

EUPRAXIA PHARMACEUTICALS INC.

**INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)**

For the three and six months ended June 30, 2021

EUPRAXIA PHARMACEUTICALS INC.
INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2021

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EUPRAXIA PHARMACEUTICALS INC.
INTERIM CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Unaudited and Expressed in Canadian Dollars)

	June 30, 2021	December 31, 2020
ASSETS		
Current assets		
Cash	\$ 36,075,856	\$ 150,126
Prepaid expenses	745,798	367,523
Amounts receivable (Note 5)	40,475	620,606
Total current assets	<u>36,862,129</u>	<u>1,138,255</u>
Non-current assets		
Equipment (Note 6)	64,431	68,314
Right of use assets (Note 14)	215,488	247,023
Total assets	<u>\$ 37,142,048</u>	<u>\$ 1,453,592</u>
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)		
Current liabilities		
Accounts payable and accrued liabilities (Note 8)	\$ 760,141	\$ 3,200,812
Convertible notes payable (Note 9)	-	8,592,751
Special warrants (Note 10)	-	1,715,000
Loans payable (Note 11)	-	3,924,698
Lease liability – current portion (Note 14)	56,206	52,529
Payable to Auritec Pharmaceuticals Inc. (Note 21)	-	5,056,482
Total current liabilities	<u>816,347</u>	<u>22,542,272</u>
Non-current liabilities		
Derivative warrant liability (Note 12)	-	376,308
Convertible debt (Note 13)	8,615,512	-
Lease liability (Note 14)	168,724	198,665
	<u>9,600,583</u>	<u>23,117,245</u>
Shareholders' Equity (deficit)		
Share capital (Note 15 (b))	80,756,853	23,797,507
Contributed surplus (Notes 13 & 15 (c))	12,892,567	6,189,888
Deficit	(65,494,205)	(51,197,157)
Equity (deficit) attributable to the owners of the Company	<u>28,155,215</u>	<u>(21,209,762)</u>
Non-controlling interest	<u>(613,750)</u>	<u>(453,891)</u>
Total shareholders' equity (deficit)	<u>27,541,465</u>	<u>(21,663,653)</u>
Total liabilities and shareholders' equity	<u>\$ 37,142,048</u>	<u>\$ 1,453,592</u>
Nature of business and going concern (Note 1)		

Approved and authorized for issue on behalf of the Board of Directors on August 13, 2021:

John Montalbano
Director

James Helliwell
Director

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

EUPRAXIA PHARMACEUTICALS INC.**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**

(Unaudited and Expressed in Canadian Dollars)

	Three months ended June 30, 2021	Three months ended June 30, 2020	Six months ended June 30, 2021	Six months ended June 30, 2020
Expenses				
Depreciation of equipment (Note 6)	\$ 4,545	\$ 5,960	\$ 9,016	\$ 30,916
Depreciation of ROU assets (Note 14)	15,768	15,768	31,535	42,758
General and administrative	203,110	62,096	280,975	191,766
Professional fees	194,081	20,175	944,813	33,110
Public company costs	85,559	-	276,173	-
Research and development (Note 7)	3,625,718	397,005	4,295,422	848,459
Salaries and benefits (net) (Notes 16 & 17)	321,603	115,033	1,096,719	416,161
Stock-based compensation (Notes 15 (c) & 17)	527,927	60,198	3,239,119	108,285
Total expenses	4,978,311	676,235	10,173,772	1,671,455
Other income (expense)				
Interest income	14,728	106	14,829	213
Interest expense (Note 20)	(184,171)	(501,145)	(636,280)	(1,054,584)
Loss on conversion of notes, special warrants and loans (Notes 9, 10 & 11)	(324,561)	-	(2,260,477)	-
Loss on sale of equipment	-	(134,438)	-	(134,438)
Foreign exchange gain (loss)	(122,748)	262,586	(127,986)	(299,564)
Change in fair value of warrant liability (Note 12)	(2)	59,399	(1,273,221)	17,249
	(616,754)	(313,492)	(4,283,135)	(1,471,124)
Total loss and comprehensive loss	\$ (5,595,065)	\$ (989,727)	\$ (14,456,907)	\$ (3,142,579)
Loss and comprehensive loss attributable to:				
Owners of the Company	\$ (5,437,025)	\$ (983,239)	\$ (14,297,048)	\$ (3,129,043)
Non-controlling interests	(158,040)	(6,488)	(159,859)	(13,536)
Total loss and comprehensive loss	\$ (5,595,065)	\$ (989,727)	\$ (14,456,907)	\$ (3,142,579)
Loss per share – basic and diluted (Owners of the Company)	\$ (0.41)	\$ (0.16)	\$ (1.36)	\$ (0.51)
Loss per share – basic and diluted (Non-controlling interests)	(0.01)	(0.00)	(0.02)	(0.00)
Loss per share – basic and diluted	\$ (0.42)	\$ (0.16)	\$ (1.37)	\$ (0.51)
Weighted average shares outstanding				
- basic and diluted	13,232,891	6,118,002	10,538,637	6,118,002

The accompanying notes are an integral part of these condensed consolidated interim financial statements

EUPRAXIA PHARMACEUTICALS INC.**INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY**

(Unaudited and Expressed in Canadian Dollars)

	Number of shares	Amount	Contributed surplus	Deficit	Non-controlling interest	Total
Balance, December 31, 2019	6,118,002	\$ 23,548,357	\$ 5,961,208	\$ (47,199,955)	\$ (440,455)	\$ (18,130,845)
Stock-based compensation	-	-	108,285	-	-	108,285
Total loss and comprehensive loss for the period	-	-	-	(3,129,043)	(13,536)	(3,142,579)
Balance, June 30, 2020	6,118,002	23,548,357	6,069,493	(50,328,998)	(453,991)	(21,165,139)
Conversion of Note (Note 9)	62,288	249,150	-	-	-	249,150
Stock-based compensation	-	-	120,395	-	-	120,395
Total loss and comprehensive loss for the period	-	-	-	(868,159)	100	(868,059)
Balance, December 31, 2020	6,180,290	23,797,507	6,189,888	(51,197,157)	(453,891)	(21,663,653)
Initial Public Offering (Note 15 (b))	5,125,000	37,877,184	-	-	-	37,877,184
Conversion of Notes (Note 9)	1,261,387	10,089,835	-	-	-	10,089,835
Conversion of Special Warrants (Note 10)	298,798	2,390,085	-	-	-	2,390,085
Issuance of shares for services (Note 15 (b))	78,456	614,600	-	-	-	614,600
Conversion of Loans (Note 11)	1,298,664	5,987,642	-	-	-	5,987,642
Warrant reclassification (Note 12)	-	-	2,175,688	-	-	2,175,688
Equity component of Convertible Debt (Note 13)	-	-	1,287,872	-	-	1,287,872
Stock-based compensation (Note 15 (c))	-	-	3,239,119	-	-	3,239,119
Total loss and comprehensive loss for the period	-	-	-	(14,297,048)	(159,859)	(14,456,907)
Balance, June 30, 2021	14,242,595	\$ 80,756,853	\$ 12,892,567	\$ (65,494,205)	\$ (613,750)	\$ 27,541,465

The accompanying notes are an integral part of these condensed consolidated interim financial statements.

EUPRAXIA PHARMACEUTICALS INC.
INTERIM CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited and Expressed in Canadian Dollars)

	Six months ended June 30, 2021	Six months ended June 30, 2020
CASH FLOWS FROM OPERATING ACTIVITIES		
Total loss and comprehensive loss	\$ (14,456,907)	\$ (3,142,577)
Items not affecting cash		
Accrued interest on convertible notes (Note 9)	136,253	336,864
Accrued interest on loans (Note 11)	407,479	491,296
Accrued interest on SVB debt facility (Note 13)	29,701	-
Accrued interest and foreign exchange on Payable to Auritec Pharmaceuticals Inc.	7,046	394,613
Depreciation of equipment (Note 6)	9,016	30,916
Depreciation of ROU assets (Note 14)	31,535	42,758
Interest – lease liability (Note 14)	17,584	21,839
Loss on conversion of notes, special warrants and loans (Notes 9, 10 & 11)	2,260,477	-
Loss on sale of equipment	-	134,436
Stock-based compensation (Notes 15 (c) & 17)	3,239,119	108,285
Change in fair value of warrant liability (Note 12)	1,273,221	(17,249)
Unrealized foreign exchange	61,500	(2,808)
	<u>(6,983,978)</u>	<u>(1,601,627)</u>
Changes in non-cash working capital balances		
Accounts payable and accrued liabilities	(1,826,071)	308,024
Prepaid expenses	(378,275)	7,759
Amounts receivable	580,131	1,337,661
Cash provided by (used in) operating activities	<u>(8,608,193)</u>	<u>51,817</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale of equipment	-	79,627
Acquisition of equipment (Note 6)	(5,133)	-
Payable to Auritec Pharmaceuticals Inc.	(5,063,528)	(56,687)
Cash provided by (used in) investing activities	<u>(5,068,661)</u>	<u>22,940</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Subscriptions received in advance for convertible note	-	100,000
Receipt (repayment) of loans (Note 11)	1,857,065	(1,000,000)
Receipt of Convertible Debt from SVB (Note 13)	9,873,683	-
Convertible note issued for cash (Note 9)	100,000	500,000
IPO shares issued for cash (net of transaction costs) (Note 15 (b))	37,877,184	-
Lease payments (Note 14)	(43,848)	(56,847)
Cash provided by (used in) financing activities	<u>49,664,084</u>	<u>(456,847)</u>
Increase (decrease) in cash	35,987,230	(382,090)
Foreign exchange effect on cash	(61,500)	2,808
Cash, beginning of period	150,126	1,156,079
Cash, end of period	<u>\$ 36,075,856</u>	<u>\$ 776,797</u>

Supplemental Disclosure with respect to cash flows (Note 22)

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

EUPRAXIA PHARMACEUTICALS INC.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2021

(Unaudited and Expressed in Canadian Dollars)

1. NATURE OF BUSINESS AND GOING CONCERN

Eupraxia Pharmaceuticals Inc. (the “Company”) was incorporated under the laws of the province of Alberta on May 12, 2011 under the name Plaza Capital Partners Inc. On May 11, 2012, the Company changed its name to Eupraxia Pharmaceuticals Inc. and continued from the province of Alberta to the province of British Columbia.

On October 10, 2012, a wholly-owned subsidiary, Eupraxia Holdings, Inc. (“Holdings”) was incorporated under the laws of the State of Delaware, USA. On November 16, 2012, Holdings was registered as an extra-provincial corporation under the laws of the province of British Columbia, Canada. On October 10, 2012, Eupraxia Pharmaceuticals USA, LLC (“Eupraxia USA”) was incorporated under the laws of the State of Delaware. On November 16, 2012, Eupraxia USA was registered as an extra-provincial corporation under the laws of the province of British Columbia. On January 7, 2021, Eupraxia Pharma, Inc. (“Eupraxia Pharma”) was incorporated under the laws of the State of Delaware.

On March 9, 2021, the Company completed an initial public offering on the Toronto Stock Exchange (“TSX”) with the listing of both common shares and warrants under the symbols “EPRX” and “EPRX.WT”, respectively. The Company completed a four-for-one share consolidation of its common stock as part of the Company’s initial public offering on the TSX. All share and earnings per share information have been retroactively adjusted to reflect the share consolidation.

The Company’s principal business is the development of locally-delivered, extended-release alternatives to existing pharmaceuticals. The address of the Company’s corporate office and principal place of business is 201 – 2067 Cadboro Bay Road, Victoria, British Columbia, Canada.

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. However, 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.

These interim condensed 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. As at June 30, 2021, the Company had cash of \$36,075,856 however the Company has not yet generated revenue from operations. The Company incurred a net loss of \$14,456,907 during the six-month period ended June 30, 2021 and, as of that date the Company’s accumulated deficit was \$65,494,205. 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 indicate a material uncertainty which may cast significant doubt about its ability to continue as a going concern. These interim condensed consolidated interim 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 active in its pursuit of additional funding through partnering, and other

EUPRAXIA PHARMACEUTICALS INC.**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2021

(Unaudited and Expressed in Canadian Dollars)

1. NATURE OF BUSINESS AND GOING CONCERN (continued)

strategic activities, as well as via grants, to fund future research and development activities. 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.

2. BASIS OF PRESENTATION**Statement of Compliance**

The Company applies International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations issued by the IFRS Interpretations Committee ("IFRIC"). These interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 - Interim Financial Reporting. Accordingly, they do not include all the information required for full annual financial statements and should be read in conjunction with the Company's most recent annual consolidated financial statements as at and for the year ended December 31, 2020.

The same accounting policies and methods of computation are followed in these interim condensed consolidated financial statements as compared with the most recent annual consolidated financial statements as at and for the year ended December 31, 2020.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**Consolidation**

These condensed consolidated interim financial statements include the accounts of the Company and the accounts of its subsidiaries. The financial statements of subsidiaries are included in the condensed consolidated interim financial statements from the date that control commences until the date that control ceases. Control exists when an entity is exposed to, or has rights to variable returns from its involvement with the entity and has the ability to affect these returns through its power over the entity. All significant intercompany transactions and balances have been eliminated.

Non-controlling interest in the net assets of consolidated subsidiaries are identified separately from the Company's equity. Non-controlling interest consists of the non-controlling interest as at the date of the original transaction plus the non-controlling interest's share of changes in equity since that date.

Entity	Jurisdiction of Incorporation	Effective interest (Note 15 (e))
Eupraxia Pharma, Inc.	Delaware, USA	95%
Eupraxia Holdings Inc.	Delaware, USA	95%
Eupraxia Pharmaceuticals USA, LLC	Delaware, USA	95%

Upcoming Accounting Standards and Interpretations

The Company has not yet adopted certain new standards, amendments and interpretations to existing standards, which have been published but are only effective for accounting periods beginning on or after January 1, 2022 or later periods. The new and amended standards are not expected to have a material impact on the Company.

EUPRAXIA PHARMACEUTICALS INC.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2021

(Unaudited and Expressed in Canadian Dollars)

4. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of the interim condensed 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 condensed consolidated interim financial statements and reported amounts of expenses during the reporting period, which, by their nature, are uncertain. Actual outcomes could differ from these estimates. The impacts of such estimates are pervasive throughout the interim condensed consolidated financial statements and may require accounting adjustments based on future events. Revisions to accounting estimates are recognized in the period in which the estimate is revised and future periods if the revision affects both current and future periods. 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.

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 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;
- ii) The determination of the functional currency of the Company and its subsidiaries;
- iii) Assessment of the appropriateness of the going concern assertion and any material uncertainties that may cast significant doubt thereon; and
- iv) Rights and obligations and all legal interpretations relating to the Auritec Pharmaceuticals Inc. License and Settlement Agreements (Note 21).

EUPRAXIA PHARMACEUTICALS INC.**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2021

(Unaudited and Expressed in Canadian Dollars)

5. AMOUNTS RECEIVABLE

	June 30, 2021	December 31, 2020
Government grants (Note 16)	\$ -	\$ 179,750
Scientific research and development ITCs	-	379,000
GST/HST recoverable	23,680	22,415
Rent receivable (Note 14)	16,795	33,590
Other (Note 16)	-	5,851
Total	\$ 40,475	\$ 620,606

6. EQUIPMENT

	Computers	Office	Leasehold Improvements	Lab	Total
Cost					
As at December 31, 2019	\$ 90,719	\$ 95,710	\$ 106,464	\$ 424,891	\$ 717,784
Disposals	-	(11,193)	-	(378,948)	(390,141)
As at December 31, 2020	90,719	84,517	106,464	45,943	327,643
Additions	5,133	-	-	-	5,133
As at June 30, 2021	\$ 95,852	\$ 84,517	\$ 106,464	\$ 45,943	\$ 332,776

Accumulated depreciation

As at December 31, 2019	\$ 66,254	\$ 49,667	\$ 98,905	\$ 178,063	\$ 392,889
Depreciation	11,011	7,710	7,559	16,237	42,517
Disposals	-	(4,747)	-	(171,330)	(176,077)
As at December 31, 2020	77,265	52,630	106,464	22,970	259,329
Depreciation	3,530	3,188	-	2,298	9,016
As at June 30, 2021	\$ 80,795	\$ 55,818	\$ 106,464	\$ 25,268	\$ 268,345

Carrying amount

As at December 31, 2020	\$ 13,454	\$ 31,887	\$ -	\$ 22,973	\$ 68,314
As at June 30, 2021	\$ 15,057	\$ 28,699	\$ -	\$ 20,675	\$ 64,431

EUPRAXIA PHARMACEUTICALS INC.**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2021

(Unaudited and Expressed in Canadian Dollars)

7. RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses are comprised of the following:

Research and development expenses	3-months ended June 30, 2021	3-months ended June 30, 2020	6-months ended June 30, 2021	6-months ended June 30, 2020
Arthritis Program (EP-104IAR)				
Preclinical	\$ 254,575	\$ 542	\$ 255,117	\$ 1,084
Clinical	2,648,124	-	2,653,874	175
Manufacturing & analytical	256,185	123,675	280,583	233,688
Regulatory	82,985	2,324	82,985	2,324
Consulting	-	1,601	5,681	37,451
Veterinary	2,352	-	2,352	-
	3,244,221	128,142	3,280,592	274,722
Antibiotics Program (EP-201)				
Formulation	-	-	-	162
Preclinical	-	-	-	80
Consulting	-	-	-	2,000
	-	-	-	2,242
Pipeline Development	-	-	-	(11,804)
Other research and development	23,482	33,956	50,602	69,122
Salaries and benefits	377,790	360,551	1,021,937	662,388
Government grants (Note 16)	(7,500)	(125,644)	(45,434)	(143,259)
SR&ED adjustment from prior years	(12,275)	-	(12,275)	(4,952)
Total expenses during the period	\$ 3,625,718	\$ 397,005	\$ 4,295,422	\$ 848,459

EUPRAXIA PHARMACEUTICALS INC.**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2021

(Unaudited and Expressed in Canadian Dollars)

8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	June 30, 2021	December 31, 2020
Research and development	\$ 474,113	\$ 620,951
General and administrative	225,776	1,491,969
Wages and payroll remittances	60,252	163,984
Deferred salaries ⁽¹⁾	-	923,908
Total	\$ 760,141	\$ 3,200,812

(1) The Company entered into a salary deferral agreement with various employees. Contingent upon the Company closing an institutional financing of at least USD25 million, the Company was to pay the employee a bonus of 20% of the deferred salary as of that date. Upon completion of the initial public offering on the TSX the Company paid the deferred salaries and associated bonus.

9. CONVERTIBLE NOTES PAYABLE

On May 25, 2018, the Company approved the issue of unsecured convertible notes (the "Notes") with up to an aggregate principal amount of \$3,000,000. The aggregate principal amount was subsequently increased to \$8,000,000 on April 1, 2019.

The Notes carry an annual interest rate of 10% and originally matured on June 30, 2020, subsequently extended to December 31, 2020.

In the event of a Qualified Financing of greater than USD15,000,000, the principal and any accrued interest converts into the same class of securities issued in the Qualified Financing at a 10% discount to the price paid per share. If the Company does not consummate a Qualified Financing prior to maturity, the principal and any accrued interest will convert into common shares at a conversion price of \$4.00 per share.

On March 10, 2020, the board approved a reduction in the conversion price from \$8.00 to \$4.00 per share.

On April 30, 2020, the Company approved the issue of unsecured convertible notes (the "2020 Notes") up to an aggregate principal amount of \$2,000,000. The terms of these convertible notes are identical to the notes outlined above with the exception that they convert at a 30% discount in the event of a Qualified Financing.

On December 18, 2020, the Company offered the convertible note holders the opportunity to extend the maturity date of their convertible notes to December 31, 2021. The majority of convertible note holders elected to extend their maturity dates. A convertible note totaling \$249,150 of principal and accrued interest converted into common shares on December 31, 2020 as a result of the convertible note holder not electing to extend the maturity date. In accordance with the terms of the convertible note agreement, 62,288 common shares were issued at \$4.00 per share.

The settlement of the convertible notes required a variable number of shares; therefore, the contract was treated as a financial liability even though it involved settlement by the delivery of common shares.

On March 9, 2021, both the Notes and 2020 Notes were converted into common shares as a result of the Company's initial public offering on the TSX which constituted a Qualified Financing. Principal and interest totalling \$8,829,004 was converted into 1,261,387 common shares. These shares had a fair market value of \$10,089,835

EUPRAXIA PHARMACEUTICALS INC.**NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2021

(Unaudited and Expressed in Canadian Dollars)

9. CONVERTIBLE NOTES PAYABLE (continued)

as of the conversion date, which has been reflected in the Company's share capital balance. The difference of \$1,260,831 between the carrying value of the liability and the fair market value has been recorded in other income as a loss on conversion of notes.

As at June 30, 2021 and December 31, 2020, the following convertible notes were outstanding:

	June 30, 2021	December 31, 2020
Convertible notes ⁽¹⁾ issued June 19, 2018	\$ 2,150,000	\$ 2,150,000
Convertible notes ⁽¹⁾ issued November 13, 2018	975,000	975,000
Convertible notes ⁽¹⁾ issued December 20, 2018	350,000	350,000
Convertible notes ⁽¹⁾ issued April 1, 2019	1,500,000	1,500,000
Convertible notes ⁽¹⁾ issued April 30, 2019	700,000	700,000
Convertible notes ⁽¹⁾ issued May 23, 2019	815,000	815,000
Convertible notes ⁽²⁾ issued June 1, 2020	500,000	500,000
Convertible notes ⁽²⁾ issued July 22, 2020	121,000	121,000
Convertible notes ⁽²⁾ issued November 27, 2020	110,000	110,000
Convertible notes ⁽²⁾ issued January 5, 2021	100,000	-
Accrued interest	1,508,004	1,371,751
Loss on conversion	1,260,831	-
Conversion into common shares on March 9, 2021	(10,089,835)	-
Total	\$ -	\$ 8,592,751

(1) Converted at 10% discount as a result of qualified financing

(2) Converted at 30% discount as a result of qualified financing

EUPRAXIA PHARMACEUTICALS INC.

NOTES TO THE INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2021

(Unaudited and Expressed in Canadian Dollars)

10. SPECIAL WARRANTS

On June 23, 2018, the Company approved the issue of up to 1,000,000 special warrants with a subscription price of \$2.00 per warrant for aggregate proceeds of \$2,000,000.

The warrants originally had an expiry date of June 30, 2020 which was subsequently extended to December 31, 2021.

Under the terms of the Special Warrants, if the Company had not completed a Qualified Financing before December 31, 2021 (the "Final Conversion Date") then the Special Warrants would be deemed to be exercised for such number of common shares of the Company determined in accordance with the following formula:

$$[SW*2 + (0.1 \times SW*2) (D / 365)] \times [1/4]$$

Where:

SW = Number of Special Warrants.

D = the number of days between the date the Special Warrants were issued and the Final Conversion Date.

If the Company completed a Qualified Financing before the Final Conversion Date, then the Special Warrants would be deemed to be exercised, by the Holder on the date of the completion of the Qualified Financing into the class of shares issued and sold in the Qualified Financing and the number of shares issued and sold in the Qualified Financing in accordance with the following formula:

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

Where:

SW = Number of Special Warrants.

D = the number of days between the date the Special Warrants were issued and the date of the Qualified Financing.

PP = the per share purchase price of the equity securities issued and sold in the Qualified Financing.

The settlement of the special warrants required a variable number of shares, therefore the contract was treated as a financial liability even though it involved settlement by the delivery of common shares.

On March 9, 2021, the special warrants were converted into common shares as a result of the Company's initial public offering on the TSX which constituted a Qualified Financing. The special warrants were converted into 298,798 common shares according to the terms outlined above. These shares had a fair market value of \$2,390,085 as of the conversion date, which has been reflected in the Company's share capital balance. The difference of \$675,085 between the carrying value of the liability and the fair market value has been recorded in other income as a loss on conversion of special warrants.

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10. SPECIAL WARRANTS (continued)

As at June 30, 2021 and December 31, 2020, the following special warrants were outstanding:

	June 30, 2021	December 31, 2020
Special warrants issued July 18, 2018 (590,000)	\$ 1,180,000	\$ 1,180,000
Special warrants issued November 13, 2018 (267,500)	535,000	535,000
Loss on conversion	675,085	-
Conversion into common shares on March 9, 2021	(2,390,085)	-
Total	\$ -	\$ 1,715,000

11. LOANS PAYABLE

On January 4, 2021 and January 8, 2021, the Company borrowed an aggregate of USD1,700,000 (\$2,355,795) from certain shareholders and a director of the Company. The loans were unsecured, incurred interest at a rate of 10% per annum and matured on December 31, 2021. Under the terms of the loans and following completion of an equity financing exceeding USD15,000,000, each lender had the right to convert the principal and accrued interest under their respective loan into common shares at a 30% discount to the per share purchase price of the common shares issued and sold in the equity financing. As consideration for providing such loans, the lenders were issued an aggregate of 270,957 common share purchase warrants, with each warrant exercisable for one common share 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 an equity financing, the exercise price of such warrants will be adjusted to equal a 30% discount to the equity financing price. Upon completion of the Company's initial public offering, the exercise price of these warrants was adjusted to \$5.5993.

On January 4, 2021, the Company borrowed USD250,000 from a director of the Company. The loan was unsecured, incurred interest at a rate of 15% per annum and matured on December 31, 2021. The Company intended 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 relating to the 2020 calendar year. As consideration for providing the loan, the lender was issued a total of 39,846 common share purchase warrants, with each warrant exercisable for one Common Share for a period of three years at an exercise price of \$4.00 per share, provided that upon completion of an equity financing, the exercise price of such warrants will be adjusted to equal a 10% discount to the equity financing price. Upon completion of the Company's initial public offering, the exercise price of these warrants was adjusted to \$7.1991. On June 2, 2021, upon receipt of the Company's 2020 SR&ED refund, principal and interest owing on the loan totaling \$318,533 was repaid to the director of the Company.

On May 18, 2021, the Company offered existing lenders the opportunity to convert their outstanding principal and accrued interest into common shares at a conversion price equal to \$4.6106 per common share. Principal and interest totalling \$5,987,641 was subsequently converted into 1,298,664 common shares of the Company on June 8, 2021. The difference of \$324,561 between the carrying value of the liability and the fair market value has been recorded in other income (expense) as a loss on conversion of loans.

On June 10, 2021, accrued interest totalling \$180,197 was paid to a lender.

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11. LOANS PAYABLE (continued)

The terms and conditions of loans that were outstanding and converted or repaid during the period are as follows:

Type	Date	Principal	Currency	Security	Related Party	Interest Rate	Maturity
Secured ⁽¹⁾	Mar. 27, 2019	\$600,000	CAD	Company assets	N/A	14%	Dec. 31, 2021
Secured ⁽¹⁾	Jul. 13, 2019	\$250,000	CAD	Company assets	N/A	8%	Dec. 31, 2021
Secured ⁽¹⁾	Jul. 22, 2019	\$1,000,000	CAD	Company assets	N/A	8%	Dec. 31, 2021
Secured ⁽¹⁾	Aug. 30, 2019	\$250,000	CAD	Company assets	N/A	8%	Dec. 31, 2021
Secured ⁽¹⁾	Nov. 19, 2019	\$1,050,000	CAD	Company assets	N/A	8%	Dec. 31, 2021
Secured ⁽¹⁾	Nov. 19, 2019	\$200,000	CAD	Company assets	Director	8%	Dec. 31, 2021
Unsecured	Jan. 4, 2021	\$1,000,000	USD	N/A	N/A	10%	Dec. 31, 2021
Unsecured	Jan. 5, 2021	\$500,000	USD	N/A	N/A	10%	Dec. 31, 2021
Unsecured	Jan. 5, 2021	\$250,000	USD	N/A	Director	15%	Dec. 31, 2021
Unsecured	Jan. 8, 2021	\$200,000	USD	N/A	Director	10%	Dec. 31, 2021

As at June 30, 2021 and December 31, 2020, the loan balance is comprised of the following:

Total, December 31, 2019	\$ 4,249,105
Loan repayment	(1,029,584)
Interest accrued	328,673
Financing cost accreted	376,504
Total, December 31, 2020	3,924,698
Receipt of cash loans	2,355,795
Transaction costs	(526,161)
Interest accrued	205,879
Financing cost accreted	201,600
Loss on conversion	324,561
Repayment	(498,730)
Conversion to common shares	(5,987,642)
Total, June 30, 2021	\$ -

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12. DERIVATIVE WARRANT LIABILITY

On July 19, 2019, the directors of the Company approved a new loan structure which offered lenders interest at 8% and warrants to acquire common shares in an amount equal to one warrant for every \$10.00 of principal and interest loaned. The warrants vest immediately and allow the investor to purchase common shares anytime up to 3 years from the date of issue. The exercise price of the warrants was \$4.00 per share or if a Qualified Financing has closed any time prior to or including the expiry date then the exercise price is the per share purchase price of equity securities issued and sold in the Qualified Financing. Upon completion of the Company's initial public offering, the exercise price of these warrants was adjusted to \$7.999.

Existing loans with a total principal of \$1,500,000 and accrued interest of \$141,733 previously bearing interest at 14% were converted to the new structure on July 13, 2019 and November 19, 2019.

A total of 289,172 warrants were issued in relation to the loans. The fair value of warrants issued were recorded against the principal balance at the issuance dates.

On January 4, 2021 and January 8, 2021, a further 310,803 warrants were issued in connection with the loans outlined in Note 11.

Accretion of loan financing costs of \$201,600 (2020 - \$339,864) are included in interest expense for the six-month period ended June 30. Accretion of loan financing costs of \$70,060 (2020 - \$160,754) are included in interest expense for the three-month period ended June 30.

At issuance the warrants issued as part of the loan financings were derivative liabilities given that the warrant exercise price was subject to change if a Qualified Financing occurred. The derivative warrant liabilities were measured at fair value at each reporting period with any gain or loss resulting from re-measurement recognized in profit or loss. Upon completion of the Company's initial public offering, the exercise price was set and the fair value of warrants (measured on March 9, 2021) was reclassified to equity. The fair value of the warrants at each measurement date was estimated using the Black-Scholes option pricing model and based on the following weighted average assumptions:

	At March 9, 2021	At Issuance dates (Jan. 4, 2021 to Jan. 8, 2021)	At December 31, 2020
Annual volatility ⁽¹⁾	72.50%	71.35%	71.35
Risk free interest rate	0.39%	0.25%	0.20%
Warrant life	2.22 years	3 years	1.53 – 1.96 years
Share price	\$8.00	\$3.77	\$3.76
Exercise price ⁽²⁾	\$6.86	\$4.00	\$4.00
Number of warrants issued	599,975	310,803	289,172

(1) Estimated annual volatility is based on the historical stock prices of comparable public companies.

(2) The initial public offering closed on March 9, 2021 constitutes a qualified financing so the exercise price has been modified to \$7.999 to reflect the purchase price of equity securities issued and sold in the Qualified Financing

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12. DERIVATIVE WARRANT LIABILITY (continued)

Details related to the warrant liability are as follows:

	June 30, 2021	December 31, 2020
Fair value of warrants issued on July 13, 2019	\$ 67,306	\$ 31,285
Fair value of warrants issued on July 22, 2019	264,117	122,708
Fair value of warrants issued on August 30, 2019	68,341	31,703
Fair value of warrants issued on December 16, 2019	412,123	190,612
Fair value of warrants issued on January 4, 2021	1,221,587	-
Fair value of warrants issued on January 8, 2021	142,214	-
Fair value of warrants reclassified to contributed surplus on March 9, 2021	(2,175,688)	-
Total fair value of warrants	\$ -	\$ 376,308

13. CONVERTIBLE DEBT

On June 21, 2021, the Company entered into a contingent convertible debt agreement (the "Debt Agreement") with Silicon Valley Bank ("SVB") and concurrently drew down, in full, the \$10 million principal amount under the Agreement.

The Debt Agreement has a term of 36 months or 48 months at SVB's election. The Debt Agreement accrues interest at the greater of 2.45% and the Canadian prime rate, requiring monthly interest payments. An additional payment in kind will accrue at a rate of 7% per annum, which will be settled at maturity or on conversion.

Subject to the terms and conditions of the Debt Agreement, SVB may elect to convert the principal amount of the convertible debt and the accrued and unpaid interest thereon into Common Shares at a conversion price equal to \$5.68 per Common Share. The conversion price of the accrued and unpaid interest will be subject to the minimum pricing requirements of the TSX, to the extent applicable, at the time of conversion.

The Company will have the right (the "Call Right") to call the convertible debt by paying to SVB an amount equal to:

- 125% of the principal amount of the convertible debt (less principal amounts previously repaid), if the Call Right is exercised on or before the 18 month anniversary of the date of the Debt Agreement; and
- 150% of the principal amount of the convertible debt (less principal amounts previously repaid), if the Call Right is exercised after the 18 month anniversary of the date of the Debt Agreement,

in either case together with all accrued and unpaid interest on the principal balance of the convertible debt. If the Call Right is exercised by the Company, SVB will retain certain lookback rights in the event the Company subsequently announces its topline data from its Phase 2 clinical study or the Company enters into an agreement to be acquired in the 12 months following the exercise of the Call Right.

The Company has agreed to grant SVB a security interest in all of its assets, excluding its patents and other intellectual property, as security for its obligations under the Debt Agreement. The Company is required, on or prior to June 30, 2022, to raise additional net new capital, as defined in the Debt Agreement, in the aggregate

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13. CONVERTIBLE DEBT (continued)

amount of \$10 million. This net new capital can originate from, but is not restricted to, a variety of sources as outlined in the Debt Agreement and can include up to \$5 million in reduced project expenses.

The fair value of the liability component of the convertible debt at the time of issue was calculated as the discounted cash flows assuming a 15% discount rate, which was the estimated rate for a similar instrument without a conversion feature. The fair value of the equity component (the conversion feature) was determined at the time of issue as the difference between the face value and the fair value of the liability component. The liability component will be accreted over the life of the instrument.

As at June 30, 2021, the loan balance is comprised of the following:

	Liability component	Equity component	Total
Principal drawdown	\$ 8,695,652	\$ 1,304,348	\$ 10,000,000
Transaction costs	(109,841)	(16,476)	(126,317)
Interest expense	23,625	-	23,625
Accretion expense	6,076	-	6,076
Total, June 30, 2021	\$ 8,615,512	\$ 1,287,872	\$ 9,903,384

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14. LEASES

The carrying amounts of the Company's right-of-use assets and lease liabilities under IFRS 16 and movements during the six-month period are as follows:

Right-of-Use Assets

	Property
Cost	
Balance, January 1, 2020	\$ 371,462
Additions	-
Disposals	-
Balance, December 31, 2020 and June 30, 2021	\$ 371,462
Accumulated Depreciation	
Balance, January 1, 2020	\$ 50,147
Depreciation charge	74,292
Balance, December 31, 2020	124,439
Depreciation charge	31,535
Balance, June 30, 2021	\$ 155,974
Carrying amount as at December 31, 2020	\$ 247,023
Carrying amount as at June 30, 2021	\$ 215,488

Lease Liabilities

	June 30, 2021	December 31, 2020
Opening balance	\$ 251,194	\$ 309,241
Interest expense	17,584	42,648
Payments	(43,848)	(100,695)
Ending balance	\$ 224,930	\$ 251,194
Non-current portion	\$ 168,724	\$ 198,665
Current portion	\$ 56,206	\$ 52,529

The incremental borrowing rate on lease liabilities is 14%. Variable lease payments comprised of operating, maintenance and property tax fees totaling \$38,976 (2020 - \$50,334) for the six-month period ended June 30, 2021 and \$20,097 (2020 - \$27,405) for the 3-month period ended June 30, 2021 are included in rent expense and recognized in profit or loss. During the period ended June 30, 2021, the Company subleased a portion of its office space. An amount totaling \$10,995 (2020 - \$1,833) for the six-month period ended June 30, 2021 and \$5,498 (2020 - \$nil) for the 3-month period ended June 30, 2021 has been recorded as a reduction to rent expense included in general and administrative expenses in profit or loss. The Company's lease payments for office space over the remaining term of the lease are as follows:

	2021	2022	2023	2024
Office	\$43,848	\$87,696	\$87,696	\$80,388

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15. SHARE CAPITAL and CONTRIBUTED SURPLUS

- a) Authorized
- An unlimited number of Common shares, with no par value, with one vote per share.
 - An unlimited number of Preferred shares, with no par value (none have been issued to date).
- b) Issued

Capital transactions which took place during the prior year are as follows:

- i) On December 31, 2020, the Company issued 62,288 common shares at \$4.00 per share on the conversion of convertible notes totaling \$249,150 of principal and accrued interest at maturity.

Capital transactions which took place during the current period are as follows:

- ii) On March 9, 2021, the Company closed an 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 consisted 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 for a period of 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. As consideration for the services rendered by the Underwriters in connection with the Offering, the Company has paid the Underwriters a cash commission of \$2,460,000 which is equal to 6% of the gross proceeds raised under the Offering. An additional \$215,832 in legal and agents' expenses were also paid to the Underwriters. 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. 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 \$528.
- iii) On March 9, 2021, the Company converted outstanding Convertible Notes into 1,261,387 common shares as outlined in Note 9.
- iv) On March 9, 2021, the Company converted outstanding Special Warrants into 298,798 common shares as outlined in Note 10.
- v) On April 29, 2021, the Company issued 78,456 units comprised of one common share and one-half of one common share purchase warrant to Nordic Bioscience Clinical Development ("NBCD"). This investment was in exchange for a \$614,600 (USD500,000) reduction in services fees otherwise payable to NBCD as a contract research organization conducting the Company's Phase 2 clinical trial. Each warrant is exercisable into one common share of the Company at an exercise price of \$11.20 per warrant at any time prior to April 14, 2026, subject to adjustment in certain events. These units were issued at the same price as the Units issued as part of the Offering.

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15. SHARE CAPITAL and CONTRIBUTED SURPLUS (continued)

vi) On June 8, 2021, the Company converted outstanding loans totalling \$5,987,642 into 1,298,664 common shares as outlined in Note 11.

c) Options

Under the Stock Option Plan (the "Plan"), approved by the Board of Directors on September 27, 2015, the Board of Directors may grant stock options to directors, officers, employees and consultants of the Company up to an aggregate of 12.5% of the Company's then issued and outstanding common shares. On March 9, 2021, the Board of Directors amended and restated the Plan (the "Amended Plan") to comply with the applicable requirements of the TSX and to ensure the terms and conditions of the Amended Plan are consistent with those of other public companies. The number of shares available for directors, officers, employees and consultants to acquire pursuant to stock options granted under the Amended Plan was also increased to 15% of the aggregate of the Company's issued and outstanding shares. On May 3, 2021, the Company amended its Amended Plan to: (i) amend the maximum number of common shares that may be reserved and available for issuance upon exercise of stock options, from 15% of the aggregate of the Company's issued and outstanding common shares to 17% of the total number of issued and outstanding common shares (on a non-diluted basis), at the relevant time; and (ii) remove the overall common share limitation for all security based compensation arrangements contained in the Company's existing amended and restated stock option plan.

The Amended Plan will, pursuant to Section 613(a) of the Toronto Stock Exchange ("TSX") Company Manual, require approval of the TSX and a majority of the votes cast by disinterested shareholders of the Company ("Disinterested Shareholder Approval") at the Company's 2021 annual general meeting of shareholders (the "AGM"). The Board subsequently approved the grant of 257,000 Options on May 3, 2021 with an exercise price of \$8.00 per share, which are subject to Disinterested Shareholder Approval at the AGM. The Options vest 25% as of the date of grant, 25% on the one year anniversary of the date of grant, 25% the two year anniversary of the date of grant and 25% on the three year anniversary of the date of grant.

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15. SHARE CAPITAL and CONTRIBUTED SURPLUS (continued)

c) Options (continued)

Options granted under the Plan have lives of up to ten years from the date of grant. The vesting schedule of all granted options is determined at the discretion of the Board. Unless otherwise determined by the Board, in its sole discretion, all grants of options will vest over a three year period, with the first twenty-five percent (25%) of the Options vesting on the date of grant, and the remaining options vesting over the following thirty-six month period in three equal instalments on an annual basis.

The following table summarizes the Company's option transactions:

	Number of options	Weighted average exercise price
Outstanding, December 31, 2019	766,000	\$ 8.00
Cancelled	(32,500)	(8.00)
Outstanding December 31, 2020	733,500	8.00
Issued	1,083,750	8.00
Outstanding June 30, 2021	1,817,250	\$ 8.00

As at June 30, 2021, the following options were outstanding:

Grant date	Options outstanding	Options exercisable	Exercise price	Expiry date	Remaining contractual life (years)
Sep 27, 2015	118,750	118,750	8.00 ⁽³⁾	Mar 31, 2025	3.75
Sep 27, 2015	67,500	67,500	8.00 ⁽³⁾	Mar 31, 2025	3.75
Nov 2, 2015	62,500	62,500	8.00 ⁽³⁾	Nov 2, 2025	4.35
Nov 2, 2015	32,500	32,500	8.00 ⁽³⁾	Nov 2, 2025	4.35
Mar 5, 2018	198,750	198,750	8.00 ⁽³⁾	Mar 5, 2028	6.68
Mar 5, 2018	253,500	253,500	8.00 ⁽³⁾	Mar 5, 2028	6.68
Mar 9, 2021	756,950	189,237 ⁽¹⁾	8.00	Mar 9, 2031	9.70
Mar 9, 2021	326,800	326,800 ⁽²⁾	8.00	Mar 9, 2031	9.70
	1,817,250	1,249,537	8.00		8.06

(1) Options granted to employees and board members of the Company vesting as follows: 25% vest immediately, 25% vest on the first anniversary of the grant date, 25% vest on the second anniversary of the grant date, and 25% vest on the third anniversary of the grant date.

(2) Options granted to employees and board members of the Company vesting 100% as of the grant date.

(3) On March 9, 2021 the exercise price of these options was modified from \$10.00 per share to \$8.00 per share.

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15. SHARE CAPITAL and CONTRIBUTED SURPLUS (continued)

c) Options (continued)

The stock-based compensation expense was determined based on the fair value of options at the date of measurement and those modified on March 9, 2021 using the Black-Scholes option pricing model with the following weighted-average assumptions.

Options granted during the period/year ended	March 31, 2021	December 31, 2018	December 31, 2015
Expected dividend yield	0.00%	0.00%	0.00%
Expected forfeiture rate	0.00%	0.00%	0.00%
Weighted average annual volatility	72.5%	71.35%	78.90%
Weighted average risk-free interest rate	0.91%	0.97%	0.66%
Weighted average option life	5.5 years	7 years	4.61 years
Weighted average share price	\$8.00	\$8.00	\$8.00
Weighted average exercise price	\$8.00	\$8.00	\$8.00
Weighted average fair value of options granted	\$4.92	\$5.33	\$4.87

The total cost of the option modification for the three and six months ended June 30, 2021 was \$174,352 (\$nil for the three and six months ended June 30, 2020) which has been included in stock-based compensation expense for three and six months ended June 30, 2021. The cost was determined based on the incremental fair value of the options using the Black-Scholes option pricing model with the following weighted-average assumptions. Stock-based compensation of \$3,608,583 which was based on the fair value of the options prior to the modification was expensed in previous periods. Stock option expense for the three months ended June 30, 2021 was \$527,927 (\$60,198 for the three months ended June 30, 2020) and was \$3,239,119 for the six months ended June 30, 2021 (\$108,285) for the six months ended June 30, 2020).

d) Warrants

The following table summarizes the Company's warrant transactions:

	Number of warrants	Weighted average exercise price
Outstanding December 31, 2019 and 2020	985,593	\$ 1.63
Issued	3,176,306	10.67
Outstanding June 30, 2021	4,161,899	\$ 8.81

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15. SHARE CAPITAL and CONTRIBUTED SURPLUS (continued)

d) Warrants (continued)

As at June 30, 2021, the following warrants were outstanding:

Expiry date	Exercise price	Remaining contractual life (years)	Warrants outstanding and exercisable
120 days after holder or common-law partner ceases to be a Director/ Officer or consultant	\$ 0.7572	N/A	380,921
120 days after holder ceases to be a Director/ Officer or consultant	0.4984	N/A	315,500
July 13, 2022 to December 16, 2022	7.999 ⁽¹⁾	1.04 – 1.46	289,172
January 4, 2024	5.5993	2.52	239,080
January 4, 2024	7.1991	2.52	39,846
January 8, 2024	5.5993	2.53	31,877
March 9, 2026	11.20	4.69	2,826,275
April 29, 2026	11.20	4.83	39,228
	\$ 8.81		4,161,899

(1) Upon completion of the Company's initial public offering, the exercise price of these warrants was adjusted pursuant to the terms of the warrant agreements.

e) Class B Non-Voting shares

On January 31, 2021, the Company entered into a contribution agreement with 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 the Chief Scientific Officer, which held 5% of the equity interest in the Company's subsidiary, Eupraxia USA. In exchange, the Company issued to the Chief Scientific Officer 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 the Chief Scientific Officer 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 the Chief Scientific Officer 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.

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16. GOVERNMENT GRANTSNational Research Council – Industrial Research Assistance Program (“IRAP”)

On April 15, 2021, the Company entered into an agreement with the National Research Council Canada via the Industrial Research Assistance Program (NRC-IRAP) for funding support from the Youth Internship Program commencing April 15, 2021 and ending on December 31, 2021. Under the agreement, the NRC agrees to contribute up to a maximum of \$36,000 for internal graduate salary costs.

On April 1, 2020, the Company entered into an agreement with NRC-IRAP for funding support from the Innovation Assistance Program (IAP) commencing April 1, 2020 and ending June 24, 2020. On June 25, 2020, the Company entered into a subsequent agreement with NRC-IRAP for funding support from the IAP commencing June 25, 2020 and ending December 19, 2020. On March 12, 2021, the Company entered into a third agreement for funding support from the IAP commencing December 20, 2020 to March 13, 2021. Under the agreements, NRC-IRAP provided a payroll subsidy to assist innovative, early-stage, small and medium sized enterprises that are unable to access existing COVID-19 business support.

On February 1, 2019, the Company entered into an agreement with NRC-IRAP for funding support of specified research and development activities during a project phase, commencing on February 1, 2019 and ending on July 31, 2020. Under the agreement, NRC-IRAP reimbursed up to 80% of supported salary costs, and 50% of supported contractor fees to a maximum of \$999,000. The project was completed on January 15, 2020.

Government of Canada - 10% Temporary Wage Subsidy

On March 18, 2020, the Company applied for and received the 10% Temporary Wage Subsidy for Employers (“TWS”) from the Government of Canada. The TWS is a 3-month measure that allows eligible employers to reduce the amount of payroll deductions they remit to the Canada Revenue Agency (“CRA”). The subsidy is equal to 10% of the remuneration paid from March 18 to June 19, 2020, up to \$1,375 for each eligible employee, with a maximum total of \$25,000 per employer.

At June 30, 2021 there was \$nil (December 31, 2020 - \$179,750) of government grants recorded in amounts receivable and collected subsequent to period end.

The following table summarizes the government grants the Company received during the period.

	Three months ended June 30, 2021	Three months ended June 30, 2020	Six months ended June 30, 2021	Six months ended June 30, 2020
NRC-IRAP	\$ 7,500	\$ 105,934	\$ 72,530	\$ 123,549
Temporary wage subsidy	-	15,581	-	20,625
Biotalent	-	5,273	-	5,273
Total	\$ 7,500	\$ 126,788	\$ 72,530	\$ 149,447
Offset against research and development expense	7,500	125,644	45,434	143,259
Offset against salaries and benefits expense	-	1,144	27,096	6,188

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17. RELATED PARTIES*Due to/from Related Parties*

Related parties include directors, companies controlled by Key Management Personnel (which includes directors and senior management comprising the CEO, CFO, and CSO).

As at June 30, 2021, \$nil (December 31, 2020 - \$725,486) is due to Key Management Personnel (as defined below) representing accrued salaries and bonuses and the reimbursement of expenses. This amount is included in accounts payable and accrued liabilities.

As at June 30, 2021, a loan payable of \$nil (December 31, 2020 - \$238,121) was due to a Director of the Company representing principal and interest as outlined in Note 11.

On June 2, 2021, \$318,533 representing loan principal and interest, was repaid to a Director of the Company as outlined in Note 11.

On June 8, 2021, \$244,110 representing loan principal and interest, was converted into 52,945 common shares of the Company and \$250,226 representing loan principal and interest, was converted into 54,271 common shares of the Company as outlined in Note 11. Both loans were from Directors of the Company.

As at June 30, 2021, \$nil (December 31, 2020 - \$869,534) of convertible notes were held by a director of the Company representing principal and interest as outlined in Note 9. On March 9, 2021, \$882,575 of convertible notes held by the Director representing principal and interest as outlined in Note 9 were converted into 122,595 common shares.

As at June 30, 2021, \$nil (December 31, 2020 - \$5,851) is due from a company controlled by common directors. This amount is included in amounts receivable.

Compensation for Key Management Personnel

Key Management Personnel include the directors and senior management of the Company.

The aggregate value of compensation for Key Management Personnel was as follows:

	Three months ended		Six Months ended	
	June 30		June 30	
	2021	2020	2021	2020
Salaries - senior management	\$ 254,167	\$ 155,000	\$ 504,167	\$ 310,000
Retroactive salary adjustment and deferred compensation bonus – senior management	-	-	696,282	-
Stock-based compensation – options granted, senior management	213,591	39,535	2,256,193	79,069
Stock-based compensation – options granted, directors	193,540	-	618,606	-
Total	\$ 661,298	\$ 194,535	\$ 4,075,248	\$ 389,069

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18. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash, rent receivable, other receivable, accounts payable and accrued liabilities and convertible debt. 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 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 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 June 30, 2021, the Company had a cash balance of \$36,075,856 (December 31, 2020 - \$150,126) and current liabilities of \$816,347 (December 31, 2020 - \$22,542,272). 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. At June 30, 2021, the Company maintains a Convertible Debt facility totalling \$10,000,000 (Note 13). The Debt Agreement accrues interest at the greater of 2.45% and the Canadian prime rate, requiring monthly interest payments. An additional payment in kind accrues at a rate of 7% per annum, which will be settled at maturity or on conversion.

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18. FINANCIAL INSTRUMENTS (continued)

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 dollars. The Company does not use derivatives to hedge against this risk however, it has purchased sufficient US dollars to cover the anticipated costs of the Company's Phase 2 clinical trial. At June 30, 2021, the Company held cash of USD7,851,303 (December 31, 2020 - USD473) and had accounts payable of USD140,785 (December 31, 2020 - USD839,212) and had an amount owing to Auritec of USDnil (December 31, 2020 - USD3,971,475) which were translated to Canadian dollars at 1.2394 (December 31, 2020 - 1.2732). The impact of a 10% change in the exchange rates would have an impact of approximately \$955,000 (2020 - \$612,000) on profit or loss.

Fair Value Measurement

The Company categorizes its financial instruments measured at fair value into one of three different levels depending on the observation of inputs used in the measurement.

Level 1: Fair value is based on unadjusted quoted prices for identical assets or liabilities in active markets

Level 2: Fair value is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly

Level 3: Fair value is based on valuation techniques that require one or more significant unobservable inputs

The fair value of other financial instruments, including cash, rent receivable, other receivable and accounts payable and accrued liabilities approximates their carrying values due to the short-term nature of these instruments. Refer to Note 13 for the fair value of convertible debt.

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19. CAPITAL DISCLOSURES

The Company's principal source of capital is from the issuance of common shares, although other initiatives such as warrants, convertible notes payable, special warrants and debt have been utilized. The Company's capital management objective is to obtain sufficient capital to develop scientific programs that can be added to the product portfolio using the Company's novel drug delivery platform. To meet these objectives, management monitors the Company's ongoing capital requirements whilst examining each scientific program for its ability to meet patient's medical needs, address a large market and novel drug kinetics. The capital structure of the Company consists of equity attributable to common shareholders, including issued share capital, contributed surplus and deficit. During the current period, the Company entered into a Convertible Debt Agreement (Note 13) that includes a requirement to raise an additional \$10 million in net new capital prior to June 30, 2022.

20. INTEREST EXPENSE

Interest expense for the three and six month periods ended June 30, 2021 and 2020 is comprised of the following:

	Three Months ended June 30, 2021	Three Months ended June 30, 2020	Six Months ended June 30, 2021	Six Months ended June 30, 2020
Interest on convertible notes (Note 9)	\$ -	\$ 169,614	\$ 136,253	\$ 336,864
Interest on loans payable (Note 11)	140,611	238,769	407,479	520,879
Interest on convertible debt agreement (Note 13)	29,701	-	29,701	-
Interest on lease liabilities (Note 14)	8,792	10,405	17,584	21,839
Interest on amount payable to Auritec (Note 20)	-	66,914	28,515	148,955
Other interest on accounts payable	5,067	15,443	16,748	26,047
Total	\$ 184,171	\$ 501,145	\$ 636,280	\$ 1,054,584

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21. AURITEC LICENSE AGREEMENT

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, Eupraxia USA was to pay USD5,000,000 to Auritec (the “Upfront Fee”). In addition, Eupraxia USA has agreed to pay Auritec up to USD30 million upon achievement of certain regulatory and commercial milestones related to products licensed under the Amended and Restated License Agreement (“Licensed Products”) as well as a royalty of 4% of net sales of Licensed Products by Eupraxia USA or its affiliates, subject to certain reductions. 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 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 USD100 million.

Eupraxia USA had made a partial payment of USD1,200,000 towards the Upfront Fee 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 USD3,800,000 balance of the Upfront Fee such that USD1,650,000 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 USD2,150,000 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 USD12,000,000 or more. The remaining balance, including principal and accrued interest totalling USD2,343,999, was paid to Auritec on March 9, 2021 following completion of the Company’s initial public offering.

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21. AURITEC LICENSE AGREEMENT (continued)

The following table summarizes the payments made with respect to the Upfront Fee in US dollars and Canadian dollars:

Upfront Fee payable	USD	5,000,000	\$	6,480,500
Principal repayments		(1,200,000)		(1,604,151)
Monthly interest accrued		303,119		402,210
Monthly interest paid		(303,119)		(402,210)
Foreign exchange		-		59,091
Balance payable at December 31, 2019		3,800,000		4,935,440
Monthly interest accrued		214,225		284,255
Monthly interest paid		(42,750)		(56,687)
Foreign exchange		-		(106,526)
Balance payable December 31, 2020		3,971,475		5,056,482
Monthly interest accrued		22,524		28,515
Monthly interest paid		(193,999)		(245,739)
Principal repayments		(3,800,000)		(4,817,789)
Foreign exchange		-		(21,469)
Balance payable June 30, 2021	USD	-	\$	-

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22. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

There were no income taxes paid during the three and six months ended June 30, 2021 and 2020.

The Company paid interest of \$459,190 (2020 - \$100,666) during the six months ended June 30, 2021.

The Company received interest of \$14,706 (2020 - \$423) during the six months ended June 30, 2021.

The Company had the following significant non-cash transactions for the six months ended June 30, 2021:

- 1,261,387 common shares were issued at \$7.999 per share on the conversion of convertible notes on March 9, 2021, valued at \$10,089,835.
- 298,798 common shares were issued at \$7.999 per share on the conversion of special warrants on March 9, 2021, valued at \$2,390,085.
- Warrants with a fair value of \$2,175,688 as at March 9, 2021 were reclassified from a financial liability to equity as outlined in Note 12.
- 78,456 units consisting of one common share and one half of one common share purchase warrant were issued on April 29, 2021 in exchange for \$614,600 (USD500,000) in services from a vendor.
- 1,298,664 common shares were issued at \$4.61 per share on the conversion of a total of \$5,987,642 of loan principal and interest on June 8, 2021.

The Company did not have any significant non-cash transactions for the six months ended June 30, 2020.