
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

For the year ended December 31, 2020

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2020**

This management's discussion and analysis ("**MD&A**") has been prepared as of March 29, 2021 and should be read in conjunction with the consolidated financial statements of Eupraxia Pharmaceuticals Inc. ("**Eupraxia**" or the "**Company**") for the years ended December 31, 2020 and 2019 and the related notes thereto (the "**Audited Financials**"). The Audited Financials are prepared in accordance with International Financial Reporting Standards ("**IFRS**") and all dollar amounts are expressed in Canadian dollars unless otherwise noted. In this discussion, unless the context requires otherwise, references to "we" or "our" are references to Eupraxia. Additional information relating to our Company is available in our final long form prospectus ("**Prospectus**"), filed on SEDAR on March 3, 2021.

Effective March 5, 2021, the Company consolidated all of its issued and outstanding common shares of the Company (the "**Common Shares**") on the basis of four pre-consolidated Common Shares for one post-consolidated Common Share (the "**Share Consolidation**"). All references to the Common Shares in this MD&A and the audited consolidated financial statements for the years ended December 31, 2020 and 2019 have been adjusted to reflect the Share Consolidation.

**Forward-Looking Statements**

Certain statements and information in this MD&A contain forward-looking statements or forward-looking information under applicable Canadian securities legislation that may not be based on historical fact, including, without limitation, statements containing the words "may," "might," "will," "likely", "could," "would," "should," "expect," "intend," "plan," "objective," "goal," "outlook," "anticipate," "believe," "estimate," "predict," "project," "forecast," "estimate," "potential," "target," "seek," "contemplate," "continue," "design," and "ongoing," or the negative of these terms or other comparable terminology, although not all forward-looking statements contain these words and similar expressions. Forward-looking statements include estimates, plans, expectations, opinions, forecasts, projections, targets, guidance or other statements that are not statements of fact. Such forward-looking statements are made as of the date of this MD&A.

Forward-looking statements are necessarily based on estimates and assumptions made by us in light of our experience and perception of historical trends, current conditions and expected future developments, as well as the factors we believe are appropriate. Forward-looking statements in this MD&A include, but are not limited to, statements relating to:

- the Company's business strategies and objectives, including current and future plans, expectations and intentions;
- our ability to obtain funding for our operations, including funding for research, development and commercial activities;
- the Company's projected operating expenses and capital expenditures;
- our ability to achieve profitability;
- projected revenues, future trends, opportunities and growth in the Company's industry and the drug development markets;
- the Company's ability to maintain and enhance its competitive advantages and technological advantages;
- the entry into commercial partnerships and commercialization of our technology;
- the Company's ability to enter into definitive agreements with its contract research organizations;
- the Company's ability to enter into co-development and/or collaborative partnership;
- the Company's clinical development activities;
- the timing and results of clinical trials;
- the success of regulatory submissions;
- potential regulatory approval;
- hiring of additional research and development team members;
- the potential for the Company's technology to impact the drug delivery process;
- the Company's ability to protect, expand upon and exploit its existing intellectual property;
- development of additional intellectual property, ability to patent or otherwise protect such developed intellectual property and licenses with third parties for intellectual property;

- entry into sponsored research agreement and the benefits therefrom;
- competitive advantages of the Company and its technology;
- application of regulations and standards to the Company's future products and services or research and development activities;
- the Company's retention of funds or payment of dividends;
- the translation of the Company's technologies and expansion of its offerings into clinical applications;
- the benefits to patients from Eupraxia's platforms;
- the value of the strategic relationship to Eupraxia's clients and investors;
- the Company's engagement with legal and regulatory authorities in various jurisdictions;
- the demand and commercial viability of the Company's technology; and
- the demand and market acceptance for products developed by the Company.

Forward-looking statements and information involve significant risks, assumptions, uncertainties and other factors that may cause actual future results or anticipated events to differ materially from those expressed or implied in any forward-looking statements or information and, accordingly, should not be read as guarantees of future performance or results. These risks and factors include, but are not limited to:

- we have a limited operating history;
- we have a novel technology with uncertain market acceptance;
- if we breach any of the agreements under which we license rights to our product candidates or technology from third parties, we could lose license rights that are important to our business. Our current license agreement may not provide an adequate remedy for its breach by the licensor;
- our technology may not be successful for its intended use;
- our future technology will require regulatory approval, which is costly and we may not be able to obtain it and we may fail to obtain regulatory approvals or only obtain approvals for limited uses or indications;
- until contained, a global pandemic, including COVID-19, could cause a slowdown in global economic growth, impact the Company's business, operations, financial condition and share price and cause delays or disruptions to the running of Eupraxia's Phase 2 study;
- we completely rely on third parties to provide supplies and inputs required for our products and services;
- we rely on external contract research organizations to provide clinical and non-clinical research services and agreements with the Company's clinical contract organization have not yet been signed;
- if we are unable to establish sales and marketing capabilities or enter into agreements with third parties to market and sell our drug candidates, if approved, we may be unable to generate any product revenue;
- we rely on key personnel;
- we may not be able to successfully execute our business strategy;
- we will require additional financing, which may not be available;
- we are in a highly competitive industry which is continuously evolving with technological changes;
- our future success will depend on our ability to continually enhance and develop our products and services;
- if we are unable to differentiate EP-104IAR from existing therapies for treatment of osteoarthritis ("**OA**"), or if the US Food and Drug Administration (the "**FDA**") or other applicable regulatory authorities approve new or generic products that compete with EP-104IAR, our ability to successfully commercialize EP-104IAR would be adversely affected;
- a variety of risks associated with potential international business relationships could materially adversely affect our business;
- co development and/or collaboration arrangements we may enter into in the future may not be successful;
- we may acquire businesses or products, or form strategic alliances in the future, and we may not realize the benefits of such acquisitions or alliances;
- we do not have any long-term customer commitments;
- we have traditionally relied on key collaborations and grants;
- our business and operations would suffer in the event of computer system failures, cyberattacks, or a deficiency in our cyber security;
- we may fail to manage our growth successfully which may adversely impact our operating results;
- any therapeutics we develop will be subject to extensive, lengthy and uncertain regulatory requirements, which could adversely affect our ability to obtain regulatory approval in a timely manner, or at all;

- we may not be able to obtain marketing approval;
- we rely on the protection of our intellectual property rights;
- the Company may not be able to enforce the Company's intellectual property rights throughout the world;
- guidelines and recommendations published by various organizations can reduce the use of products that we may commercialize;
- patent reform legislation in the US;
- risk of reduced or eliminated patent protection from non-compliance with regulatory requirements;
- we may infringe the intellectual property rights of others;
- we may be subject to claims arising from consultants or contractors misappropriating intellectual property;
- we use hazardous chemicals and biological materials in our business. Any claims relating to improper handling, storage or disposal of these materials could be time consuming and costly;
- if product liability lawsuits are brought against us, then we may incur substantial liabilities and may be required to limit commercialization of EP-104IAR, if approved, and any other future products;
- our employees, independent contractors, principal investigators, consultants, commercial partners and vendors may engage in misconduct or other improper activities, including non-compliance with regulatory standards and requirements and insider trading, which could significantly harm our business;
- we may be subject to securities litigation, which is expensive and could divert management attention;
- the Company may be unable to adequately prevent disclosure of trade secrets and other proprietary information;
- lawsuits relating to intellectual property infringement will be costly and time consuming;
- intellectual property disputes could distract the Company's personnel from their normal responsibilities;
- our directors may serve as directors of other biotech companies and may have conflicts of interest;
- our business is affected by macroeconomic conditions;
- the Company may be responsible for corruption and anti-bribery law violations;
- we are subject to foreign exchange risks;
- we are subject to taxation risks and changing rules by different tax authorities;
- we have had negative operating cash flows since inception and expect to incur losses for the foreseeable future;
- we are subject to a number of risks and hazards, of which not all of them may be sufficiently insured for;
- our Company will devote significant resources to regulatory compliance as a public entity;
- coverage and reimbursement may be limited or unavailable in certain market segments for our product candidates, if approved, which could make it difficult for us to sell any product candidates or therapies profitably;
- our relationships with healthcare providers and physicians and third-party payors will be subject to applicable anti-kickback, fraud and abuse and other healthcare laws and regulations, which could expose us to criminal sanctions, civil penalties, contractual damages, reputational harm and diminished profits and future earnings;
- ongoing healthcare legislative and regulatory reform measures may have a material adverse effect on our business and results of operations;
- investing in the Common Shares (as defined in the Prospectus) is speculative, and investors could lose their entire investment;
- we may experience fluctuations in our market value;
- our Common Shares could be subject to large price and volume volatility;
- we will need to raise additional financing in the future which may dilute our share capital;
- we have no history of dividends;
- there is no established market for our Common Shares
- our existing executive officers and directors own a significant percentage of Common Shares and will be able to exert a significant control over matters submitted to the Company's shareholders for approval;
- future sales of shares of the Common Shares by our existing shareholders could cause the Company's share price to decline;
- we may issue, without shareholder approval, Preferred Shares (as defined in the Prospectus) that have rights and preferences potentially superior to those of the Common Shares; and
- if equity research analysts do not publish research or reports about our business or if they issue unfavourable commentary or downgrade our Common Shares, the price of the Common Shares could decline.

Such statements reflect our current views with respect to future events, are subject to risks and uncertainties and are necessarily based upon a number of estimates and assumptions that, while considered reasonable by Eupraxia as of the date of such statements, are inherently subject to significant medical, scientific, business, economic, competitive, political and social uncertainties and contingencies. Many factors could cause our actual results, performance or achievements to be materially different from any future results, performance, or achievements that may be expressed or implied by such forward-looking statements. In making the forward-looking statements included in this MD&A, the Company has made various material assumptions, including but not limited to (i) the Company's ability to attract and retain skilled staff; (ii) future research and development plans for the Company proceeding substantially as currently envisioned; (iii) industry growth trends, including with respect to projected and actual industry sales; (iv) the Company's ability to obtain positive results from the Company's research and development activities, including clinical trials; (v) sufficient working capital and the Company's ability to control costs and raise additional financing going forward; (vi) obtaining regulatory approvals and the potential benefits of our products, if approved; (vii) general business and economic conditions; (viii) the Company's ability to achieve profitability; (ix) the Company's ability to successfully commercialize its current products, enter into commercial partnerships and develop new products; (x) the availability of financing on reasonable terms; (xi) market competition; (xii) the products and technology offered by the Company's competitors; (xiii) the Company's ability to protect patents and proprietary rights; (xiv) the impact of the COVID-19 pandemic on our business, our industry and the economy; and (xv) the availability and cost of personnel, materials and supplies.

In evaluating forward-looking statements, current and prospective shareholders should specifically consider various factors, including the risks outlined herein under the headings "*Market Risk*", "*Interest rate risk*", "*Liquidity Risk*" and "*Credit Risk*" and under the heading "*Risk Factors*" in the Prospectus. Should one or more of these risks or uncertainties, or a risk that is not currently known to us materialize, or should assumptions underlying those forward-looking statements prove incorrect, actual results may vary materially from those described herein. These forward-looking statements are made as of the date of this MD&A and we do not intend, and do not assume any obligation, to update these forward-looking statements, except as required by applicable securities laws. Investors are cautioned that forward-looking statements are not guarantees of future performance and are inherently uncertain. Accordingly, investors are cautioned not to put undue reliance on forward-looking statements.

**COVID-19**

On March 11, 2020, the World Health Organization declared COVID-19 a pandemic. In response to the pandemic, we have modified our business practices with a focus on the health and safety of our employees, partners, service providers, and communities. At the onset of the outbreak of COVID-19, the Company implemented appropriate measures to allow our offices to remain open and operational while allowing employees to work from home where possible.

While our Company remained open and operational, several of our partners were impacted by COVID-19 (including shutdown of some of their offices), which resulted in project delays. The effect of COVID-19 on other aspects of our results of operations and financial performance remains uncertain and may only be known in future periods.

**Overview of the Company**

Eupraxia is a clinical stage biotechnology company focused on the development of locally-delivered, extended-release alternatives to new and existing pharmaceuticals. Leveraging our proprietary and innovative delivery technology, Eupraxia's goal is to provide the right dose of drug, in the right place, for the right amount of time in indications with a high unmet medical need. Each of Eupraxia's product candidates are designed to achieve improved patient benefit by providing longer term activity than currently available treatments, combined with precisely targeted local delivery. This offers the dual potential of providing long-lasting treatment while minimizing safety complications in target and non-target tissues.

Eupraxia's lead product candidate, EP-104IAR, is designed to meet the significant unmet medical need and market demand for long-lasting pain relief for knee osteoarthritis ("**OA**"). Knee OA accounts for approximately 80% (US$5.6 billion) of the global US$7.3 billion OA therapeutics market, which is currently underserved by pharmaceuticals that are challenged by poor safety, inadequate efficacy, and/or limited duration.

*Overview of Osteoarthritis*

OA is a chronic progressive disease characterized by deterioration of joint cartilage and inflammation which results in pain and stiffness, usually in the morning or after a period of inactivity; and loss of joint function which limits daily activities. In normal joints, cartilage acts as a cushion between bones and provides a smooth gliding surface for movement. In OA, the inflammatory processes integral to disease progression damage the cartilage, and over time cartilage wears away, causing bone to rub directly against bone resulting in joint damage, severe pain and disability.

Globally, OA is the leading cause of disability in older adults. Estimates of prevalence and incidence vary according to the definition of OA used (i.e., radiographic (x-ray) versus symptomatic) and the joints assessed. Approximately 10-15% of all adults over the age of 60 have some form of OA, with the knees being the most commonly affected joints. Knee OA is a leading cause of lower extremity disability in the developed world, OA is estimated to affect more than 30 million patients in the US alone, including an estimated 14 million people with symptomatic knee OA. It is also often associated with depression and loss of sleep which can greatly affect quality of life, causing further impact on the public health system.

Current evidence-based OA treatment guidelines aim to manage signs and symptoms, with the goal of slowing progression if possible. Recommended pharmacological interventions include topical and oral non-steroidal anti-inflammatory drugs, and IA corticosteroids. IA corticosteroid injections have been used for decades to manage pain and stiffness associated with inflammation in knee OA and have proven to be safe and effective. However, IA corticosteroid injections often result in suboptimal patient outcomes due to their short duration of activity and systemic side effects such as flushing, glucose alterations and cortisol suppression due to the high peak exposures required to maintain efficacious concentrations for prolonged durations. Evidence is also emerging regarding the risk of adverse joint findings and/or OA progression following frequent/repeated immediate release IA corticosteroid injections.

*Composition of EP-104IAR*

EP-104IAR contains a solid core of the active ingredient Fluticasone Propionate ("**FP**") with an outer layer of the biocompatible polymer, PVA. The PVA-coated FP particles are heat-treated to form the extended-release product EP-104IAR.

The active ingredient of EP-104IAR is FP, a synthetic trifluorinated corticosteroid with potent anti-inflammatory activity and a well-established systemic safety record in the form of widely used inhaled, intranasal and topical agents. FP has shown to be locally active, and what little is absorbed is rapidly metabolized. Relative to other corticosteroids (including triamcinolone acetonide or "**TCA"**) FP has a high affinity for the glucocorticoid receptor, low solubility, a low rate of dissociation, and a comparatively long half-life. The Company believes these characteristics make the drug an excellent candidate for prolonged anti-inflammatory activity.

FP is currently approved by the FDA, Health Canada, European Medicines Agency ("**EMA**") and many other regulatory agencies around the world for the treatment of symptoms of asthma, rhinitis, nasal polyps and a variety of inflammatory skin conditions. It has an established history of clinical efficacy and safety in its marketed inhaled and topical formulations in the form of Flovent®, Advair® and Cutivate®, amongst others. To the Company's knowledge, EP-104IAR is the only extended-release formulation of FP in development. FP is not currently approved for use in any formulation for the treatment of OA pain.

*EP-104IAR Development*

Eupraxia has completed Investigational New Drug ("**IND**")-enabling non-clinical studies, which demonstrated EP-104IAR has a potentially favourable tolerability profile, and a Phase 1 clinical study in 32 knee OA patients. See *"Development Program, Clinical Development."* Eupraxia anticipates initiating a Phase 2 efficacy and safety study in 2021. The IND application containing this Phase 2 study protocol is in effect with the US FDA. The Company is not required to wait for any additional approvals from the FDA to start the Phase 2 study in the US. Ethics approvals are still necessary to permit patient enrolment at any sites.

Eupraxia anticipates submitting a New Drug Application ("**NDA**") under the *Federal Food, Drug, and Cosmetic Act* (the "**FDCA**"), Section 505(b)(2) with the FDA, for approval of EP-104IAR, which is required before marketing a

new drug in the US. A 505(b)(2) NDA will rely in part on non-clinical studies and clinical trials that Eupraxia needs to conduct, and in part on third-party findings of safety and efficacy for the active ingredient for which Eupraxia does not have a right of reference or which have been established in the scientific literature in the public domain. Eupraxia intends to conduct activities to support marketing approval and commercialisation of EP-104IAR in the US and globally.

*Eupraxia's Pipeline Product Candidates*

Eupraxia's technology platform is potentially suitable for a wide range of indications and drugs that may be improved by an extended-release profile. The technology takes advantage of controlled diffusion of drug from the central core across a polymer-based membrane. Eupraxia can alter the polymer amount, composition and manufacturing parameters with the intent of achieving drug release rates that are designed to maximize disease treatment and reduce side effects. Unlike other technologies in which the drug is less than 20% of the injected material, with Eupraxia's technology the drug comprises more than 90% of the formulation given to patients.

In addition to EP-104IAR, Eupraxia is developing a pipeline of earlier-stage long-acting formulations. Potential pipeline candidates include drugs for a range of indications such as post-surgical pain (EP-105), and post-surgical site infections (EP-201), each designed to improve on the activity and tolerability of approved drugs. Eupraxia is also developing a formulation of EP-104IAR for use in canine and equine OA. Eupraxia currently anticipates that development, regulatory approval and commercialization of the veterinary version of EP-104IAR will be performed in collaboration with a third-party veterinary partner. Eupraxia is planning on adding an internally-developed oncology product candidate to our pipeline in 2021.

For a summary of anticipated EP-104IAR and pipeline program costs over the 24 months following the date of this MD&A see *"Development Timelines and Cost Estimates"* and "*Additional Development Costs"* below.

*Clinical Development*

Phase 1

Eupraxia completed a Phase 1, double-blind, placebo-controlled clinical study at three sites in Canada. Thirty-two patients with moderate to severe knee OA pain were given a single dose of 15 mg EP-104IAR (n=24) or placebo (n=8) and evaluated for up to 42 weeks or until the patient returned to baseline pain. The final median post-administration follow-up in the study was 23 weeks. The primary outcome measures were safety and PK. The study was not powered to detect efficacy; however, patient reported outcome measures were collected and analyzed to evaluate pain and symptom relief. Despite the limitations of this study (the small size, the low dose, nine subjects received significantly less than the target dose, and that two placebo subjects demonstrated a delayed high reduction in pain), the Company believes it provides safety and PK data, and preliminary efficacy results that support future development of EP-104IAR.

Phase 2

Eupraxia plans to conduct a Phase 2 clinical study for EP-104IAR beginning in 2021. Eupraxia, along with its key clinical advisors, have designed a study to evaluate the efficacy, safety and PK of 25 mg EP-104IAR (approximately double the dose administered in the phase 1 study) over six months in patients with moderate knee OA (defined as Kellgren Lawrence Grade 2-3, with moderate to severe pain (between 5 - 9 on a 0-10 point numerical pain rating scale)).

Phase 3

In order to seek marketing approval for EP-104IAR, the Company will be required to carry out at least one Phase 3 study with at least several hundred patients. The target patient population will be dependent on the advice of our clinical advisors, key opinion leaders, discussions with the FDA and EMA, and the results from the Phase 2 study. In the Phase 3 program, Eupraxia anticipates patients will participate in the trial over a 12-month period. In addition to efficacy and safety assessments, Eupraxia plans to evaluate the impact of EP-104IAR on cartilage health (e.g., via X-Ray and/or MRI).

Clinical Development

The FDA requires two adequate and well-controlled clinical trials demonstrating the safety and efficacy of any proposed new treatment as part of the NDA. For EP-104IAR, this will require data from the proposed Phase 2 study and at least one other Phase 3 study. To fulfil requirements under the 505(b)(2) pathway, Eupraxia may also be required to conduct a clinical trial to establish pharmacokinetic equivalence between EP-104IAR and Flovent® HFA. Additional clinical studies and/or analyses may be required for alternate regulatory jurisdictions.

*Development Timelines and Cost Estimates*

Eupraxia currently anticipates advancing the development of EP-104IAR through to completion of Phase 2 within the next two years. The figure below summarizes our current estimates of development timelines and costs for EP-104IAR and pipeline products over the 24 months following the date of this MD&A.

**Eupraxia's Estimated Product Development Timelines and Costs to End of Phase 2**

| Program | Development Milestones | 2021 Q1 | 2021 Q2 | 2021 Q3 | 2021 Q4 | 2022 Q1 | 2022 Q2 | 2022 Q3 | 2022 Q4 | Cost (C$) |
|---|---|---|---|---|---|---|---|---|---|---|
| **EP-104IAR** | Phase 2 Efficacy Study | | | ■ | ■ | ■ | ■ | ■ | | 13,821,000 |
| | Manufacturing Optimisation for Phase 3 | | ■ | ■ | ■ | ■ | ■ | | | 1,397,000 |
| | Non-clinical Studies to support Phase 3 | | | ■ | ■ | ■ | ■ | ■ | | 1,098,000 |
| **Pipeline** | Formulation Development & In vivo proof of concept | ■ | ■ | ■ | ■ | ■ | ■ | ■ | ■ | 681,000 |
| | | | | | | | | | **Total** | 16,997,000 |

*Additional Development Costs*

The Company estimates the total additional cost to reach commercial launch of EP-104IAR will consist of C$70 million in development and regulatory costs, C$100 million in commercial and marketing fees, and C$20 million in other direct personnel fees. The final cost and timing of the commercial launch of EP-104IAR will depend on multiple factors, including results of the Company's clinical studies. These costs will be spread out over three to four years. The Company believes there will be multiple events, including the readout of our Phase 2 and future Phase 3 studies, that will provide opportunities for Eupraxia to either raise more capital or transact on the EP-104IAR asset. These opportunities will have the potential to either fund the program or to shift some or all of these development costs to other parties. If, for any reason, the Company decides to not take EP-104IAR forward after the conclusion of the upcoming Phase 2 trial, then these costs would not be incurred. See "*Risk Factors – We will require additional financing, which may not be available*" in the Prospectus for a discussion of the risks associated with the Company's requirement for additional financing.

*Eupraxia Business Strategy*

Eupraxia's goal is to deliver long-acting medications based on proven treatments in areas of high unmet medical need.

Our focus over the 24 months following the date of this MD&A will be the execution of the EP-104IAR development program, including:

- Initiation and completion of the Phase 2 clinical study to evaluate the safety and efficacy of EP-104IAR to support a new drug application;
- Manufacturing optimization to simplify the supply chain, reduce the cost of goods and prepare for Phase 3 activities; and
- Complete non-clinical studies to support subsequent Phase 3 clinical studies that would enhance the EP-104IAR label (e.g., a multi-dose study) and evaluate the safety and biocompatibility of all excipients.

Additional EP-104IAR development activities will include interactions with key regulatory authorities, such as the FDA and the EMA, to obtain program guidance and explore expedited review program options (e.g., Fast Track, Breakthrough Therapy) as well as the continued execution of the patent strategy.

In parallel, the Company will seek out licencing, co-development or marketing partners for select geographies (e.g., Asia Pacific) and market segments (e.g., veterinary). It is the Company's intention to put in place conditions and resources that support the success of the development program, marketing authorization(s) and commercialization across multiple jurisdictions, as well as exploitation of any opportunities for lifecycle and patent extension. Depending on market conditions, this may take the form of co-development or commercialization partnerships, transactional opportunities and/or public financing options.

Pipeline programs are another area of potential growth in the 24 months following the date of this MD&A. Eupraxia's platform technology is potentially compatible with a wide variety of drugs and therapeutic indications. Our pipeline strategy focusses on modulating the release of existing drugs to achieve better clinical outcomes in areas of high medical need. The technology has the potential to be particularly suitable for diseases requiring precisely targeted and controlled localized therapy where broader tissue or systemic exposure should be avoided (e.g., tumour oncology).

We currently have three pipeline candidates in development. Our goal is to add a further 1-2 new pipeline product candidates over the 24 months following the date of this MD&A to allow for sustained corporate growth. Eupraxia expects that this will involve a multidisciplinary review of candidate drugs, formulation development, *in vitro* screening to identify the most promising lead candidates and non-clinical proof-of-concept studies. Information generated from these inquiries will be used to support go/no go decisions for further development.

**Subsequent Events**

Subsequent to December 31, 2020 the following events occurred:

Amendments to Amended and Restated License Agreement

The Company's subsidiary, Eupraxia Pharmaceuticals USA, LLC ("**Eupraxia USA**"), entered into an amended and restated license agreement with Auritec Pharmaceuticals Inc. ("**Auritec**") on October 9, 2018 (as further amended, the "**Amended and Restated License Agreement**"). Under the terms of the Amended and Restated License Agreement, Auritec has granted Eupraxia USA an exclusive license (including the right to sublicense to its affiliates and third parties) under the licensed patents held by Auritec and for all the technical information and know-how relating to the technology claimed in the licensed patents held by Auritec with respect to the use of Auritec's "Plexis Platform" for the delivery of fluticasone in all medical fields (except for otolaryngology and the prevention, treatment and control of all diseases, disorders and conditions of the eye and its adnexa (collectively, the "**Excluded Fields**")), to develop, make, have made, manufacture, use, commercialize, sell, sub-license, offer for sale, import, and have imported products for the delivery of fluticasone drug products using the Plexis Platform in all medical fields except the Excluded Fields ("**Licensed Products**").

Pursuant to the terms of the Amended and Restated License Agreement, in consideration for the rights and exclusive license granted to Eupraxia USA, Eupraxia USA was required to pay an upfront payment of US$5,000,000 (the "**Upfront Fee**"), in respect of which Eupraxia USA had made partial payment of US$1,200,000 as of December 31, 2020. On January 6, 2021, Eupraxia USA and Auritec entered into the seventh amendment to the Amended and Restated License Agreement, pursuant to which the parties agreed to extend the deadline for the US$3,800,000 balance of the Upfront Fee such that US$1,650,000 would be paid on or prior to the earlier of January 8, 2021. Eupraxia USA paid such amount on January 6, 2021. The deadline for the remaining US$2,150,000 balance plus outstanding interest was due on or prior to the earlier of December 31, 2021 or three days after which Eupraxia received aggregate proceeds of debt and/or equity financing of US$12,000,000 or more. The remaining balance, including principal and accrued interest totalling US$2,343,999, was paid to Auritec on March 9, 2021 following completion of the Offering (as defined below).

Issuance of Convertible Notes

On January 5, 2021, the Company issued a convertible unsecured promissory note with an aggregate principal amount of $100,000. The note had a maturity date of December 31, 2021 and accrued interest at 10% per annum. In the event of a "Qualified Financing" the principal amount and accrued and unpaid interest under the note would automatically convert into Common Shares at a conversion price equal to a 30% discount to the per share price of the Qualified Financing. In the event the note reached maturity on December 31, 2021 prior to the completion of a Qualified Financing, the principal amount and the accrued and unpaid interest would convert into Common Shares at a price of $4.00 per share. The note converted into Common Shares on completion of the Offering as described below under "Subsequent Events - Conversion of Convertible Notes and Special Warrants".

Shareholder Loans

On January 4, 2021 and January 8, 2021, the Company borrowed an aggregate of US$1,700,000 from certain shareholders and a director of the Company, which loans were unsecured, incur interest at a rate of 10% per annum and mature on December 31, 2021. Under the terms of the loans, following completion of the Offering (which represented an arm's length equity financing exceeding US$15,000,000), each lender has the right to convert the principal and accrued but unpaid interest under their respective loan into Common Shares at an exercise price of $5.5993 per share, representing a 30% discount to the per share purchase price of the Common Shares issued and sold in the Offering. As of the date of this MD&A, the full balance of principal and interest remained outstanding under such loans. As consideration for providing such loans, the lenders were issued common share purchase warrants to acquire an aggregate of 270,957 Common Shares for a period of three years from the date of issuance at an exercise price of $4.00 per share, provided that, upon completion of the Offering, the exercise price of such common share purchase warrants was adjusted to $5.5993 per share, being an amount equal to a 30% discount to the per share price of the Common Shares issued and sold in the Offering, in accordance with the terms of such common share purchase warrants.

SR&ED Loan

On January 4, 2021, the Company borrowed US$250,000 from a director of the Company. The loan is unsecured, incurs interest at a rate of 15% per annum and matures on December 31, 2021. The Company intends to repay the loan using the proceeds of the Scientific Research and Experimental Development Tax Incentive Program (SR&ED) tax credits and/or refunds received by the Company in regards to the 2020 calendar year. As of the date of this MD&A, the full balance of principal and interest remained outstanding under such loan. As consideration for providing the loan, the lender was issued common share purchase warrants to acquire a total of 39,846 Common Shares for a period of three years at an exercise price of $4.00 per share, provided that upon completion of the Offering, the exercise price of such common share purchase warrants was adjusted to $7.1991, being an amount equal to a 10% discount to the per share price of the Common Shares issued and sold in the Offering, in accordance with the terms of such common share purchase warrants.

US Subsidiary Restructuring

On January 31, 2021, the Company entered into a contribution agreement with Amanda Malone, the Chief Scientific Officer of the Company, and certain of the Company's subsidiaries (the "**Contribution Agreement**"). Pursuant to the Contribution Agreement, the Company acquired AMDM Holdings Inc., a corporation wholly-owned by Ms. Malone, which held 5% of the equity interest in the Company's subsidiary, Eupraxia USA. In exchange, the Company issued to Ms. Malone 225 non-voting Class B shares (the "**Class B Shares**") in Eupraxia Pharma Inc. ("**Eupraxia Pharma**"), representing 5% of the outstanding securities of Eupraxia Pharma. The Company holds the remaining 95% of such securities, which consists of 4,275 voting Class A shares.

Each Class B Share is exchangeable into Common Shares based on an exchange rate of 2,500 Common Shares for each Class B Share, subject to adjustments upon the occurrence of certain events, for a total of 562,500 Common Shares. The Class B Shares are exchangeable by Ms. Malone at her election, provided that the Company may force the exchange of the Class B Shares into Common Shares at any time on or after January 31, 2031, or on or after January 31, 2026 if the Company is listed on a stock exchange and is a reporting issuer in Canada at such time. The Company may also force the exchange of the Class B Shares into Common Shares if there is a change of control transaction involving the Company, a change in law which makes the exchange necessary or desirable or if there are a *de minimis* number of Class B Shares outstanding. If the Company is listed on a stock exchange at the time of the

applicable exchange, the Company may elect to pay Ms. Malone cash in lieu of issuing Common Shares, with such cash amount to be determined based on the then current market price of the Common Shares.

Amendment to Outstanding Loan Agreements

On January 20, 2021, the Company entered into an amending agreement with each of the lenders outlined in Note 11 of the Audited Financials, pursuant to which the maturity date under each loan agreement was extended to December 31, 2021. Each lender was also granted the right to convert the principal amount under the loan into Common Shares at a price of $7.1991 per share, representing a 10% discount to the per share price of the Common Shares issued and sold in the Offering. If the applicable lender elects to convert such principal amount, the remaining accrued but unpaid interest will, at the election of the Company, either be paid to the applicable lender in cash out of the Company's working capital or converted into Common Shares at a price of $7.1991 per Common Share. At the time of such repayment or conversion, all security interest under the loans will be discharged. As of the date of this MD&A, the full balance of principal and interest remained outstanding under such loans.

Existing Option Re-Pricing

On March 2, 2021, the Company adjusted the exercise price of all existing stock options, as referenced in Note 14 of the Audited Financials, to $8.00.

Initial Public Offering

On March 3, 2021, the Company obtained a receipt for its final prospectus filed with the securities regulatory authorities in each of the provinces of Canada, other than Quebéc, in connection with the initial public offering (the "**Offering**") of 5,125,000 units of the Company (the "**Units**") at a price of $8.00 per Unit (the "**Offering Price**") for gross proceeds of $41,000,000.

Each Unit consist of one common share in the Company and one-half of one common share purchase warrant of the Company (each whole common share purchase warrant, a "**Warrant**"). Each Warrant is exercisable into one common share of the Company (each, a "**Warrant Share**") at an exercise price of $11.20 per Warrant Share at any time prior to 5:00 p.m. (Toronto time) on the date that is five years following the closing of the Offering, subject to adjustment in certain events. The Warrants include an acceleration provision, exercisable at the Company's option, if the Company's daily volume weighted average share price is greater than $22.40 for five consecutive trading days.

Raymond James Ltd. acted as sole bookrunner and lead agent for the Offering on behalf of a syndicate of agents including BMO Nesbitt Burns Inc. and Canaccord Genuity Corp. (collectively the "**Agents**").

The Company also granted the Agents an over-allotment option (the "**Over-Allotment Option**"), exercisable in whole or in part, at the sole discretion of the Agents, at any time up to 30 days following the closing of the Offering, to purchase up to an additional number of Units equal to 15% of the Units sold pursuant to the Offering (the "**Agents' Option Units**") at a price of $8.00 per Agents' Option Unit to cover the Agents' over-allocation position, if any, and for market stabilization purposes.

The closing of the Offering occurred on March 9, 2021 (the "**Closing Date**"). The Company is now listed on the Toronto Stock Exchange ("**TSX**") with the listing of both the Common Shares and the Warrants under the symbols "EPRX" and "EPRX.WT", respectively. On March 23, 2021, the Agents partially exercised the Over-Allotment Option pursuant to which the Company issued 263,775 Warrants to the Agents at a price of $0.002 per Warrant for gross proceeds of $527.55.

Conversion of Convertible Notes and Special Warrants

On March 9, 2021, upon the closing of the Offering, (i) the $6,690,000 aggregate principal amount of convertible notes issued from June 19, 2018 to May 23, 2019 (collectively, the "**Convertible Notes (10%)**"), plus accrued and unpaid interest of $**1,457,086.30**; (ii) the $831,000 aggregate principal amount of convertible notes issued from June 1, 2020 to January, 2021 (collectively, the "**Convertible Notes (30%)**"), plus accrued and unpaid interest $**50,918.00**; and (iii) 857,500 special warrants (collectively, the "**Special Warrants**"), were automatically converted into **1,103,886** Common Shares and 157,501 Common Shares and exercised into **298,798** Common Shares, respectively.

The Offering constituted a "Qualified Financing", being an arm's-length equity financing resulting in gross proceeds to the Company of at least US$15,000,000 and pursuant to the terms of the Convertible Notes (10%), the Convertible Notes (30%) and the Special Warrants, such securities automatically converted or were deemed to be exercised, as the case may be, into Common Shares.

The Convertible Notes (10%) had an accruing interest rate of 10% per annum. The principal amount and accrued and unpaid interest converted automatically into Common Shares on the closing of the Offering at a conversion price equal to $7.1991, representing a 10% discount to the per share price of the Common Shares issued and sold in the Offering.

The Convertible Notes (30%) had an accruing interest rate of 10% per annum. The principal amount and accrued and unpaid interest converted automatically into Common Shares on the closing of the Offering at a conversion price equal to $5.5993, representing a 30% discount to the per share price of the Common Shares issued and sold in the Offering.

The Special Warrants were automatically exercised into Common Shares on the closing of the Offering based on the per share price of the Common Shares issued and sold in the Offering of $7.999, without payment of any additional consideration, in accordance with the following formula, where "SW" means the number of Special Warrants and "D" means the number of days between the issuance date of the Special Warrants and the Closing Date:

$$(SW \times \$2.00) / (\$7.999 \times 0.9) + 0.1 \times [(SW \times \$2.00) / (\$7.999 \times 0.9)](D / 365)$$

**Selected Annual Information**

The financial information reported here-in has been derived from the consolidated financial statements prepared in accordance with IFRS. The Canadian dollar is the Company's functional and presentation currency. From time to time, the Company may deal with manufacturers and consultants in other countries (primarily the United States). Our financial results may be subject to fluctuations between the Canadian dollar and other international currencies, primarily the U.S. dollar.

The following table represents selected financial information for the Company's years ended December 31, 2020, 2019 and 2018.

*Selected Condensed Consolidated Statement of Loss Data*

| | **Year ended December 31** | | |
|---|---|---|---|
| | **2020** | **2019** | **2018** |
| | **$** | **$** | **$** |
| Revenue | - | - | - |
| Total comprehensive (loss) – Owners of the Company | (3,997,202) | (7,176,138) | (13,231,983) |
| Total comprehensive (loss) – Non-controlling interest | (13,436) | (64,439) | (1,601,025) |
| Weighted average shares outstanding, basic and diluted | 6,118,673 | 6,118,002 | 6,118,002 |
| Loss per share, basic and diluted – Owners of the Company | (0.65) | (1.17) | (2.16) |
| Loss per share, basic and diluted – Non-controlling interest | (0.00) | (0.01) | (0.26) |

The comprehensive loss for the year ended December 31, 2020 decreased by $3,229,939 as compared to the year ended December 31, 2019, primarily due to lower research and development expenses and general and administration expenses recognized during 2020.

*Selected Consolidated Statement of Financial Position Data*

| | **Year ended December 31, 2020** | **Year ended December 31, 2019** | **Year ended December 31, 2018** |
|---|---|---|---|
| | **$** | **$** | **$** |
| Cash and cash equivalents | 150,126 | 1,156,079 | 823,481 |
| Net working capital surplus/(deficit) | (21,404,017) | (18,027,707) | (11,870,686) |
| Total assets | 1,453,592 | 3,285,063 | 2,909,263 |

| | Year ended December 31, 2020 | Year ended December 31, 2019 | Year ended December 31, 2018 |
|---|---|---|---|
| | $ | $ | $ |
| Total non-current financial liabilities | 574,973 | 749,348 | - |
| Equity (deficit) attributable to owners of the Company | (21,209,762) | (17,690,390) | (11,059,202) |
| Non-controlling interest | (453,891) | (440,455) | (376,016) |
| Total shareholders' equity (deficit) | (21,663,653) | (18,130,845) | (11,435,218) |

Cash and cash equivalents decreased by $1,005,953 to $150,126 as at December 31, 2020 as compared to $1,156,079 at December 31, 2019. The decrease reflects funds used in operations primarily on research and development expenses and general and administration expenses.

Working capital deficit increased by $3,376,310 to ($21,404.017) as at December 31, 2020 from ($18,027,707) at December 31, 2019. This increase is attributable to the decrease in cash and amounts receivable, combined with an increase in accounts payable and accrued liabilities, convertible notes payable and the payable to Auritec.

The Company experienced a decrease in total assets to $1,831,471 as at December 31, 2020 from $3,285,063 as at December 31, 2019, primarily due to a lower cash and cash equivalents and amounts receivable balance. The Company also saw a decrease to equipment as a result of the closure of its Vancouver office and lab in the first quarter of 2020.

The Company did not pay any dividends or make any distributions to shareholders in any of the above periods.

**Comparison of the 2020 and 2019 financial years**

*Results of Operations*

| | 2020 $ | 2019 $ | Change $ |
|---|---|---|---|
| Research and development expenses | 859,781 | 2,941,935 | (2,082,856) |
| General and administrative expenses | 1,386,412 | 3,216,596 | (1,808,856) |
| Other expenses | 1,764,445 | 1,082,046 | 607,283 |
| Total comprehensive loss | 4,010,638 | 7,240,577 | (3,283,727) |

*Research and Development*

Comparing the year ended December 31, 2020, to the same period in 2019, research and development activities decreased in expenses to $859,781 from $2,941,935. This decrease in expense of $2,082,154 in research and development activities are primarily from the following items:

- A decrease of $2,047,962 resulting from a decrease in preclinical development, manufacturing and analytical and consulting costs. The reduction in the current period was a result of completing the manufacture of the drug product to be used in future clinical trials for the Arthritis Program (EP-104).

- A decrease of $193,450 relating to formulation, preclinical and consulting work associated with the Antibiotics program. The Company received grant funding for this program from the National Research Council via the Industrial Research Assistance Program ("**NRC-IRAP**") which concluded on January 15, 2020.

- A decrease of $359,623 relating to other research development costs which included legal fees associated with patent filing, travel expenses and laboratory expenses. Legal fees were higher in 2019 due to filings being made for EP-104 patents in multiple geographies. Laboratory expenses decreased as a result of the closure of our Vancouver office in the first quarter. Travel expenses have decreased during the current period as a result of the ongoing COVID-19 pandemic and its limitations on travel.

- A decrease of $584,997 relating to salaries and benefits resulting from the closure of our Vancouver office and the termination of lab-based employees in the first quarter of 2020.

- A decrease of $260,360 in relation to funding received from government grants. A government grant being received from the NRC-IRAP concluded on January 15, 2020 which resulted in less research and development costs being eligible for reimbursement during the current year.

*General and Administrative*

Comparing the year ended December 31, 2020, to the same period in 2019, general and administrative activities decreased in expenses to $1,386,412 from $3,216,596. This decrease in expense of $1,830,184 in general and administrative activities are primarily from the following items:

- A decrease of $141,165 related to consulting fees. In prior periods the Company had incurred costs related to business development activities associated with licensing opportunities and human resources initiatives associated with compensation benchmarking.

- A decrease of $422,423 related to professional fees. The higher fees in the prior period was directly related to higher legal fees associated with exploring financing opportunities.

- A decrease of $94,062 related to rent expense. The reduction in rent for the current period is a direct result of the Vancouver office closure and the expiry of our lease on March 31, 2020.

- A decrease of $390,863 related to salaries and benefits. The reduction to salaries and benefits in the current period is the result of a reduction in employees involved in business development and administrative support functions.

- A decrease of $ 316,270 related to stock-based compensation expense. This decrease for the current period was a result of no new stock-based compensation issued to board members or employees during 2019 and 2020.

- A decrease of $229,403 related to travel expenses. Travel expenses decreased in current periods as a result of the ongoing COVID-19 pandemic and its limitations on travel.

*Other expenses (income)*

Comparing the year ended December 31, 2020, to the same period in 2019, other income and expense increased to $1,764,445 from $1,082,046. This increase in expense of $682,399 was primarily from the following items:

- An increase of $417,845 related to interest expense. The increase in interest expense for the current period is primarily a result of loans and convertible notes entered into during 2019 and 2020 that had only accrued interest for a portion of the prior period.

- An increase of $132,759 related to loss on the sale of equipment. The loss in the current period relates to the sale of office and laboratory equipment following the closure of the Vancouver office in the first quarter of 2020.

- An increase of $211,423 related to foreign exchange loss. The increase in foreign exchange loss is a result of fluctuations in the US exchange rate versus the Canadian dollar on our cash and US denominated liabilities.

- An increase of $92,982 relating to a change in the estimated fair value of warrant liabilities for the respective periods.

We believe the Company has sufficient personnel to manage both its Research and Development and public company activities and anticipate minimal increases in staffing. Research and Development expenses are expected to increase as we undertake our Phase 2 clinical trial and incur significant costs for Contract Research Organizations and other consultants. General and administrative expenses are likely to increase in the future as a result of increased compliance costs associated with the Company going public.

**Selected Quarterly Information**

Selected Quarterly Information and Fourth Quarter Analysis have not been provided as the Company has not previously prepared financial statements on a quarterly basis prior to becoming a reporting issuer.

**Liquidity, Capital Resources and Outlook, Management of Cash Resources**

As of December 31, 2020, the Company had a cash balance of $150,126 and a working capital deficiency of $21,404,017. Of this working capital deficit, $10,307,751 relates to convertible notes payable and special warrants that are being settled via equity conversion.

The Company's business currently does not generate revenue or positive cash flows from operations and is reliant on equity and debt financing to provide the necessary cash to continue its research and development activities and ongoing operations. There can be no assurance that equity financings will be available in the future with terms that are satisfactory to the Company.

The Company's cash flow forecasts are continually updated to reflect actual cash inflows and outflows so to monitor the requirements and timing for additional financial resources. Given the volatility of the Canadian and US dollar exchange rate, the Company estimates its USD expenses for the year and sets appropriate levels of USD cash and cash equivalent balances. By holding US dollars, the Company remains subject to currency fluctuations which effect its loss and comprehensive loss during any given year.

Further, we continue to monitor additional opportunities to raise equity capital and/or secure additional funding through non-dilutive sources such as government grants and additional license agreements. However, it is possible that our cash and working capital position may not be enough to meet our business objectives in the event of unforeseen circumstances or a change in our strategic direction.

As referenced in the Subsequent Events, the Company recently completed an Initial Public Offering for gross proceeds of $41,000,000. These funds will be used to fund our Phase 2 clinical trial and advance other drugs in the Company's pipeline. The remainder of the net proceeds will be used for working capital and general corporate purposes and based on current forecasts, will be sufficient to fund the Company through to late 2022.

**Comparison of Cash Flow**

| | **December 31, 2020** | **December 31, 2019** |
|---|---|---|
| | **$** | **$** |
| Net cash provided by (used in): | | |
| Operating activities | (403,927) | (5,171,012) |
| Investing activities | 24,618 | (1,895,039) |
| Financing activities | (626,644) | 7,398,649 |
| Net increase (decrease) in cash | **(1,005,953)** | **332,598** |

Cash used in operating activities:

Cash used in operating activities for the year ended December 31, 2020 and 2019 was $403,927 and $5,171,012 respectively. Our use of cash for operating activities primarily consisted of salaries and wages for our employees, fees paid in connection with preclinical and clinical studies, drug manufacturing costs and professional fees.

Cash used in investing activities:

Cash from investing activities for the year ended December 31, 2020 and 2019 was $24,618 and ($1,895,039) respectively. Our use of cash for investing activities primarily consisted of payments made to Auritec in relation to our licensing agreement combined with an offset from proceeds from the sale of capital equipment as a result of the Vancouver office closure in 2020.

Cash from financing activities:

Cash from financing activities for the year ended December 31, 2020 and 2019 was ($626,644) and $7,398,649 respectively. During the current period, $710,000 was received via the issuance of convertible notes. Lease payments totaling $100,695 were also made during the period. A repayment of $1,000,000 was made to the principal owing on a loan secured by the Company's 2019 SR&ED refund.

**Going Concern**

The consolidated financial statements have been prepared on a going concern basis with the assumption that the Company will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. At December 31, 2020, the Company has cash of $150,126 and a working capital deficit of $21,404,017 and the Company has not yet generated revenue from operations. The Company incurred a net loss of $4,010,638 during the year ended December 31, 2020 and, as of that date the Company's accumulated deficit was $51,197,157. As the Company is in the research and development stage, the recoverability of the costs incurred to date is dependent upon the ability of the Company to obtain the necessary financing to complete the research and development of its projects and upon future profitable production or proceeds from the monetization of research activities to date. The Company will periodically have to raise funds to continue operations and, although it has been successful in doing so in the past, there is no assurance it will be able to do so in the future. These events and conditions create a material uncertainty which may cast significant doubt about its ability to continue as a going concern. The consolidated financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue in business.

The continued operations of the Company are dependent on its ability to generate future cash flows or obtain additional financing. The Company is also active in its pursuit of additional funding through partnering, and other strategic activities, as well as via grants, to fund future research and development activities.

Management is of the opinion that sufficient working capital will be obtained from external financing and operations to meet the Company's liabilities and commitments as they become due. There is a risk that in the future, additional financing will not be available on a timely basis or on terms acceptable to the Company.

The consolidated financial statements do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern and, therefore, be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying consolidated financial statements. These adjustments could be material.

**Long-Term Obligations and Other Contractual Commitments**

The Company may be required to make milestone, royalty, and other research and development funding payments under research and development collaboration and other agreements with third parties. These payments are contingent upon the achievement of specific development, regulatory and/or commercial milestones. The Company has not accrued for these payments as at December 31, 2020 due to the uncertainty over whether these milestones will be

achieved. The Company's significant contingent milestone, royalty and other research and development commitments are as follows:

Auritec License Agreement

Auritec is a privately held clinical-stage drug delivery company that holds patents in the field of extended release delivery of drug products utilizing its proprietary drug delivery platform, the "Plexis Platform". Eupraxia, through its subsidiary, Eupraxia USA, is a party to the Amended and Restated License Agreement with Auritec.

Under the terms of the Amended and Restated License Agreement, Auritec has granted Eupraxia USA an exclusive license (including the right to sublicense to its affiliates and third parties) under the licensed patents held by Auritec and for all the technical information and know-how relating to the technology claimed in the licensed patents held by Auritec with respect to the use of the Plexis Platform for the delivery of fluticasone in all medical fields (except for the Excluded Fields), to develop, make, have made, manufacture, use, commercialize, sell, sub-license, offer for sale, import, and have imported the Licensed Products.

Pursuant to the terms of the Amended and Restated License Agreement, in consideration for the rights and exclusive license granted to Eupraxia USA, Eupraxia USA was required to pay the Upfront Fee of US$5,000,000. As of the date of this MD&A, Eupraxia USA has fully paid the Upfront Fee. See "Subsequent Events" above.

In consideration for an extension of Eupraxia USA's initial deadline for paying the Upfront Fee granted by Auritec, Eupraxia USA and Auritec entered into a separate Security Agreement pursuant to which Eupraxia USA granted Auritec a continuing first priority lien and security interest in Eupraxia USA's rights and interest in the License Agreement and corresponding regulatory approvals.

In addition to the Upfront Fee, pursuant to the Amended and Restated License Agreement, Eupraxia USA has agreed to pay Auritec up to US$30 million upon achievement of certain regulatory and commercial milestones related to Licensed Products under the Amended and Restated License Agreement as well as a royalty of 4% of net sales of Licensed Products by Eupraxia USA or its affiliates, subject to certain reductions.

The following table summarizes the milestone payment schedule:

| **Milestone Event** | **Milestone Payment (US$)** |
|---|---|
| Successful Completion of a Phase 2b Study | 5,000,000 |
| First OA Regulatory Approval | 5,000,000 |
| Second OA Regulatory Approval | 5,000,000 |
| Non-OA Indication Regulatory Approval | 10,000,000 |
| First calendar year in which aggregate Net Sales by Eupraxia USA, its affiliates and sublicenses exceed US$500,000,000 | 5,000,000 |
| **Maximum amount payable** | 30,000,000 |

Eupraxia USA also agreed to pay to Auritec 20% of sublicensing royalties or other consideration based on net sales of Licensed Products. Eupraxia USA further agreed to pay Auritec a percentage of Non-Royalty Monetization Revenue (as defined in the Amended and Restated License Agreement), which includes payments received for a sale of Eupraxia USA or its assets or sale or sublicense of a Licensed Product, which percentage ranges from 30% to 15% depending on the development stage of the most-advanced Licensed Product, up to a maximum of US$100 million.

Lease Agreement

On October 21, 2019, the Company entered into a lease agreement for its head office located at Suite 201 – 2067 Cadboro Bay Road, Victoria BC. The lease is for a period of 5 years, expiring November 30, 2024. The annual base rent for the lease is $87,696 with anticipated additional annual rent of $75,516 to cover the Company's share of property taxes and operating costs. Additional rent is subject to adjustment at the end of each lease year based on actual costs incurred.

Summary of Contractual Obligations

As of December 31, 2020, and in the normal course of business, the Company has the following obligations to make future payments, representing contracts and other commitments that are known and committed.

| | ***Payments Due by Period*** | | | | |
|---|---|---|---|---|---|
| ***Contractual Obligations*** | ***Total*** | ***Less than 1 year*** | ***1 - 3 years*** | ***4 - 5 years*** | ***After 5 years*** |
| *Loans Payable* | $3,924,698 | $3,924,698 | | | |
| *Operating Leases* | $251,194 | $52,529 | $128,149 | $70,516 | |
| *Payable to Auritec* | $5,056,482 | $5,056,482 | | | |
| *Total Contractual Obligations* | $9,232,374 | $9,033,709 | $128,149 | $70,516 | |

**Transactions with Related Parties**

Key management includes personnel having the authority and responsibility for planning, directing and controlling the Company and includes the directors and current executive officers (CEO, CSO & CFO/COO). During the year ended, December 31, 2020 and 2019, expenses incurred for key management compensation are summarized as:

| | **2020** | **2019** |
|---|---|---|
| **Salaries** | **$** | **$** |
| Chief Executive Officer | 220,000 | 220,000 |
| Chief Scientific Officer | 200,000 | 200,000 |
| Chief Financial Officer/Chief Operating Officer | 200,000 | 200,000 |
| **Stock Based Compensation** | | |
| Chief Executive Officer | 52,577 | 125,292 |
| Chief Scientific Officer | 24,360 | 58,051 |
| Chief Financial Officer/Chief Operating Officer | 81,200 | 193,502 |
| | **778,137** | **996,845** |

As at December 31, 2020 and 2019, the following amounts were payable to executive officers of the Company:

| | **2020** | **2019** |
|---|---|---|
| **Accrued Compensation** | **$** | **$** |
| Chief Executive Officer | 262,381 | 68,347 |
| Chief Scientific Officer | 215,033 | 52,533 |
| Chief Financial Officer/Chief Operating Officer | 236,168 | 62,133 |
| **Expense Reimbursements** | | |
| Chief Executive Officer | 1,108 | 727 |
| Chief Financial Officer/Chief Operating Officer | 10,796 | 10,796 |
| | **725,486** | **194,536** |

As at December 31, 2020, $238,121 (2019 - $222,121) is due to John Montalbano, a director of the Company representing principal and interest on a loan as outlined in Note 11 of Audited Financials.

As at December 31, 2020, $869,534 (2019 - $799,334) of convertible notes are held by John Montalbano, a director of the Company representing principal and interest.

**Off-Balance Sheet Arrangements**

The Company has no material undisclosed off-balance sheet arrangements that have or are reasonably likely to have, a current or future effect on our results of operations or financial condition.

**Critical Accounting Estimates and Judgments**

The preparation of the consolidated financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and reported amounts of expenses during the reporting year, which, by their nature, are uncertain. Actual outcomes could differ from these estimates. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future events. Revisions to accounting estimates are recognized in the year in which the estimate is revised and future periods if the revision affects both current and future years. These estimates are based on historical experience, current and future economic conditions and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

*Critical accounting estimates*

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the end of the reporting period, that could result in a material adjustment to the carrying amounts of assets and liabilities in the event that actual results differ from assumptions made, relate to, but are not limited to, the following:

(i) the valuation of stock-based compensation and other non-cash stock-based payments; and

(ii) the fair value of warrant liabilities.

*Critical accounting judgments*

Critical accounting judgments are accounting policies that have been identified as being complex or involving subjective judgments or assessments. The Company's management made the following critical accounting judgments:

(i) the determination of deferred tax assets and liabilities recorded in the consolidated financial statements;

(ii) the determination of whether the Company is in the "research" or "development" stage of operations. During the research stage of operations, all expenditures associated with the advancement of the technology are expensed in the period they are incurred;

(iii) the determination of the functional currency of the Company, the Company's wholly owned subsidiary and Eupraxia USA;

(iv) assessment of the appropriateness of the going concern assertion and any material uncertainties that may cast significant doubt thereon; and

(v) rights and obligations and all legal interpretations relating to the Auritec License and Settlement Agreements.

**Accounting Standard Issued and Adopted**

No new standards, amendments to standards, or interpretations to existing standards were adopted during the year ended December 31, 2020.

**Accounting standards and amendments issued but not yet adopted**

There are new accounting standards, amendments to accounting standards and interpretations that are effective for annual periods beginning on or after January 1, 2021 that have not been applied in preparing the consolidated

financial statements for the year ended December 31, 2020. These standards and interpretations are not expected to have a material impact on the Company's consolidated financial statements.

**Financial Instruments**

The Company's financial instruments consist of cash, other receivable, accounts payable and accrued liabilities, payable to Auritec, convertible notes payable, special warrants, loans payable and derivative warrant liabilities. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

*Credit Risk*

Credit risk is the risk of loss associated with counterparty's inability to fulfill its payment obligations. The Company believes it has no significant credit risk, as its cash, being its primary exposure to credit risk, is on deposit with a large Canadian bank. The Company's maximum exposure to credit risk is the carrying value of its financial assets.

*Liquidity Risk*

Liquidity risk is the risk that the Company will not be able to meet its financial obligations when they become due. The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at December 31, 2020, the Company had a cash balance of $150,126 (2019 - $1,156,079) and current liabilities of $22,542,272 (2019 - $20,666,560). The current liabilities balance at December 31, 2020 includes $10,307,751 (2019 - $9,031,616) which will be settled with Company equity on completion of the Initial Public Offering (note 24). Management is currently working on certain strategic alternatives including, but not limited to, financing arrangements. There is no assurance, however, that any or all of these alternatives will materialize or that additional funding will be available, if and when needed.

*Market Risk*

Market risk is the risk of fluctuations in fair values or future cash flows that may arise from changes in market factors such as interest rates, foreign exchange rates, and commodity and equity prices.

*Price Risk*

The Company is not exposed to significant price risk with respect to commodity or equity prices.

*Interest rate risk*

Interest rate risk consists of two components; to the extent that payments are made or received on the Company's monetary assets or liabilities are affected by changes in the prevailing market interest rates, the Company is exposed to interest rate cash flow risk; and to the extent that the prevailing market interest rates differ from the interest rate on the Company's monetary assets and liabilities, the Company is exposed to interest rate price risk. The Company has cash balances and interest payable to Auritec Pharmaceuticals Inc. that is calculated using the US Bank prime interest rate. A 10% change in the prime interest rate would have an impact of $12,350 on the annual interest amount. The Company is not otherwise at a significant risk to fluctuating interest rates.

*Foreign currency risk*

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Company is exposed to foreign currency risk due to its frequency of transactions in $US. The Company does not use derivatives to hedge against this risk. At December 31, 2020, the Company held cash of USD$473 (2019 - USD$4,738) and had accounts payable of USD$839,212 (2019 - USD$845,854) and an amount owing to Auritec of USD$3,971,475 (2019 – USD$3,800,000) which were translated

to Canadian dollars at 1.2732 (2019 – 1.2988). The impact of a 10% change in the exchange rates would have an impact of $612,497 (2019 – $109,860) on the profit or loss.

**Risks and Uncertainties**

The primary risk factors affecting the Company are set forth under the heading "*Risk Factors*" in the Prospectus.

**Outstanding Share Capital**

As of the date of this MD&A, the Company had 12,865,475 Common Shares issued and outstanding. The maximum number of additional Common Shares issuable, should all convertible rights be exercised are as follows:

| **Common Shares Issuable:** | **As of the date of MD&A** |
|---|---|
| Options[(1)] | 1,929,821 |
| 2013 Warrants[(2)] | 380,921 |
| Founders Warrants[(3)] | 315,500 |
| Underlying Founders Warrants[(4)] | 315,500 |
| 2019 Warrants[(5)] | 289,172 |
| 2021 30% Warrants[(6)] | 270,957 |
| 2021 10% Warrants[(7)] | 39,846 |
| Outstanding Loans (10%)[(8)] | 590,642 |
| Outstanding Loans (30%)[(9)] | 421,169 |
| Class B Shares[(10)] | 562,500 |
| Warrants[(11)] | 2,826,274 |
| **Total Common Shares Issuable** | **7,942,302** |

Notes:

(1) Represents options outstanding under the Company's stock option plan, each having an exercise price equal to $8.00 and expiry dates ranging from March 31, 2025 to March 9, 2031.

(2) Represents common share purchase warrants to acquire up to 380,921 Common Shares at an exercise price of $0.7572 per share, with each such common share purchase warrant expiring 120 days after the warrant holder or the holder's spouse ceases to be a director, officer or consultant of the Company.

(3) Represents common share purchase warrants to acquire 315,500 units, with each unit consisting of one Common Share and one underlying common share purchase warrant (an "**Underlying Founder Warrant**") at an exercise price of $0.4984 per unit, expiring 120 days after the warrant holder ceases to be a director, officer or consultant of the Company.

(4) Represents Underlying Founder Warrants to acquire up to 315,500 Common Shares, at an exercise price of $0.75 per share, expiring two years from the date of issuance of the Underlying Founder Warrant.

(5) Represents common share purchase warrants to acquire up to 289,172 Common Shares at an exercise price $7.999 per share, being the per share price of the Common Shares issued and sold in the Offering, with expiry dates ranging from July 13, 2023 to December 16, 2022.

(6) Represents common share purchase warrants to acquire up to 270,957 Common Shares at an exercise price of $5.5993 per share, being a 30% discount to the per share price of the Common Shares issued and sold in the Offering, with expiry dates ranging from January 4, 2024 to January 8, 2024.

(7) Represents common share purchase warrants to acquire up to 39,846 Common Shares at an exercise price of $7.1991, being a 10% discount to the per share price of the Common Shares issued and sold in the Offering, with an expiry date of January 4, 2024.

(8) Represent loans with an aggregate principal amount of $3,491,732 from certain shareholders and John Montalbano, a director of the Company, with each such loan incurring interest at rates ranging from 8% to 14% per annum and having a maturity date of December 31, 2021. Each such lender has the right to convert the principal amount and any accrued and unpaid interest under its loan into Common Shares at a price of $7.1991, being a 10% discount to the per share price of the Common Shares issued and sold in the Offering.

(9) Represent loans with an aggregate principal amount of US$1,700,000 from certain shareholders and Paul Geyer, a director of the Company, with each such loan incurring interest a rate of 10% per annum and having a maturity date of December 31, 2021. Each such lender has the right to convert the principal amount and any accrued and unpaid interest under their respective loan into Common Shares at a price of $5.5993

per share, representing a 30% discount to the per share price of the Common Shares issued and sold in the Offering. The number of Common Shares issuable under such loans assumes a conversion of US dollars into Canadian dollars on the basis of C$1.2626:US$1.00.

(10) Represents 562,500 Common Shares that are issuable upon conversion of the 225 Class B Shares of Eupraxia Pharma held by Amanda Malone, the Chief Scientific Officer of the Company. See "Subsequent Events – US Subsidiary Restructuring" for additional information.

(11) Represents the Warrants issued in connection with the Offering. See "Subsequent Events – Initial Public Offering" for additional information.

## Additional Information

Additional information about the Company is available on SEDAR at www.sedar.com.