts and a small amount of cash equivalents held in Guaranteed Investment Certificates. Cash and cash equivalents earn interest at prevailing short-term interest rates. During the six-month period ended June 30, 2021, the Company earned interest income of $11,000 (2020 - $39,000) from its cash and cash equivalents.

INTERNAL CONTROLS

DISCLOSURE CONTROLS AND PROCEDURES

The Company has established disclosure controls and procedures for the timely and accurate preparation of financial and other reports. Such disclosure controls and procedures are designed to provide reasonable assurance that material information required to be disclosed is recorded, processed, summarized and reported within the periods specified by applicable securities regulations. In addition, the disclosure controls ensure that information required to be disclosed is accumulated and communicated to the appropriate members of management and properly reflected in the Company's continuous disclosure filings.

As with most small or developing companies and consistent with the concept of reasonable assurance, the Company recognizes that the relative cost of maintaining these disclosure controls and procedures should not exceed their expected benefits. As a result, the Company's disclosure controls and procedures can only provide reasonable assurance, and not absolute assurance, that the objectives of such controls and procedures are met.

The Interim Chief Executive Officer and Interim Chief Financial Officer are responsible for evaluating the disclosure controls and procedures. They have concluded that the design and operation of these disclosure controls and procedures were not effective due to the existence of material weaknesses in the internal controls over financial reporting noted in the following section.

The Company mitigates these weaknesses by using external consultants as appropriate; however, such mitigating procedures do not constitute compensating controls for the purposes of National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings (**"NI 52-109"**).

INTERNAL CONTROLS OVER FINANCIAL REPORTING (ICFR)

The Interim Chief Executive Officer and Interim Chief Financial Officer of the Company are responsible for designing and ensuring the operating effectiveness of internal controls over financial reporting. They are also responsible for causing the internal controls to be designed and operated effectively under their supervision. They are intended to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. It is management's belief that any control system, no matter how well conceived or operated, can provide only reasonable, but not absolute, assurance that the objectives of the control system are met. An internal control system cannot prevent all errors or fraud.

The Company does not have adequate in-house personnel to properly implement segregation of duties with respect to complex accounting and non-routine transactions that may arise and also to prevent and monitor the potential for management override. It is not deemed economically feasible at this time to have such personnel. The volume of transactions and reporting requirements puts significant strain on the limited accounting personnel such that the Company relies on external experts and assistance to complete these activities on time.

These material weaknesses may increase the risk of material misstatements in the financial statements; the Company mitigates these weaknesses by using external consultants as appropriate; however, such mitigating procedures do not constitute compensating controls for the purposes of NI 52-109.

OFF BALANCE SHEET ARRANGEMENTS

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

OUTSTANDING SHARES

As of the date of this MD&A, the Company has 42,174,847 Common Shares and 935,000 stock options issued and outstanding.

FORWARD-LOOKING INFORMATION

Certain statements in this MD&A may constitute "forward-looking" statements which involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking information is often, but not always, identified by the use of words such as "anticipate", "believe", "could", "estimate", "expect", "plan", "intend", "forecast", "future", "guidance", "may", "predict", "project", "should", "strategy", "target", "will" or the negative or similar words or phrases suggesting future outcomes or language suggesting an outlook.

Forward-looking statements may include, but are not limited to, management's expectations, intentions, and beliefs concerning: the development and operation of the Potash Project or the Nitrogen Project; future extraction and exploitation of mineral deposits; capital expenditure requirements; future commodity prices; expectations regarding prices and costs; expectations regarding the Company's ability to obtain additional financing necessary to develop the Potash Project or the Nitrogen Project; expectations regarding the production capacity of the Potash Project and the Nitrogen Project; expectations regarding markets for potash in North America and globally; expectations regarding markets for nitrogen fertilizer products; expectations regarding the distinction between standard-grade and high-grade potash; expectations regarding markets for magnesium; the effectiveness of the Company's anticipated solution mining methods; expenditures to be made by the Company to meet certain work commitments; work plans to be conducted by the Company; reclamation and rehabilitation obligation and liabilities; treatment under governmental regulatory regimes with respect to environmental matters; treatment under governmental taxation regimes; impact of foreign governments and regulation on the Company's operations; future development of infrastructure; government regulation of mining operations; dependence on key personnel; and competitive conditions.

Forward-looking statements in this MD&A include statements regarding: the Company's ability to commence and increase production from 625,000 TPY, to 1.375 million TPY, and thereafter to 2.125 million TPY of potash; the production of potash, nitrogen fertilizer products, or magnesium; the costs related to the operation of the plant and facilities will be consistent with other solution mining operations subject to differences in the Company's mineral body and processing; the implementation and ongoing use of solution mining process; further seismic exploration and drilling; global fertilizer demand and consumption; capital expenditure and operational expenditure estimates; anticipated results of development and extraction activities and estimated future developments; the Company's ability to produce sufficient potash to meet its obligations under the Offtake Agreement; the Company's ability to obtain additional financing on satisfactory terms; the market prices for potash, nitrogen fertilizer products, and magnesium; the Company's ability to pump the waste underground to eliminate surface salt tail piles; the Company's ability to economically extract and process mineralized material into potash; and the improvements that the Company has developed for the solution mining process are as effective as expected by the Company.

Such forward-looking statements are based on a number of material factors and assumptions, including: the stabilization of the global potash industry and market; the Company obtains additional financing in the future; the Company executes its project development plans in a manner consistent with the Company's technical report filed on July 15, 2016 (the "**2016 Technical Report**"); the Company executes its discounted cash flow model assumptions as described in the 2016 Technical Report; estimates of mineral resources and mineral reserves in the 2016 Technical Report are accurate; full potash production is reached; that the Company continues to have rights to the property subject to subsurface mineral leases KL 246, KL 247A and KLSA 010, and such rights are not challenged or impacted in any material manner; that the Company is able to obtain required approvals, licences and permits, in a timely manner; the Company is able to successfully develop and market nitrogen fertilizer products; the Company is able to successfully develop and market magnesium products; the Company's key senior management continue in their respective roles with the Company; the Company's intellectual property is not challenged; the Company does not become subject to litigation; the Company's ability to meet its obligations under the Offtake Agreement; environmental and other applicable law and other regulations are not amended, repealed or applied in a manner that impacts the development and operation of the Potash Project or the Nitrogen Project as currently anticipated; there are no adverse changes to the price of potash, nitrogen fertilizer products, or magnesium that would adversely affect the prospects for developing and operating the Potash Project or the Nitrogen Project, or making it inadvisable or uneconomic to proceed with development; the future mining operations operate as anticipated; the Company's ability to maintain and develop positive relationships with foreign governments and future business partners; the Company is able to develop and maintain the infrastructure required to export, store and transport its potash, nitrogen fertilizers, or magnesium production; there are no comparable mining companies targeting carnallite in North America; and the continued existence and operation of the primary potash production facility.

Forward-looking statements involve significant risks and uncertainties, should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not such results will be achieved. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under "Financial Risk Factors" elsewhere in this MD&A and the following factors, which are discussed in greater detail under the "Risk Factors" section of the Annual Information Form: exploration, development and operation risks related to the Potash Project and the Nitrogen Project; the ability to secure adequate financing to implement the Company's strategic and development objectives; the ability to maintain adequate capital to meet the Company's financial commitments; the successful execution of the Company's project plans; the uncertainty regarding the estimation of mineral resources and mineral reserves in the 2016 Technical Report; the lack of current revenues and uncertainty about future revenues; the risks associated with the limited operating history of the Company; the lack of developed markets for the Company's magnesium products; the unproven nature of solution mining of carnallite in Saskatchewan; no assurance of titles, leases, or maintenance of existing permits; permit and licensing requirements related to exploration and development activities; the Company's ability to satisfy its material agreements, including the Offtake Agreement; the risks associated with the enforcement of the Company's material agreements, including the Offtake Agreement; the potential loss of key employees, technical experts or key suppliers; the potential for a volatile market for the Common Shares of the Company; the potential dilution of shareholders through future financings; failure to protect the Company's intellectual property rights; litigation and tax matters; adequacy of the Company's insurance coverage; adequacy of the Company's internal controls over financial reporting; environmental and regulatory risks; the volatility of potash and magnesium prices; the cyclical nature of the potash and magnesium industries; availability and cost of labour and materials required for the construction of Phase I; competition; and currency exchange rate fluctuations.

Although the forward-looking statements contained in this MD&A are based upon what management of the Company believes are reasonable assumptions, the Company cannot assure investors that actual results will be consistent with these forward-looking statements. These forward-looking statements are made as of the date of this MD&A and are expressly qualified in their entirety by this cautionary statement. Subject to applicable securities laws, the Company assumes no obligation to update or revise them to reflect new events or circumstances.

Further information about the factors affecting forward-looking statements is available in Karnalyte's Annual Information Form and the audited annual financial statements for the year ended December 31, 2020, which have been filed with Canadian provincial securities commissions and are available on SEDAR at www.sedar.com.