MANAGEMENT'S DISCUSSION AND ANALYSIS

For the year ended December 31, 2019

KARNALYTE.COM
TSX: KRN

Karnalyte RESOURCES

TABLE OF CONTENTS

MANAGEMENT’S DISCUSSION AND ANALYSIS

This Management’s Discussion and Analysis (**“MD&A”)** is intended to provide a summary of the operational and financial results of Karnalyte Resources Inc. (**“Karnalyte”** or the **“Company”)** for the year ended December 31, 2019 and 2018. This MD&A should be read in conjunction with the audited financial statements of the Company and the related notes thereto for the year ended December 31, 2019. This commentary is dated March 20, 2020. The financial statements have been prepared in accordance with International Financial Reporting Standards (“**IFRS**”). These documents, the annual information form dated March 20, 2020 (the “**Annual Information Form**”), and additional information about the Company are available on SEDAR at www.sedar.com. Some of the statements made herein contain forward-looking information and accordingly please refer to the “Forward-Looking Information” section at the end of the MD&A.

OVERVIEW

GENERAL OVERVIEW

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

2019 – YEAR IN REVIEW

In 2019, Karnalyte continued to make progress in investigating the economic and technical viability of its proposed nitrogen project (the “**Proteos Nitrogen Project**”). Karnalyte also continued to prepare the Wynyard Potash Project for improvement in market conditions such that when the Wynyard Potash Project becomes economically viable, it could be advanced to the next development stage.

POTASH – THE WYNYARD POTASH PROJECT

In 2019, the Company continued its process of optimizing capital costs for the Wynyard Potash Project in order to position the Company to advance the development of this project when it becomes economically feasible to do so. The Company is optimistic about the long-term outlook for potash and this was supported by increases in potash prices through the first three quarters of 2019. Furthermore, global potash demand continues to grow and is projected to rebound in 2020 to around 66.6 million metric tonnes with projections to grow to 80 million metric tonnes by 2030. However, the Company has been maintaining caution as the industry continues to face headwinds with major potash mines in Saskatchewan shuttering production during the third and fourth quarters of 2019 and some into the first quarter of 2020 in order to bolster prices after forecasted North American demand in the fourth quarter of 2019 didn’t materialize due to a delayed harvest season. More recently, the uncertainty around the impact of the global coronavirus pandemic on the economy and capital markets has deepened the Company’s sense of caution. The Company continues to monitor potash prices, the state of the capital markets and the economy generally and continues to discuss with its strategic partner Gujarat State Fertilizers & Chemicals Limited (“**GSFC**”) the optimal path forward to develop the Wynyard Potash Project.

NITROGEN – THE PROTEOS NITROGEN PROJECT

The Proteos Nitrogen Project is a compelling part of Karnalyte's future and diversifies our business by adding a second fertilizer product line. The Proteos Nitrogen Project is a proposed regional-scale nitrogen fertilizer plant to be located in central Saskatchewan, with a nameplate capacity of 700 metric tonnes per day ("**MTPD**") ammonia and 1,200 MTPD urea. Our primary target market is local, independent wholesalers within a ~400-kilometre radius of Saskatoon, with a secondary target market of Midwest USA wholesalers near the Canadian border.

Saskatchewan has a number of competitive advantages for nitrogen fertilizer production, including:

- Plentiful natural gas;
- Some of the lowest global natural gas prices;
- Higher urea usage rates;
- Premium pricing in local markets; and
- Proximity to local markets.

The Company believes its regional scale design will provide farmers with local supply, while at the same time allowing them to reduce transportation costs and associated risks. As with any industrial material, the ultimate consumers are always looking for local, alternate and independent sources of supply.

In 2019, progress on investigating the viability of the Proteos Nitrogen Project included the preparation of a pre-feasibility study for the Proteos Nitrogen Project. At the end of 2019, the Company received the first draft of the study. The study includes investigation and analysis of project location and site selection, an evaluation of the production process and technology options, a project description, analysis of process selection for both the ammonia and urea plants, an analysis of raw material, utility and product specifications, an analysis of environmental implications, a financial analysis, and identification and analysis of the risks inherent in the project. The study also contemplates a project implementation plan and time schedule. The Company hopes to finalize the report in 2020.

CORPORATE MATTERS

Director changes

In 2019, the Company appointed two new independent directors. On August 8th, 2019, the Company appointed Mr. D.C. Anjaria of Ahmedabad, India as an independent director. Mr. Anjaria brings a wealth of experience in international business, capital markets and financial risk management having worked with Citibank in India, Africa, the Middle East and Europe. Mr. Anjaria is also an independent director of GSFC.

On December 20th, 2019, the Company appointed Gerald Scherman of Saskatoon, Saskatchewan as an independent director. Mr. Scherman, a CPA, CA, is currently retired after more that 15 years with AREVA Resources Canada Inc., now Orano Canada Inc. ("**AREVA**"). He retired from AREVA as its Senior Vice President & Chief Financial Officer and a member of its Board of Directors. Prior to joining AREVA, Mr. Scherman was a partner with Coopers & Lybrand (now Pricewaterhouse Coopers LLP), a national accounting firm. Mr. Scherman brings to the board extensive experience in the mining sector.

Incumbent director Mr. W. Todd Rowan retired from the Board in December 2019.

Executive change
On September 11, 2019, the Company announced that Mr. Frank Wheatley, until then the Chief Executive Officer and former President of the Company, was no longer with the Company. As of the same date, the Company's Chief Financial Officer, Ms. Danielle Favreau, was appointed as Interim Chief Executive Officer.

OUTLOOK FOR 2020

The Company continues to move towards the development of the Wynyard Potash project as well as conclude some preliminary investigation of the viability of the Proteos Nitrogen Project. For the Wynyard Potash Project, the Company plans to continue to optimize the project costs with a view to re-activating the development of the project if an improving potash price environment results in the Wynyard Potash Project becoming economically viable and financeable.

For the Proteos Nitrogen Project, the Company plans to complete the pre-feasibility study for the project with a view towards making a decision on how to take the project forward including exploring and securing an offtake partner. The Company continues to have discussions with a number of agricultural industry participants who have shown interest in the project.

SELECTED ANNUAL INFORMATION

The information has been summarized from the Company's audited financial statements.

Selected annual results
(CAD $ thousands)

	Year ended December 31		
	2019	**2018**	**2017**
Total revenue	-	-	-
Interest and other income	183	122	114
Net and comprehensive loss	(3,090)	(6,018)	(3,395)
Basic and diluted per share	(0.07)	(0.21)	(0.12)
Total current assets	8,064	11,136	12,757
Total assets	13,875	16,921	18,602
Total current liabilities	870	901	691
Total liabilities	2,548	2,608	846
Total shareholders' equity	11,327	14,313	17,756

During the year ended December 31, 2019, the Company's focus was on continuing to investigate the technical and economic viability of developing the Proteos Nitrogen Project as discussed in the "Overview" section above while continuing to monitor the potash price environment such that when the Wynyard Potash Project becomes economically viable, it could be advanced to the next development stage.

During the comparative year ended December 31, 2018, the Company's focus was on the initial exploration of the economic and technical viability of the Proteos Nitrogen Project and on monitoring the potash price environment.

RESULTS OF OPERATIONS

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative ("**G&A**") costs for the year ended December 31, 2019 amounted to $2,320,000 which is a decrease of $1,442,000 from the comparative 2018 amount.

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

G&A Expenditures
(CAD $ thousands)

	Year ended December 31,	
	2019	**2018**
Salaries, wages and benefits	606	699
Business development, investor relations, regulatory fees	146	224
Accounting and legal	564	1,381
Consulting	235	381
Directors Fees	185	267
Office and general	584	538
Total general and administrative	2,320	3,490

Salaries, wages and benefits for the year ended December 31, 2019 were $606,000 compared to $699,000 in 2018 which is a decrease of $93,000. Salaries, wages and benefits decreased from 2018 to 2019 as the number of full time equivalent staff decreased by 2 from 2018 to 2019.

Business development, investor relations and regulatory fees for the year ended December 31, 2019 amounted to $146,000 compared to $224,000 for the year ended December 31, 2018, which is a decrease of $78,000. The decrease is due to the additional spending in 2018 to respond to a potential attempt to take control of Karnalyte and its Board of Directors. Spending in this category in 2019 consisted of recurring expenses incurred each year to conduct the Company's annual general meeting ("**AGM**") and expenses related to the development of a brand identity, brand collateral and website for the Company's new name "Alere Chemicals and Fertilizers Inc."

Accounting and legal expenses for the year ended December 31, 2019 were $564,000 compared to $1,381,000 in the comparative period which is a decrease of $817,000. The decrease in expenses in this category is due to a decrease in legal activities to respond to a potential attempt to take control of Karnalyte and its Board of Directors. In connection with these activities, the legal expenses were principally incurred by the Company during the year ended December 31, 2018. Expenses continued to be incurred through the first quarter of 2019 relating to the preparation of final documentation for the court hearing. On

February 18, 2020, the court decided that it was not prepared to provide the requested declarations sought by the Company. The Court found, however, that one of the shareholders published an improper proxy solicitation. The Company does not anticipate any further significant legal expenses to be incurred in relation to that court application.

Consulting expenses for the year ended December 31, 2019 amounted to $235,000 compared to $381,000 in the comparative 2018 period, which is a decrease of $146,000. The decrease is due to the engagement of a financial advisor in 2018 to assist the Company in assessing potential strategic alternatives for the Company. No such advisor was engaged in 2019. Additional consulting expenses were incurred in 2018 for the engagement of an executive search firm to assist in recruiting the Company's former Chief Executive Officer and for the engagement of Integer Research to undertake a first phase independent market study of the nitrogen fertilizer industry in North America. No such expenses were incurred in 2019. In 2019, consulting expenses mostly consisted of expenses incurred in relation to site selection for the Proteos Nitrogen Project and preparation of a pre-feasibility study for the Proteos Nitrogen Project.

Director fees for the year ended December 31, 2019 amounted to $185,000 compared to $267,000 for the 2018 comparative period. The decrease is due to the resignation of three directors in January 2019.

Office and general expenses for the year ended December 31, 2019 amounted to $584,000 compared to $538,000 for the comparative period representing an increase of $46,000. This increase is due to an increase in travel expenses in 2019.

OTHER COSTS IMPACTING COMPREHENSIVE LOSS

Depreciation and amortization for the year ended December 31, 2019 was $54,000 compared to $60,000 in the 2018 comparative period. Depreciation decreased over the year as certain assets have become fully depreciated.

Share-based compensation expense for the year ended December 31, 2019 was $104,000 compared to $305,000 in the 2018 comparative period. Share-based compensation expenses in 2018 related to the granting of stock options to officers and employees in December 2017 when 530,000 stock options were granted and to 1,150,000 options granted in June 2018. Share-based compensation expenses in 2019 related to the granting of stock options to officers and employees in December 2017 and June 2018 referred to above. These expenses are all non-cash in nature and stock options are expensed over a two year vesting period.

Restructuring costs for the year December 31, 2019 were $233,000 compared to $10,000 in the 2018 comparative period. Restructuring costs in 2018 related to the Company reaching a settlement with a former employee who filed a statement of claim at the Small Claims Court of Saskatchewan for alleged constructive dismissal resulting in a small restructuring expense. Restructuring costs incurred in 2019 were in the third quarter relating to the departure of one officer. As a result, the Company estimated and accrued $233,000 for the costs of this restructuring of which approximately $15,000 has been paid.

Impairment expenses for the year ended December 31, 2019 were $747,000 compared to the period ending December 31, 2018 of $2,079,000. In 2014, previous management determined assets with a carrying amount of $63,165,000 were no longer recoverable. At December 31, 2019, the Company determined that those impairment indicators continue to impact recoverability. The Company and the industry as a whole continue to face significant headwinds including depressed pricing on international potash contracts. Therefore, incremental expenditures incurred on intangible and mine development assets in 2019 of $747,000 were determined not to impact the previously determined recoverable amount.

Other income and expenses for the year ended December 31, 2019 were $218,000 compared to $104,000 in the 2018 comparative period. The major item making up this amount in both periods is rental income from the leasing out of some of the Company's land holdings to local area farmers. In 2019, there was also a $132,000 recovery recorded as a result of a change in estimate of the Company's decommissioning liability.

Net finance income for the year ended December 31, 2019 was $149,000 compared to net finance income of $94,000 in the 2018 comparative period. The amounts recorded as net finance income are mostly the result of the amount of cash the Company is holding at a given time and the corresponding interest income the cash generates. Interest income included in net finance income increased $61,000 from 2018 to 2019. This increase was offset by an increase in accretion expense which resulted from the change in estimate to the decommissioning liability.

SUMMARY OF QUARTERLY RESULTS

The following table provides selected financial information of the Company for each of the last eight quarters ended at December 31, 2019:

	2019				2018			
	Dec 31	**Sep 30**	**Jun 30**	**Mar 31**	**Dec 31**	**Sep 30**	**Jun 30**	**Mar 31**
Total revenue	-	-	-	-	-	-	-	-
Comprehensive (loss)	(311)	(907)	(967)	(905)	(2,719)	(1,339)	(1,215)	(745)
Basic and diluted loss per share	(0.01)	(0.02)	(0.03)	(0.03)	(0.06)	(0.05)	(0.04)	(0.03)
Total current assets	8,064	8,690	9,318	10,068	11,136	10,089	10,880	12,010
Total assets	13,875	14,517	15,162	15,843	16,921	15,885	16,692	17,839
Total liabilities	2,548	2,892	2,646	2,383	2,608	1,217	788	790
Total shareholders' equity	11,327	11,625	12,516	13,460	14,313	14,668	15,904	17,049

*Expressed in thousands except loss per share

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

The comprehensive losses in the second, third and fourth quarters of 2018 and the first two quarters of 2019 were negatively impacted by the legal and consulting expenses the Company incurred. The restructuring costs estimated and accrued for in the third quarter of 2019 had a negative impact on the comprehensive loss recorded in this period. The fourth quarter of 2019 was positively impacted by a reduction in salaries, a reduction in legal expenses, a reduction in travel expenses, a reduction in restructuring expenses, the receipt of land rental income and the recovery recorded as a result of a change in estimate to the Company's decommissioning liability

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

Total assets on a quarterly basis reflect two main components, cash from financings still available to the Company and capitalized expenditures on capital assets and mineral properties for moving the Wynyard Potash Project forward. Total assets remained relatively constant for most of the periods above.

Total liabilities for the periods relate primarily to trade and other payables. These balances vary in the analysis due to the timing of the payments required relative to the work performed in bringing the Wynyard Potash Project to its current level. Balances in all the quarters presented include the accrual of an estimate of the costs of restructuring that took place in the second and third quarters of 2017. The increase in the third quarter of 2018 is due to an increase in legal activities in response to threats to the Company by three shareholders who actively tried to take control of Karnalyte and its Board of Directors. The increase in the fourth quarter of 2018 and all the quarters in 2019 is due to a significant increase in the decommissioning liability recorded due to a change in the estimate of this liability made during the fourth quarter of 2018. Also, the third and fourth quarters of 2019 include the accrual of the costs estimated for the restructuring that took place in the third quarter of 2019.

Total shareholders' equity in the fourth quarter of 2018 was positively impacted by the completion of a rights offering by the Company on December 21st, 2018, despite the fourth quarter loss of $2,719,000. Upon closing of the rights offering, the Company issued 14,058,282 common shares for gross proceeds of $2,389,908.

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 year ended December 31, 2019, $747,000 in additions to intangible assets were impaired. The additions to intangible assets all related to the Wynyard Potash Project. The net balances classified as intangible assets are as follows:

Intangible Assets
(CAD $ thousands)

	December 31, 2019	December 31, 2018
Mineral property		
Surface land	4,804	4,804
Drilling	240	240
Balance, end of period	5,044	5,044

CAPITAL ASSETS

The net balances classified as capital assets are as follows:

Capital Assets
(CAD $ thousands)

	December 31, 2019	December 31, 2018
Machinery and equipment	31	51
Buildings	140	151
Land	125	125
Land improvements	25	27
Vehicles	-	3
Furniture and equipment	-	-
Computer hardware	9	9
Right of use asset	62	-
Assets under construction	-	-
Balance, end of period	392	366

The only additions to capital assets in 2019 was the addition of the right of use asset which was recorded as a result of a change to the Company’s accounting policies and the adoption of the new accounting standard IFRS 16 “Leases” (see discussion below). The standard impacted a new office lease entered into during the year and hence the recording of this right of use asset. The decrease in capital assets is a result of depreciation expenses of $54,000 recognized during the year.

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

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2019, the Company had net working capital of $7.2 million compared to $10.3 million at December 31, 2018 including $7.5 million and $10.4 million, respectively, in cash.

As at December 31, 2019 and 2018, the Company also had $0.4 million in restricted cash that was set up as a requirement from the Government of Saskatchewan with respect to reclamation obligations regarding the Wynyard Potash Project. The Company has updated its reclamation program for the Wynyard Potash Project in accordance with Government of Saskatchewan regulations. This update will result in the requirement to increase the amount held as restricted cash in order to satisfy the financial assurance requirements of the Government of Saskatchewan. The Company is in the process of negotiating this amount.

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

The Company has sufficient cash to meet its short-term corporate costs and existing capital plans and has sufficient funds to finance existing development and ongoing corporate functions.

CONTRACTUAL OBLIGATIONS

The following table summarizes the commitments of the Company as at December 31, 2019:

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	870	870	-	-	-
Office lease	197	118	79	-	-
Leases on mineral property	5,863	248	738	738	4,139
Project contracts	64	64			
Total	6,994	1,300	817	738	4,139

Trade and other payables relate to operating and investing expenditures that were payable at the period ended December 31, 2019.

Office lease refers to the lease for the Saskatoon office location. The Saskatoon office is under a lease containing a monthly fee of $10,000 and will expire on August 31, 2021. The lease is being accounted for in accordance with the new accounting standard for leases (IFRS 16) as detailed below. In the second quarter of 2019, the Company recorded a right-to-use asset and corresponding lease liability of $80,000 on the condensed interest statements of financial position for that period.

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

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

RESTRICTIONS ON DISPOSITION OF THE WYNYARD POTASH PROJECT

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

CRITICAL ACCOUNTING ESTIMATES

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

STAGE OF DEVELOPMENT

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

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

INTANGIBLE ASSETS AND PROPERTY, PLANT AND EQUIPMENT

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

Assets under construction, machinery and equipment, buildings, vehicles, furniture, land improvements and leasehold improvements are recorded at cost, less accumulated depreciation. Capital assets are depreciated using the straight-line method over three to seven years. Leasehold improvements are amortized on a straight line basis over the terms of the respective leases. Assets under construction will start being depreciated when the assets are available for use for their intended purpose and will be calculated on a unit of production basis. The Company also reviews capitalized amounts for impairment whenever events or changes in internal or external circumstances indicate that the carrying value may not be recoverable.

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

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

SHARE-BASED PAYMENTS

The Company has share-based payments expenses for stock option awards to employee, directors, officers and consultants, as explained in the Company's financial statements. IFRS requires that all share-based awards be accounted for using the fair value method. Under this method, the Black-Scholes option pricing model requires estimates of the expected life of the option, forfeiture rates, stock volatility and the risk-free interest rate expected over the life of the option. A change in these assumptions could materially change the amount of share-based payments expenses recorded.

INCOME TAXES

The Company accounts for income taxes in accordance with the asset and liability method. Under this method, deferred income tax assets and liabilities are recognized for differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of a change in income tax rates is recognized in the period that includes the date of substantive enactment. A deferred income tax asset is recognized only when it is more likely than not that the income tax asset will be realized.

FINANCIAL RISK FACTORS

CREDIT RISK

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

LIQUIDITY RISK

The Company manages liquidity risk by maintaining sufficient cash balances to meet liabilities when due. As at December 31, 2019, the Company had cash totalling $7,520,000 (2018 – $10,504,000) to settle current liabilities of $870,000 (2018 - $901,000). As at December 31, 2019 and December 31, 2018, 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. In addition to operating expenses, the Company is committed to expenditures in 2020 on its mineral properties to keep the Company in good standing. The Company has sufficient cash to meet its short-term corporate operating and capital requirements but does not currently have adequate funds to proceed with full-scale development of the solution mining facility. The ability of the Company to continue as a going concern will require further equity issuances or other forms of financings. There is no assurance that the Company will be successful in obtaining required funding at an acceptable cost as and when needed or at all. Failure to obtain additional funding on a timely basis may cause the Company to postpone development plans, forfeit rights in its properties or reduce or terminate its operations.

MARKET RISK

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

CURRENCY RISK

The Company’s functional currency is the Canadian dollar with the majority of transactions denominated in Canadian dollars. At this time management believes the foreign exchange risk derived from currency conversions is not significant and therefore does not hedge its foreign exchange risk. At December 31, 2019, 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 December 31, 2019, 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 year ended December 31, 2019, the Company earned interest income of $183,000 (2018 - $122,000) from its cash.

CHANGES IN ACCOUNTING POLICY

On January 1, 2019, the Company adopted the new standards, IFRS 16 and IFRIC 23, as issued by the International Accounting Standards Board.

IFRS 16 “Leases”

This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term greater than 12 months, unless the underlying asset is of a low value. A lessee is required to recognize a right of use asset representing its right to use the underlying asset and a lease ability representing its obligation to make lease payments. IFRS 16 has replaced IAS 17, Leases and is effective for annual periods beginning on or after January 1, 2019.

Adoption of IFRS 16 resulted in a change to the Company’s accounting policies as previously disclosed in the 2018 annual financial statements. The Company now recognizes a right of use asset and a lease liability at the lease commencement date. The right of use asset is initially measured at cost, and subsequently at cost less any accumulated depreciation and impairment losses. The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease, or, if that rate cannot be readily determined, the Company’s incremental borrowing rate. Generally, the Company uses its incremental borrowing rate as the discount rate.

The lease liability is subsequently measured by increasing the lease liability by the interest cost on the lease liability and decreasing it by the lease payments made. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, a change in the estimate of the amount expected to be payable under a residual value guarantee, or as appropriate, changes in the assessment of where a purchase or extension option is reasonably certain to be exercised or a termination option is reasonably certain to not be exercised.

The Company uses judgement in determining the lease term for some lease contracts that include renewal options. The assessment of whether the Company is reasonably certain to exercise such options impacts the lease term, which affects the amount of lease liabilities and right of use assets recognized.

The Company does not recognize right of use assets and lease liabilities for leases of low value and short-term leases that have a lease term of less than 12 months. The lease payments related to these leases are recognized as an expense on a straight-line basis over the term of the lease.

Adoption of IFRS 16 had no impact on the financial statements as at January 1, 2019. This standard did impact a new office lease entered into during the year.

IFRIC 23 "Uncertainty over Income Tax Treatments"
IFRIC 23 provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments. The implementation of this standard had no impact on the Company's financial statements.

INTERNAL CONTROLS

DISCLOSURE CONTROLS AND PROCEDURES

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

As with most small or developing 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 Chief Financial Officer is responsible to evaluate the disclosure controls and procedures. She has concluded that the design and operation of these disclosure controls and procedures were not effective due to the existence of material weaknesses in the internal controls over financial reporting noted in the following section.

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

INTERNAL CONTROLS OVER FINANCIAL REPORTING (ICFR)

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

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

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

OFF BALANCE SHEET ARRANGEMENTS

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

OUTSTANDING SHARES

As of the date of this MD&A, the Company has 42,174,847 Common Shares and 1,150,000 stock options issued and outstanding.

FORWARD-LOOKING INFORMATION

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

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

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

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

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

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

Further information about the factors affecting forward-looking statements is available in Karnalyte’s Annual Information Form and the audited annual financial statements for the year ended December 31, 2019, which have been filed with Canadian provincial securities commissions and are available on SEDAR at www.sedar.com.