MANAGEMENT'S DISCUSSION AND ANALYSIS

For the year ended December 31, 2015

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, 2015 and 2014. 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, 2015. This commentary is dated March 28, 2015. The financial statements have been prepared in accordance with International Financial Reporting Standards ("**IFRS**"). These documents, the Annual Information Form, and additional information about the Company are available on SEDAR at www.sedar.com. Some of the statements made herein contain forward-looking information and accordingly please refer to the "Forward-Looking Statements" section at the end of the MD&A.

OVERVIEW

Business Overview

Karnalyte was incorporated under the *Business Corporations Act* (Alberta) on November 16, 2007 and is a Saskatchewan headquartered company focused on exploration and development of potash in Saskatchewan. The Company intends to develop and extract a carnallite-sylvite mineral deposit through a solution mining process, at competitive cost and with minimal environmental impact. Using a staged approach to potash plant construction, the Company plans to operate the initial facility at Wynyard, Saskatchewan to produce 625,000 tonnes per year ("**TPY**") of potash, increasing to 1,375,000 and 2,125,000 TPY of potash in subsequent phases of the project (the "**Project**").

Proxy Contest

In early 2015 Karnalyte's founder Robin L. Phinney submitted a shareholder proposal containing, among other things, a request for a shareholders meeting on behalf of a group of concerned shareholders (the "**Concerned Shareholder Group**") to remove four incumbent directors of the Company and elect four new directors of the Company. The Company rejected the shareholder proposal and later announced that it had determined that, given the prevailing price environment for potash and magnesium, it was not possible to finance and profitably construct and operate the Company's planned Project. The Company suspended all activity in relation to the Project, other than the minimum required activities to maintain title to the Project and secure the Project site on a care and maintenance basis.

Subsequent thereto Mr. Phinney and the Concerned Shareholder Group announced that the largest shareholder of Karnalyte, Gujarat State Fertilisers and Chemicals Ltd. ("**GSFC**"), had agreed to support the immediate reconstitution of Karnalyte's board of directors (the "**Board of Directors**"), and had entered into an agreement which provides a proposed framework for raising funds required by the Company to implement the Company's Project.

In May, 2015, the Company announced that in recognition of the number of shareholders who support the Concerned Shareholder Group and in order to avoid the time and expense of litigation, its directors (other than Mr. Vishvesh Nanavaty) had agreed to immediately resign and be replaced by five nominees of Robin L. Phinney and GSFC. In addition to himself, Mr. Phinney nominated Mr. Henry Kerkhoven and Ms. Sokuen Sue Ng. GSFC nominated Mr. Sanjeev Varma and Mr. Mukund Purohit. The Company announced that Mr. Phinney had been appointed President and had withdrawn his requisition and

shareholder proposal, that mutual releases were exchanged between the parties, and that all litigation and complaints to regulators were being withdrawn or discontinued.

Subsequent to the reconstitution of Karnalyte's Board of Directors the Company re-hired its engineering and technical teams to carry out a planned pilot program to optimize potassium chloride ("KCl") concentration and confirm Project design parameters (the "**Optimization Program**"). Shortly thereafter, the Company announced that it was restarting its operations at Wynyard, Saskatchewan to develop its Project.

Optimization Program

In 2015 the Company's engineering and construction teams completed the first phase of the Optimization Program on time and within budget. Highlights include:

- Engaging ERCOSPLAN Ingenieurgesellschaft Geotechnik und Bergbau mbH to advise on the design and operation of the Optimization Program and prepare an independent project report;
- Completing design and construction of the mechanical equipment and instrumentation for the first phase of the cavern preparation system; and
- Completing the design work on the cavern production equipment and electrical controls for the first phase of the Optimization Program.

Subsequent to December 31, 2015 the Company retained SaskPower for installation of the electrical supply line, transformer and metering. Karnalyte's engineering and construction teams are now focused on making arrangements for the natural gas supply pipeline which is expected to be installed in June, 2016 and hiring staff to implement the Optimization Program.

The Company expects to commence the second phase of the Optimization Program in the spring of 2016 with initial water injection for cavern preparation followed by cavern production in the summer of 2016. The Company anticipates that the Optimization Program will be completed in the fall of 2016.

Proposed Transactions

In the second half of 2015 the Company focused on negotiating the indicative terms of the financing for Phase I (defined below). On March 14, 2016 the Company announced that Karnalyte had entered into an agreement in principle (the "**Agreement in Principle**") with GSFC to finance construction of the first phase of Karnalyte's 625,000 tonnes TPY potash mine at Wynyard, Saskatchewan ("**Phase I**"), and an agreement in principle to spin-out Karnalyte's secondary mineral assets and unexplored lands into one or more separate entities.

In order to facilitate the completion of the transactions, Karnalyte, GSFC and Robin L. Phinney entered into an agreement (the "**Framework Agreement**"), effective February 24, 2016, which contains, among other things, an agreement with respect to the composition of the Board of Directors, voting support and solicitation.

Proposed Financing

The Agreement in Principle contemplates a proposed financing that includes senior secured debt, subordinated unsecured debt, and an equity infusion to be backstopped by GSFC (the "**Proposed**

Financing"). The financing structure allows for a 3:1 debt to equity ratio for the Project financing. The equity component of the Project financing is anticipated to be fulfilled 50% by way of the issuance of common shares by the Company ("**Common Shares**"), and 50% by way of the issuance of unsecured subordinated debt, which is anticipated to limit the dilution to shareholders of the Company. Key attributes of the Proposed Financing include:

- Senior secured debt in excess of $500 million USD over a 20 year term;
- A total equity requirement equal to one-third of the amount of the senior secured debt, with up to 50% to be raised through subordinated unsecured debt and the remainder to be raised through the issuance of Common Shares;
- Backstop guarantees by GSFC for any shortfalls of equity in the event that Karnalyte is unable to raise sufficient amounts through the issuance of Common Shares; and
- Backstop guarantees by GSFC in the event of Project cost overruns.

Proposed Spin-Out Transactions

The Agreement in Principle further contemplates one or more newly created corporations to be initially held by current Karnalyte shareholders in proportion to their shareholdings as at the closing date of the spin-out transactions (the "**Proposed Spin-Out Transactions**"). The Company anticipates that:

- Karnalyte's secondary minerals, including magnesium, will be developed in a separate entity to allow current Karnalyte shareholders to benefit from these currently untapped assets; and
- Karnalyte will assign its unexplored lands (compromising approximately 241 km2 or approximately 70% of the Karnalyte property) to a separate entity which will have the benefit of a license for associated intellectual property to allow such entity to further explore and develop these currently untapped assets and allow current Karnalyte shareholders to further benefit from such development.

The Board of Directors has determined that the comprehensive financing package and associated transactions as set forth in the Agreement in Principle are in the Company's best interests as it will allow Karnalyte to fully finance the construction of Phase I and will also allow current Karnalyte shareholders to realize the value in the Company's non-potash assets. This determination was based on a number of factors, including but not limited to, the unanimous recommendation of a special committee of independent directors formed to consider the Company's financing alternatives after consultation with the Company's financial and legal advisors.

Over the course of 2016 the Company expects to negotiate the definitive terms of the Proposed Financing and Spin-Out Transactions, which, if approved by shareholders, could be transformative for the Company. Completion of the proposed transactions are subject to finalization of definitive documentation, approval by the boards of directors of Karnalyte and GSFC, approval by Karnalyte's shareholders, and receipt of all necessary regulatory approvals, including the approval of the Toronto Stock Exchange, as well as other customary closing conditions. The Company cautions that there is no assurance that the Proposed Financing or the Proposed Spin-out Transactions will be agreed upon or that the terms set forth herein will be the final terms agreed to in the definitive documents for the Proposed Financing or the Proposed Spin-out Transactions. Refer to the "Risk Factors" in the Company's Annual Information Form for additional information. Any announcements regarding the Proposed Financing or the Proposed Spin-out Transactions will be disclosed in accordance with all applicable legal and regulatory requirements.

SELECTED ANNUAL INFORMATION

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

Selected Annual Results (CAD $ thousands)			
	Year ended December 31		
	2015	2014	2013
Total revenue	$ -	$ -	$ -
Interest and other income	160	680	1,011
Net and comprehensive loss	(14,536)	(67,581)	(6,742)
Basic and diluted per share	(0.53)	(2.46)	(0.25)
Total current assets	28,067	41,026	47,780
Total assets	31,962	45,417	111,457
Total current liabilities	1,883	1,525	746
Total liabilities	2,064	1,689	881
Total shareholders' equity	29,898	43,728	110,576

During the year ended December 31, 2015, the Company spent the first part of the year heavily focused on the proxy contest as described in the "Overview" section. As a result of this proxy contest a significant amount of legal and consulting fees were incurred to resolve these matters. During the first quarter of 2015, management made a decision to suspend all activity in relation to the Project, other than the minimum required to maintain title to the Project. This decision resulted in some major restructuring which saw 18 employees terminated including senior officers of the Company. As a result of this restructuring, $3,451,000 of restructuring expenses were incurred during the first two quarters of 2015. Subsequent to the reconstitution of the Board of Directors in May 2015, the Company re-hired its engineering and technical teams to carry out the Optimization Program. Shortly thereafter, the Company announced that it was restarting its operations at Wynyard, Saskatchewan to develop its Project. In addition to this focus during the second half of 2015, the Company was also focused on the negotiation of the terms of the Agreement in Principle with GSFC.

During the comparative year ended December 31, 2014, the Company's previous management made a determination that there was an indication of impairment related to its potash cash generating unit. A general stabilization in the potash commodity market at lower pricing levels combined with the significant uncertainty caused by the proxy contest were exacerbating the Company's ability to secure adequate financing and it was determined that a significant delay would result on the original expected mine development timeline. These negative outcomes resulted in the Company performing an impairment test. While the Company intended to review whether there were any possibilities of finding a buyer for the Project or whether the Project could be otherwise disposed of on reasonable terms, consistent with the restrictions to which the Company and the Project were subject in the Company's various agreements with GSFC, the Company determined such a disposition was unlikely; therefore, there were no values ascribed to intangible mineral properties including engineering, drilling, feasibility studies or amounts incurred for site preparation because there was no certainty the values could be recuperated at that time. As a result, the fair value less cost to sell was determined based on the Company's estimate of the amount it would receive for the resale value of individual assets. The Company's estimates were determined based on a third party valuation as well as recent transactions for comparable or similar assets. The Company recognized an impairment loss of $59,149,000 to impair the assets to their estimated recoverable amount

of $4,016,000. The Company also derecognized $2,899,000 in deferred financing fees for a prior engagement for financing with BNP Paribas and Natixis as this engagement was terminated as it was no longer considered to be a credible option. The termination triggered the need to expense all debt financing fees which had accumulated since the contract was entered into in addition to the associated break fees to terminate the contract. The Company disputes that any such termination fees are owing.

RESULTS OF OPERATIONS

General and administrative expenses (G&A)

G&A costs for the year ended December 31, 2015 amounted to $8,795,000 which is an increase of $4,563,000 from the comparative 2014 amount.

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

G&A Expenditures (CAD $ thousands)		
	Year ended December 31,	
	2015	2014
Salary, wages and benefits	$ 1,283	$ 1,456
Business development, investor relations, regulatory fees	821	819
Accounting and legal	3,282	490
Consulting	1,741	336
Rent	235	266
Directors Fees	595	239
Other	838	626
Total general and administrative	$ 8,795	$ 4,232

Salaries, wages and benefits for the year ended December 31, 2015 was $1,283,000 compared to $1,456,000 in 2014 which is a decrease of $173,000. The decrease is the result of a significant headcount reduction related to the corporate restructuring which took place during the first two quarters of 2015. During the restructuring eighteen employees were terminated or resigned which reduced salaries and wages significantly. During the last half of the year ended December 31, 2015, the Company resumed operations and hired nine employees bringing the total headcount to ten which is a significant reduction from nineteen at the year ended December 31, 2014.

Business development, investor relations and regulatory fees for the year ended December 31, 2015 amounted to $821,000 compared to $819,000 in the 2014 comparative period, which is an increase of $2,000. The expenses from year to year were comparable due to the fact that more significant than usual expenses in this area were incurred both in the last quarter of 2014 and the first quarter of 2015 relating to the proxy contest. Otherwise, regulatory expenses and investor relations expenses were consistent with prior years.

Accounting and legal expenses for the year ended December 31, 2015 were $3,282,000 compared to $490,000 in the comparative period, which is an increase of $2,792,000. The significant increase from the prior year was mostly the result of the legal fees incurred relating to the proxy contest which began in December 2014 and concluded in May 2015. In the first and second quarters of 2015, $2,495,000 in legal

fees were incurred relating to the proxy contest and corporate restructuring activities under previous management. The remaining increase is driven by the temporary outsourcing of accounting and CFO services during the third quarter and part of the fourth quarter of 2015 as well as the sourcing and evaluation activities related to potential future financing.

Consulting expenses for the year ended December 31, 2015 amounted to $1,741,000 compared to $336,000 in the comparative 2014 period, which is an increase of $1,405,000. The increase during the period was a result of an increase in consulting fees paid to former and current senior officers of the Company and the retention of numerous outside consultants in connection with the proxy contest during the first two quarters of 2015.

Rent expense for the year ended December 31, 2015 amounted to $235,000 compared to $266,000 for the comparative period, which is a decrease of $31,000. Rent has decreased due to the change in location of the Company's offices from Okotoks to Calgary in late 2014 and then from Calgary to Saskatoon in September of 2015.

Director fees for the year ended December 31, 2015 amounted to $575,000 compared to $239,000 for the 2014 comparative period representing an increase of $336,000. The increase is due to an overall increase in the number of meetings held particularly during the first two quarters of 2015 as a result of the proxy contest.

Other expenses for the year ended December 31, 2015 amounted to $838,000 compared to $626,000 for the comparative period representing an increase of $212,000. Part of this increase is due to a significant amount of shipping and freight expenses incurred relative to a drilling contract that was terminated by previous management resulting in the Company being required to ship the contractor's equipment off the site. This accounted for $80,000 of the increase. There was an increase in travel and entertainment expenses of $50,000 due in part to the proxy contest and also the contemplation of financing options during the year. There was also an increase of $43,000 in insurance expenses $26,000 of which was payments for health insurance premiums. The remaining increase in insurance expenses related to an increase in the directors and officers insurance policy and a slight increase in the regular commercial insurance policy.

Other costs impacting comprehensive loss

Depreciation and amortization for the year ended December 31, 2015 was $642,000 compared to $789,000 in the 2014 comparative period. These non-cash expenses were related to the purchase and subsequent depreciation of machinery and equipment and are proportionate to the capital assets the Company owned at the years ending December 31, 2015 and 2014.

Share-based payments for the year ended December 31, 2015 was $706,000 compared to $450,000 in the 2014 comparative period. Share based payments made in 2014 are all non-cash in nature and are expensed over a two year vesting period. On July 14, 2015, 1,930,000 stock options were granted to employees, officers and directors. This share based payment was non-cash in nature and vested immediately upon issuance.

Restructuring costs for the year ended December 31, 2015 were $3,451,000 compared to the year ending December 31, 2014 of $736,000. In 2015, these amounts represent termination payments for 18

terminated positions including three former officers of the Company. This compares to termination payments in 2014 for 7 terminated positions, including the chief executive officer.

Financing expenses for the year ended December 31, 2015 were $nil compared to December 31, 2014 of $2,899,000. In previous years, financing expenses were incurred as a result of the Company pursuing previous forms of debt financing. These costs were deferred until the debt was issued or until the related financing was no longer considered probable. In 2014, these deferred financing expenses (including break-fees) were recognized in the statement of comprehensive loss as these previous forms of debt financing were no longer considered probable and so the previous financing contracts were cancelled.

Impairment expenses for the year ended December 31, 2015 were $1,125,000 compared to the year ending December 31, 2014 of $59,149,000. In 2014, previous management determined assets with a carrying amount of $63,165,000 were no longer recoverable having given consideration to the combined effects of the significant uncertainty caused by the proxy contest, the prolonged depression of commodity markets in general, and the potash market in particular, and a determination that these matters would result in a delay to the original expected mine development timeline and resulting negative impact on the Company's expected return on the Project . At December 31, 2015 the Company assessed whether there was any indication that this previously recognized impairment loss required reversal. The Company determined that there were no indications that the recoverable amount of the assets had increased during the period. Incremental expenditures incurred on intangible and mine development assets throughout 2015 of $1,125,000 were determined not to impact the previously determined recoverable amount, which was based on the salvage value of tangible equipment and land, and were impaired as incurred. Refer to the "Investing - Impairment" section of this MD&A and the notes to the financial statements dated December 31, 2015 for additional disclosures.

Net finance income for the year ended December 31, 2015 was $150,000 compared to $668,000 in the 2014 comparative period. Finance income is a direct result of the amount of cash the Company is holding at a given time and the corresponding interest income the cash generates.

USE OF PROCEEDS

The Company is currently in the process of updating its estimated capital and operating expenditures, after which it expects it will be in a better position to anticipate timing and costs to take the Project to the next stage of development. In connection therewith, the Company has engaged consultants to review the validity of the 2012 Technical Report and the Technical Report of the Company titled "Amended and Restated Reserve and Resource Estimate for the Wynyard Carnallite Project, Subsurface Mineral Permit KP 360A and Subsurface Mineral Lease KLSA 010, Saskatchewan, Canada" dated March 30, 2012.

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, 2015:

Selected Quarterly Results (CAD $ thousands)								
	2015				2014			
	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
Total revenue	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Comprehensive loss	(2,369)	(2,961)	(6,824)	(2,816)	(63,500)	(1,480)	(1,347)	(1,254)
Basic and diluted loss per share	(0.09)	(0.11)	(0.25)	(0.10)	(2.31)	(0.05)	(0.05)	(0.05)
Total current assets	28,067	29,973	32,268	38,736	41,026	43,084	44,827	46,209
Total assets	31,962	33,853	36,276	42,935	45,417	107,669	109,109	110,220
Total liabilities	2,064	2,022	2,219	1,913	1,689	564	762	460
Total shareholders' equity	29,898	31,831	34,057	41,022	43,728	107,105	108,347	109,760

Comprehensive loss for the quarter ended December 31, 2014 is not indicative of a typical quarter due to significant impacts from the asset impairment expense of $59,149,000 and the expensing of the deferred financing costs and break fees of $2,899,000. $754,000 of an additional $1,125,000 of impairment expense was recognized in the fourth quarter of 2015. This was due to the increased expenses incurred relating to the planning of the Optimization Program planned for 2016. Excluding these impacts, the comprehensive loss in the fourth quarter of 2015 was driven primarily by G&A expenses and particularly legal and consulting expenses relating to the Proposed Financing as discussed in the “Overview – Proposed Financing” section of this MD&A. Outside consulting fees were also incurred during the fourth quarter of 2015 relating to the outsourcing of CFO and accounting services during more than half of the quarter. Other notable items during the quarters are the significant severance expenses incurred in the second quarter of 2015 . Restructuring expenses of $2,553,000 were incurred in the three month period ended June 30, 2015 in relation to severance packages paid to senior officers and employees of the Company as well as contract termination penalties related to the consulting agreements of the Company's senior officers. Legal expenses of $1,850,000 related to the proxy contest were incurred in the second quarter of 2015. Finally, another main component of the quarterly losses relates to non-cash share based payment expenses for amortizing stock option costs. Stock based compensation expenditures range from a high of an expense of $735,000 in the third quarter ending September 30, 2015 to a reversal of $128,000 in June 2014 and a reversal of $143,000 in June 2015 as a result of forfeited options from employees, consultants and directors no longer with the Company.

Current assets principally reflect activity in the cash account. Cash outlays vary over the quarters depending on the Company's activities. During the last three quarters of 2014 and in the first two quarters of 2015 severance amounts paid ranged from a high of $1,146,000 in June 2015 to a low of $15,000 in December 2014.

Total assets on a quarterly basis reflect two main components, cash from financings still available to the Company and capitalized expenditures on capital assets and mineral properties for moving the Project forward. Excluding the impairment expense and write off of deferred financing fees in the fourth quarter of 2014 noted above, total assets remained relatively constant for the majority of the periods above. The quarterly fluctuations generally reflect cash expended on G&A expenses.

Total liabilities for the periods relate primarily to trade and other payables. These balances vary in the analysis due to timing of payments that are required on the various work performed on bringing the Project to the current level. The increase in the fourth quarter of 2014 compared to the other quarters during that year are a result of the accrual of break fees in relation to the cancellation of the BNP and Natixis contracts. The Company disputes that any such termination fees are owing. However this accrual remained on the books throughout 2015 and at December 31, 2015. Overall the increase in liabilities

during all of the quarters of 2015 are a result of the increased expenses during the first part of 2015 resulting from the proxy contest and during the last half of 2015 due to increased activity relating to the planning and preparation of the Optimization Program planned for 2016. Refer to the "Overview – Optimization Program" section for additional information.

STOCK OPTIONS

Subsequent to December 31, 2015

On January 12, 2016, the Company granted 90,000 stock options to employees. The options have an exercise price of $0.75 per option and will expire on June 12, 2021, December 12, 2021, June 12, 2022 and December 12, 2022.

2015

On July 14, 2015, the Company granted 1,930,000 stock options to employees, directors and officers. The options vest upon issuance, have an exercise price of $0.75 per option and will expire on July 14, 2020.

2014

On July 4, 2014, the Company granted 695,000 options to senior executives, members of the Board of Directors, and consultants. The options have an exercise price of $1.27 and will expire on July 4, 2018. At the same time 651,000 options previously held by employees were repriced to $1.27 and $1.90.

Throughout the year ended December 31, 2014 there were 499,750 options expired and 587,250 options forfeited.

INVESTING

The Company capitalizes costs that are determined to provide future benefits and charges other costs to comprehensive loss including administrative salaries, support and office costs, community relations programs and other administrative related expenditures. Costs directly related to capital assets are capitalized to appropriate categories and depreciated over their useful lives. Costs of personnel related entirely to preparation of mineral properties on the Company's property and for the future construction of facilities or product development are capitalized as part of the mineral properties or of the processing facilities.

Expenditures to date were focused on the completion of the Company's resource reports, including the 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, 2015, $460,000 in additions to intangible assets were impaired. This was due to the fact that the Company identified an impairment indicator in 2014 that resulted in the intangible assets being impaired in that year by $40,925,000 to $2,382,000. For further discussion, see the

"Investing - Impairment" section of this MD&A and the notes to the financial statements dated December 31, 2015. The net balances classified as intangible assets are as follows:

Intangible Assets (CAD $ thousands)		
	Year ended December 31,	
	2015	2014
Mineral property		
Surface land	$ 2,288	$ 2,142
Drilling	240	240
Balance, end of period	$ 2,528	$ 2,382

In 2015, the Company purchased a parcel of land near Wynyard for $146,000. All categories of intangible assets have been recognized with a $nil value with the exception of land and drilling for the years ended December 31, 2015 and 2014 as a result of the impairment losses. The identification of a potential buyer of the Project in its entirety, or the Company's ability to secure adequate financing for the development of the mine on economic terms, could result in a material difference from the current estimate of the recoverable asset. Such a situation would require the Company to review the impairment in future periods and could result in recovering a portion or all of this impairment.

Capital assets

As with the intangible assets mentioned above, the Company identified an impairment indicator in the year ended December 31, 2014 that resulted in the capital assets being impaired by $18,224,000 to $1,634,000. In 2015, additions of $665,000 were also impaired. For further discussion, see the "Investing - Impairment" section of this MD&A and the notes to the financial statements dated December 31, 2015.

During the year ended December 31, 2015, excluding the impairment loss, the Company capitalized $665,000 to assets under construction. The net balances classified as capital assets are as follows:

Capital Assets (CAD $ thousands)		
	Year ended December 31,	
	2015	2014
Machinery and equipment	$ 641	$ 1,240
Buildings	183	194
Land	125	125
Land improvements	33	35
Vehicles	-	25
Furniture and equipment	10	15
Assets under construction	-	-
Balance, end of period	$ 992	$ 1,634

Assets under construction shows a net book value of $nil although $665,000 of additions were recorded to this account and then subsequently impaired. The expenses capitalized to this account related to the

detailed engineering and site preparation for the Optimization Program described under in the "Overview" section. There has been no depreciation charges recorded for assets under construction.

There were no other additions to capital assets during 2015. The changes in the assets from 2014 to 2015 are a result of depreciation expenses.

Decommissioning obligations

The Company's decommissioning obligations are based on the Company's ownership in wells and facilities. Management estimates the costs to abandon and reclaim the wells and the facilities and the estimated time period during which these costs will be incurred in the future. The majority of these costs are expected to be incurred over the next 30 years. The undiscounted amount of estimated costs required to settle the obligations at December 31, 2015 is $212,000 (2014 – $212,000). The estimated costs have been inflated at 2.0 percent and discounted at a risk free rate of 1.84 percent for the year ending December 31, 2015 (2.11 percent – 2014).

Impairment

For the year ended December 31, 2014, the Company determined there was an indication of impairment related to its potash cash generating unit. A general stabilization in the potash commodity market at lower pricing levels combined with the significant uncertainty caused by the proxy contest were exacerbating the Company's ability to secure adequate financing and it was determined that a significant delay would result on the original expected mine development timeline. During the first quarter of 2015, the Company decided to suspend all activity in relation to the Project, other than the minimum required activities to maintain title to the Project, secure the site on a care and maintenance basis, and otherwise preserve intact the Project. The Company performed an impairment assessment as at December 31, 2014. The recoverable amount was determined using the fair value less cost to sell. It was determined that there could be no assurance that circumstances would change or that the market for potash would improve to the point where the Project would have a value in excess of its salvage value; therefore, there were no values ascribed to intangible mineral properties including engineering, drilling, feasibility studies or amounts incurred for site preparation because there was no certainty the values could be recuperated at that time. As a result, the fair value less cost to sell was determined based on the Company's estimate of the amount it would receive for the resale value of individual assets. The Company's estimates were determined with the assistance of a third party valuator as well as in reference to recent transactions for comparable or similar assets. The Company recognized an impairment loss of $59,149,000 to impair the assets to their estimated recoverable amount of $4,016,000.

During the second quarter of 2015 and under new management, the decision to suspend all activity in relation to the Project was reversed and the previously planned development program was implemented. At December 31, 2015, the Company assessed whether there was any indication that this previously recognized impairment loss still existed or had reversed. The Company determined that there were no indications that the asset values had increased during the period. The Company has still not obtained project financing, the Company's market capitalization continues to be depressed as does the market for potash. Incremental expenditures incurred on intangible and mine development assets throughout 2015 of $1,125,000 were determined not to impact the previously determined recoverable amount, which was based on the salvage value of tangible equipment and land, and were impaired as incurred.

Karnalyte RESOURCES

Segmentation Reporting

The Company's operating segments have been identified as the Company's individual mineral reserve streams. The Company has currently identified two operating segments, potash and magnesium, however due to materiality they are currently grouped as one segment for financial reporting purposes. If magnesium reserves were advanced to a material stage, costs would be allocated to separate reporting segments.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2015, the Company had net working capital of $26.2 million compared to $39.5 million at December 31, 2014 including $27.7 million and $40.7 million, respectively, in cash. As at December 31, 2015 and 2014, the Company also had $0.4 million in restricted cash that was set up as a requirement from the Government of Saskatchewan in order to operate the test plant in Saskatchewan. The Company maintains cash in bank accounts for day to day operations and invests the excess in overnight financial instruments in high interest saving accounts that are highly liquid.

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

CONTRACTUAL OBLIGATIONS

The following table summarizes the commitments of the Company as at December 31, 2015:

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	$ 1,883	$ 1,883	$ -	$ -	$ -
Office lease	220	147	73	-	-
Permit/lease on mineral property	2,582	52	340	340	1,850
Project contracts	853	853	-	-	-
Total	$ 5,538	$ 2,935	$ 413	$ 340	$ 1,850

Trade and other payables relate to operating, investing and financing expenditures that were payable at the year ended December 31, 2015.

Office lease refers to the lease for the Saskatoon office location. The Saskatoon office is under a lease containing a monthly fee of $12,000 and will expire on August 31, 2017.

Mineral lease and permit obligations refer to the annual fees which are required to maintain the permit and lease areas related to the Project. The period between March 2015 to March 2016 represented the Company's third and final extension period of Permit KP 360A which cost $40,000 to maintain. At the end of the extension period on March 12, 2016 the Company must convert the area to a lease in order to

maintain the mineral rights for the property. All the required exploration on the property has been completed and no further spending will be required until such time as the property is converted to a lease. On March 8, 2016, the Company applied to the Saskatchewan Ministry of the Economy to convert the lands subject to Permit KP 360A to one or more leases. As part of its application, the Company requested that the Saskatchewan Ministry of the Economy add 15,363.20 acres of such lands to the Lease. The Company also requested that the Ministry of the Economy convert the remaining permit acreage to one or more new leases to be issued to the Company. The Company expects that the Saskatchewan Ministry of the Economy will make certain acreage adjustments as it considers the Company's applications, including to address the addition of contiguous road allowance lands. As part of its applications to the Saskatchewan Ministry of the Economy, the Company submitted application fees, deposits, and the estimated first year's rent payments for the leases. While the Company expects that the Saskatchewan Ministry of the Economy will amend the Lease and issue one or more new leases, as requested, there is no assurance in that regard. See "Risk Factors" in the Annual Information Form. The Company is required to pay annual lease payments of $10.00 per hectare on any area held under lease for a term of twenty-one years for a total cost of $214,000 per year. The Company is required to expend not less than $3,000,000 for work during the first three years of the term of the lease.

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

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amount of assets, liabilities and expenses. The Company evaluates the estimates periodically. In making judgments about the carrying values, the Company uses estimates based on historical experience and various assumptions that are considered reasonable in the circumstances. Actual results may differ from those reported. The Company reviews significant areas subject to estimation with the Audit Committee. Significant areas requiring 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 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, permits and the exploration and development thereon are recorded at cost and include direct and indirect acquisition and exploration costs associated with specific mineral properties. These costs are capitalized on the basis of the potential realization from the underlying asset. Amortization of these amounts will be recognized

using the unit-of-production method over the shorter of estimates of reserves or service life following the commencement of production or written off, if the properties are sold or abandoned.

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 indicated that the carrying value may not be recoverable.

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

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

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.

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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, 2015, the Company had cash totalling $27,733,000 (2014 – 40,740,000) to settle current liabilities of $1,883,000 (2014 - $1,525,000). As at December 31, 2015 and December 31, 2014, the Company's trade and other receivables were all considered current and are subject to normal trade terms.

Market risk

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual instrument or its issuer or factors affecting all instruments traded in the market. The Company'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, 2015, 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, 2015, 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, 2015, the Company earned interest income of $0.4 million (2014 - $0.7 million) from its cash. Had the interest rate been 100 basis point higher (or lower) throughout the year ended December 31, 2015, comprehensive loss would have been lower (or higher) by approximately $0.3 million (2014 - $0.4 million).

NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

IFRS 9 "*Financial Instruments*" – The standard is the first step in the process to replace IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 introduces new requirements for classifying and measuring financial assets and liabilities and carries over from the requirements of IAS 39. Financial instruments: recognition and measurement derecognition of financial assets and financial liabilities. The extent of the impact of adoption of these standards has not yet been determined.

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

INTERNAL CONTROLS

Disclosure Controls and Procedures

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

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

The Company mitigates these weaknesses 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 President and Chief Financial Officer of the Company are responsible for designing and ensuring the operating effectiveness of internal controls over financial reporting. They are also responsible for causing 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's management has assessed the design and operating effectiveness of internal controls over financial reporting for this period and identified material weaknesses in the control environment. Management sets the tone of the control environment, influences the control consciousness of its

employees, and is the foundation of the other components of ICFR. As was disclosed in the restated third quarter of 2015, the Company has concluded that certain members of senior management did not adequately establish and enforce a strong culture of compliance and controls during the period. This includes adherence to the Company's policies and procedures relating to the segregation of accounting roles in connection with the Company's internal accounting functions.

The majority of the current directors and officers of the Company were appointed subsequent to a settlement following the proxy contest by the Concerned Shareholder Group. As a result, and due to a lack of continuity of personnel and business process, there is a material risk that current officers and directors of the Company are not aware of possible contractual arrangements, commitments, vendor invoices or other obligations to which the Company may have been committed by the former officers and directors. As a result, there is a risk that any such arrangements, commitments, vendor invoices or other obligations are not recorded or disclosed in the condensed interim financial statements. Management has undertaken a review of the accounting records, vendor invoices, minutes of meetings of the Board of Directors and its committees, among other records of the Company, to partly mitigate the aforementioned risk.

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. 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.

During the fourth quarter of 2015, the former Interim Chief Financial Officer, working on a consulting basis was replaced by a permanent Controller who is also acting Interim Chief Financial Officer and now oversees the accounting affairs of the Company. While this has significantly improved the control environment, management is still of the view that the Company has not remediated these material weaknesses. The material weaknesses cannot be considered to be remediated until the applicable remedial controls operate for a sufficient period of time and management has concluded through testing, that the controls are operating effectively.

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 27,479,010 Common Shares and 2,079,000 stock options issued and outstanding.

OUTLOOK

Industry Outlook

The Company's management believes that the long term prospects for the potash industry are promising. Historically, potash markets have been supported by a growing global economy. In the short term, the Company's management believes that both demand and pricing may continue to trade in a narrow, but stable range, but in the long term, the rationale for investment in potash projects looks promising. According to an Integer Research White Paper (2015) titled "Analyzing Market Trends and Addressing the Key Questions Facing Fertilizer Markets", global potash demand is expected to increase to almost 89 million tonnes in 2025, equating to growth at an average rate of approximately 2.9% per year. This is underpinned by rising incomes in developing countries stimulating a change to more varied and meat-based diets. The Company expects that investment in new potash capacity will continue to accelerate given current producers' and strategic partners' goals of securing future supply.

Of particular importance to Karnalyte is the distinction between standard-grade potash and hi-grade granular potash. Prices for hi-grade granular potash continue to trade at a premium to standard potash, and demand for hi-grade granular potash continues to grow at a faster rate than does standard grade potash product. The Company believes that the industry outlook for its Project which is expected to have significantly lower capital expenditures as compared to a conventional underground mine, and which will produce a premium, high-grade granular product, will be favoured over traditional standard-grade potash producers.

Capital Market Outlook

Access to the capital markets is crucial for all developing companies. Many junior resource companies in the exploration phase continue to face challenges in accessing the capital markets. There has been a five-year bear market in the mining sector as equity issuances have trended lower with declining prices and limited institutional interest in investment in the sector.

On March 14, 2016 the Company announced that Karnalyte had entered into the Agreement in Principle with GSFC to finance construction of Phase I of Karnalyte's potash mine at Wynyard, Saskatchewan and an agreement in principle to spin-out Karnalyte's secondary mineral assets and unexplored lands into one or more separate entities.

The Agreement in Principle contemplates a financing that includes senior secured debt, subordinated unsecured debt, and an equity infusion to be backstopped by GSFC. The equity component of the Project financing is anticipated to be fulfilled 50% by way of the issuance of Common Shares, and 50% by way of the issuance of unsecured subordinated debt, which is anticipated to limit the dilution to shareholders of the Company. Refer to the "Overview – Proposed Transactions" section for additional information.

While access to the capital markets will be important for Karnalyte in connection with the Proposed Transactions, the backstop guarantees given by Karnalyte's strategic partner, GSFC, should significantly mitigate the risk to Karnalyte in its efforts to secure the funding required to construct its full scale production facility. Management believes that GSFC's financial strength and relationships with Indian banking institutions gives Karnalyte a competitive advantage in otherwise difficult capital markets. However, there can be no assurance that Karnalyte will be able to complete the Proposed Financing or the

Proposed Spin-out Transactions on the terms described herein or at all. See "Risk Factors" in the Company's Annual Information Form.

Company Outlook

In 2016 the Company intends to continue its focus on the two key areas necessary to move the Project forward: 1) securing complete financing to construct Phase I and 2) completing the second phase of the Optimization Program designed to improve production from the underground caverns, increase KCl concentration and confirm equipment design parameters in preparation for construction of the full-scale production facility.

Any announcements regarding the Proposed Transactions contemplated under the Agreement in Principle and Optimization Program will be disclosed in accordance with all applicable legal and regulatory requirements.

FORWARD-LOOKING INFORMATION

Statements in this MD&A may constitute "forward-looking" statements which involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Forward-looking statements may include, but are not limited to, statements regarding:

- expectations regarding the state of the global potash and magnesium industry;
- expectations regarding the Company's ability to finance the Project;
- future extraction and exploitation of mineral deposits;
- capital expenditure requirements;
- expectations regarding prices and costs;
- the completion of the Proposed Financing and the Proposed Spin-Out Transactions and the anticipated benefits to be derived therefrom;
- the terms of the Proposed Financing;
- development of mineral reserves and mineral extraction processes;
- the Company spending the funds available to it as stated in this MD&A;
- expectations regarding the Company's ability to subsequently raise capital;
- expenditures to be made by the Company to meet certain work commitments;
- future reductions in general and administrative costs resulting in a lower burn rate;
- work plans to be conducted by the Company, and
- reclamation and rehabilitation obligations and liabilities.

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

- the future stability of potash prices and the cyclical nature of potash prices;

- the Company's ability to commence and ramp up production from 625,000 TPY, to 1.375 million TPY, and thereafter to 2.125 million TPY of potash;
- the Company's expectation that the Saskatchewan Ministry of the Economy will convert the lands subject to Permit KP 360A into one or more new leases and amend the Lease, as described herein;
- the capital expenditures related to the Project will be lower than conventional underground mines;
- the use of solution mining process;
- the Company's ability to economically extract and process mineralized material into potash;
- the Company's ability to maintain a strong working capital position in the near term;
- the Company's ability to obtain additional financing on satisfactory terms;
- future increases in global fertilizer demand and consumption;
- anticipated results of development and extraction activities and estimated future development; and
- the possible reversal of a portion, or all, of the impairment loss.

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

- the global potash market stabilizes and the stock prices of potash companies rebound above the current depressed market;
- the Company is able to manage its working capital position and is able to act on appropriate strategies and opportunities to access the capital markets as they arise;
- the Company obtains additional financing in the future;
- the Company is able to successfully negotiate definitive documentation with respect to the Proposed Financing;
- the Company is able to receive, in a timely manner, the necessary regulatory approvals, Board of Directors approval, shareholder approval and other third party approvals;
- the Company is able to obtain the Proposed Financing on terms favourable to it;
- the Company is able to successfully spin-out its secondary mineral rights and unexplored lands;
- the Company continues to have title to its properties, and such title is not challenged or impacted in any material manner; and
- the Company is able to obtain required approvals, licenses, leases and permits, in a timely manner.

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 Project;
- the risks associated with the Proposed Financing and the Proposed Spin-Out Transactions;
- additional funding requirements;
- the risks associated with the limited operating history of the Company;
- no assurance of titles, leases or maintenance of existing permits;
- permit and licensing requirements related to exploration and development activities;

Karnalyte RESOURCES

- the risks associated with the enforcement of the Company's material agreements;
- the potential loss of key employees, technical experts or key suppliers;
- the potential for a volatile market for the Common Shares;
- 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 prices;
- the cyclical nature of the potash industry;
- 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.