

Financial Statements



AuriniaTM

First Quarter Ended March 31, 2020

Aurinia Pharmaceuticals Inc.
Interim Condensed Consolidated Statements of Financial Position (*Unaudited*)
As at March 31, 2020

(expressed in thousands of US dollars)

| | March 31, 2020 \$ | December 31, 2019 \$ |
|---|-------------------------|----------------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | 274,207 | 306,019 |
| Short term investments (note 4) | 11,913 | — |
| Accrued interest and other receivables (note 5) | 3,511 | 368 |
| Prepaid expenses and deposits | 8,266 | 8,750 |
| | <u>297,897</u> | <u>315,137</u> |
| Clinical trial contract deposits | 209 | 209 |
| Property and equipment (note 7) | 5,922 | 93 |
| Acquired intellectual property and other intangible assets | 10,944 | 11,244 |
| | <u>314,972</u> | <u>326,683</u> |
| Liabilities | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 12,411 | 11,177 |
| Deferred revenue | 118 | 118 |
| Contingent consideration (note 6) | 1,649 | — |
| | <u>14,178</u> | <u>11,295</u> |
| Deferred revenue | 176 | 206 |
| Contingent consideration (note 6) | 4,060 | 5,113 |
| Lease liability (note 7) | 5,851 | — |
| Royalty obligation (note 8) | 7,800 | 7,200 |
| Derivative warrant liabilities (note 9) | 19,499 | 29,353 |
| | <u>51,564</u> | <u>53,167</u> |
| Shareholders' Equity | | |
| Common shares (note 10) | 794,932 | 790,472 |
| Contributed surplus | 25,621 | 23,655 |
| Accumulated other comprehensive loss | (805) | (805) |
| Deficit | (556,340) | (539,806) |
| | <u>263,408</u> | <u>273,516</u> |
| | <u>314,972</u> | <u>326,683</u> |
| Commitments (note 14) | | |
| Subsequent events (note 16) | | |

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

Aurinia Pharmaceuticals Inc.Interim Condensed Consolidated Statements of Operations and Comprehensive Loss (*Unaudited*)**For the three month periods ended March 31, 2020 and 2019**

(expressed in thousands of US dollars, except per share data)

| | March 31, 2020 \$ | March 31, 2019 \$ |
|--|-------------------------|-------------------------|
| Revenue | | |
| Licensing revenue | 30 | 30 |
| Expenses | | |
| Research and development | 13,835 | 10,631 |
| Corporate, administration and business development | 11,061 | 3,901 |
| Amortization of acquired intellectual property and other intangible assets | 348 | 346 |
| Amortization of property and equipment | 55 | 37 |
| Other expenses (note 11) | 2,212 | 55 |
| | <u>27,511</u> | <u>14,970</u> |
| Loss before interest income, finance costs, change in estimated fair value of derivative warrant liabilities and income taxes | (27,481) | (14,940) |
| Interest income | 891 | 811 |
| Finance costs | (25) | (11) |
| Loss before change in estimated fair value of derivative warrant liabilities and income taxes | (26,615) | (14,140) |
| Change in estimated fair value of derivative warrant liabilities (note 9) | 9,845 | 1,725 |
| Loss before income taxes | (16,770) | (12,415) |
| Income tax (recovery) expense | (236) | 13 |
| Net loss and comprehensive loss for the period | (16,534) | (12,428) |
| Net loss per common share (note 12) (expressed in \$ per share) | | |
| Basic and diluted loss per common share | <u>(0.15)</u> | <u>(0.14)</u> |

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

Aurinia Pharmaceuticals Inc.
Interim Condensed Consolidated Statements of Changes in Shareholders' Equity (*Unaudited*)
For the three month periods ended March 31, 2020 and 2019

(expressed in thousands of US dollars)

| | Common shares \$ | Contributed surplus \$ | Deficit \$ | Accumulated other comprehensive loss \$ | Shareholders' equity \$ |
|--|------------------------|------------------------------|------------------|---|-------------------------------|
| Balance – January 1, 2020 | 790,472 | 23,655 | (539,806) | (805) | 273,516 |
| Exercise of stock options | 4,450 | (1,530) | — | — | 2,920 |
| Exercise of derivative warrants | 10 | — | — | — | 10 |
| Stock based compensation | — | 3,496 | — | — | 3,496 |
| Net loss and comprehensive loss for the period | — | — | (16,534) | — | (16,534) |
| Balance - March 31, 2020 | <u>794,932</u> | <u>25,621</u> | <u>(556,340)</u> | <u>(805)</u> | <u>263,408</u> |
| Balance – January 1, 2019 | 504,650 | 24,690 | (415,960) | (805) | 112,575 |
| Issue of common shares | 30,000 | — | — | — | 30,000 |
| Share issue costs | (1,170) | — | — | — | (1,170) |
| Exercise of derivative warrants | 7,413 | — | — | — | 7,413 |
| Exercise of stock options | 2,170 | (819) | — | — | 1,351 |
| Stock based compensation | — | 1,604 | — | — | 1,604 |
| Net loss and comprehensive loss for the period | — | — | (12,428) | — | (12,428) |
| Balance - March 31, 2019 | <u>543,063</u> | <u>25,475</u> | <u>(428,388)</u> | <u>(805)</u> | <u>139,345</u> |

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

Aurinia Pharmaceuticals Inc.
Interim Condensed Consolidated Statements of Cash Flows *(Unaudited)*
For the three month periods ended March 31, 2020 and 2019

(expressed in thousands of US dollars)

| | March 31, 2020 \$ | March 31, 2019 \$ |
|--|-------------------------|-------------------------|
| Cash flow provided by (used in) | | |
| Operating activities | | |
| Net loss for the period | (16,534) | (12,428) |
| Adjustments for | | |
| Amortization of deferred revenue | (30) | (30) |
| Amortization of property and equipment | 55 | 37 |
| Amortization of acquired intellectual property and other intangible assets | 348 | 346 |
| Royalty obligation expense (note 8) | 600 | — |
| Revaluation of contingent consideration | 596 | (7) |
| Interest expense (note 7) | 25 | 11 |
| Amortization of short term investment discount (note 15) | — | 4 |
| Unrealized foreign exchange on lease liability | — | 8 |
| Change in estimated fair value of derivative warrant liabilities | (9,845) | (1,725) |
| Stock-based compensation | 3,496 | 1,604 |
| | <u>(21,289)</u> | <u>(12,180)</u> |
| Net change in other operating assets and liabilities (note 15) | (1,425) | (969) |
| Net cash used in operating activities | <u>(22,714)</u> | <u>(13,149)</u> |
| Investing activities (note 15) | | |
| Purchase of short term investments | (11,913) | — |
| Purchase of equipment | (58) | (12) |
| Capitalized patent costs | (48) | (8) |
| Proceeds on maturity of short term investment | — | 3,910 |
| Net cash generated from (used in) investing activities | <u>(12,019)</u> | <u>3,890</u> |
| Financing activities (note 15) | | |
| Proceeds from exercise of stock options | 2,920 | 1,351 |
| Proceeds from exercise of derivative warrants | 1 | 1,493 |
| Principal elements of lease payments | — | (23) |
| Net proceeds from issuance of common shares | — | 28,830 |
| Net cash generated from financing activities | <u>2,921</u> | <u>31,651</u> |
| Increase (decrease) in cash and cash equivalents during the period | <u>(31,812)</u> | <u>22,392</u> |
| Cash and cash equivalents – Beginning of period | <u>306,019</u> | <u>117,967</u> |
| Cash and cash equivalents – End of period | <u><u>274,207</u></u> | <u><u>140,359</u></u> |

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

(expressed in US dollars, tabular amounts in thousands)

1 Corporate information

Aurinia Pharmaceuticals Inc. or the Company is late-stage clinical biopharmaceutical company, focused on developing and commercializing therapies to treat targeted patient populations that are suffering from serious diseases with a high unmet medical need. The Company is currently developing voclosporin, an investigational drug, for the treatment of lupus nephritis (LN), Dry Eye Syndrome (DES) and proteinuric kidney diseases.

Aurinia's head office is located at #1203-4464 Markham Street, Victoria, British Columbia, and its registered office located at #201, 17873-106 A Avenue, Edmonton, Alberta. Aurinia also has a US Commercial office located at 77 Upper Rock Circle, Rockville, Maryland.

Aurinia Pharmaceuticals Inc. is incorporated pursuant to the Business Corporations Act (Alberta). The Company's common shares are currently listed and traded on the Nasdaq Global Market (Nasdaq) under the symbol AUPH and on the Toronto Stock Exchange (TSX) under the symbol AUP.

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Aurinia Pharma U.S., Inc. (Delaware incorporated) and Aurinia Pharma Limited (UK incorporated).

2 Basis of preparation

Statement of compliance

These interim condensed consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (IFRS), as applicable to interim financial reports including IAS 34, Interim Financial Reporting, and should be read in conjunction with the annual financial statements of the Company for the year ended December 31, 2019 which have been prepared in accordance with IFRS, as issued by International Accounting Standards Board (IASB).

These interim condensed consolidated financial statements were authorized for issue by the Board of Directors on May 12, 2020.

Basis of measurement

The interim condensed consolidated financial statements have been prepared on a going concern and historical cost basis, other than certain financial instruments recognized at fair value.

Functional and presentation currency

These interim condensed consolidated financial statements are presented in United States (US) dollars, which is the Company's functional currency.

COVID-19

IFRS requires management to make estimates and assumptions that affect amounts reported in the interim condensed consolidated financial statements and accompanying notes. The interim condensed consolidated financial statements reflect all adjustments of a normal, recurring nature that are, in the opinion of management, necessary for a fair presentation of results for these interim periods. The full extent to which the novel coronavirus (COVID-19) pandemic will directly or indirectly impact the Company's estimates related to the contingent consideration (note 6), lease liability (note 7), royalty obligation (note 8) or results of operations will depend on future developments that are uncertain at this time. As events continue to evolve and additional information becomes available, the Company's estimates may change materially in future periods.

3 Accounting policy

These interim condensed consolidated financial statements follow the same accounting policies and methods of their application as the December 31, 2019 annual audited consolidated financial statements.

(expressed in US dollars, tabular amounts in thousands)

4 Short term investments

| | March 31, 2020 \$ | December 31, 2019 \$ |
|--|-------------------------|----------------------------|
| Amortized cost | | |
| Canadian Government Bond - due July 2, 2020 - with an effective interest rate of 1.75% | 9,913 | — |
| TD cashable GIC - due January 12, 2021 - with an effective interest rate of 1.30% | 2,000 | — |
| | <u>11,913</u> | <u>—</u> |

The fair value of the short term investment(s) at March 31, 2020 was \$11,979,000 (December 31, 2019 - \$nil). The average duration of the interest-bearing securities held at March 31, 2020 was 0.75 years and the average yield to maturity was 1.68%.

5 Accrued interest and other receivables

| | March 31, 2020 \$ | December 31, 2019 \$ |
|---------------------------------|-------------------------|----------------------------|
| FDA application fee recoverable | 2,943 | — |
| Other receivables | 223 | 163 |
| Accrued interest receivable | 188 | 205 |
| Income taxes recoverable | 157 | — |
| | <u>3,511</u> | <u>368</u> |

FDA application fee recoverable

The Prescription Drug User Fee Act (PDUFA) was a law passed by the United States Congress in 1992 which allowed the Food and Drug Administration (FDA) to collect fees from drug manufacturers to fund the new drug approval process. During the first quarter ended March 31, 2020 the Company paid the human drug application fee for new drug application (NDA) of \$2,943,000 to the FDA. The Company also applied for a fee waiver under the the small business waiver provision, section 736(d)(1)(C)2 of the Federal Food, Drug, and Cosmetic Act (the FD&C Act) and was granted that waiver on March 26, 2020. As a result the Company has recorded all fees paid to the FDA related to NDA as recoverable application fees.

Income taxes recoverable

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was enacted by the United States Government to amongst other provisions, provide emergency assistance for individuals, families and businesses affected by the coronavirus pandemic. The CARES Act permits net operating loss (NOL) carryovers and carrybacks to offset 100% of taxable income for taxable years beginning before 2021. In addition, the CARES Act allows NOLs incurred in 2018, 2019, and 2020 to be carried back to each of the five preceding taxable years to generate a refund of previously paid income taxes. The Company's United States subsidiary generated net operating losses for the three months ended March 31, 2020 which will allow it to carryback sufficient losses to fully recover income taxes related to its 2015 to 2019 taxation years.

The Company recorded a net income tax recovery of \$237,000 in the statement of operations and comprehensive loss for the three months ended March 31, 2020 comprised of a recovery of \$240,000 related to this loss carryback provision less a \$3,000 provision for income taxes related to its United Kingdom subsidiary.

The income tax recoverable of \$157,000 is comprised of the income tax recovery of \$240,000 less \$83,000 outstanding at March 31, 2020 for 2019 United States subsidiary income taxes.

(expressed in US dollars, tabular amounts in thousands)

6 Contingent consideration

The outstanding fair value of contingent consideration payable to ILJIN, a related party and affiliated shareholder, is the result of an Arrangement Agreement (the Agreement) completed on September 20, 2013 between the Company, Aurinia Pharma Corp. and ILJIN. Pursuant to the Agreement, the remaining payments of up to \$7,750,000 may be paid dependent on the achievement of pre-defined clinical and marketing milestones.

During 2019 the Company paid ILJIN \$100,000, upon the achievement of a specific milestone. Previously, in 2017 the Company paid ILJIN \$2,150,000 upon the achievement of two specific milestones. These payments reduced the original \$10,000,000 contingent consideration to \$7,750,000.

At March 31, 2020, if all of the remaining milestones are met, the timing of these payments is estimated to occur as follows:

| | \$ |
|------|--------------|
| 2021 | 6,000 |
| 2022 | 625 |
| 2024 | 1,125 |
| | <u>7,750</u> |

The fair value estimates at March 31, 2020 were based on a discount rate of 4.3% (December 31, 2019 - 10%) and a presumed payment range between 50% and 86% (December 31, 2019 - 50% and 86%). The decrease of the discount rate was primarily attributable to the significant decline in interest rates caused by the global coronavirus (COVID-19) pandemic. The fair value of this contingent consideration as at March 31, 2020 was estimated to be \$5,709,000 (December 31, 2019 - \$5,113,000) and was determined by estimating the probability and timing of achieving the milestones and applying the income approach.

The change in discount rate and passage of time, on revaluation, resulted in an increase in contingent consideration of \$596,000 for the three months ended March 31, 2020 compared to a decrease in contingent consideration of \$7,000 for the three months ended March 31, 2019.

This is a Level 3 recurring fair value measurement. If the probability for success were to increase by a factor of 10% for each milestone, this would increase the net present value (NPV) of the obligation by approximately \$717,000 as at March 31, 2020. If the probability for success were to decrease by a factor of 10% for each milestone, this would decrease the NPV of the obligation by approximately \$717,000 as at March 31, 2020. If the discount rate were to increase to 6.3%, this would decrease the NPV of the obligation by approximately \$175,000. If the discount rate were to decrease to 2.3%, this would increase the NPV of the obligation by approximately \$186,000.

7 Leases

During March 2020, the Company entered into a commercial office lease for its US commercial center of operations in Rockville, Maryland (MD lease). The Company recognized a \$5,804,000 right-of-use asset (ROU asset) and a \$5,804,000 lease liability related to the lease. When measuring the lease liability, the Company discounted lease payments using its incremental borrowing rate at March 12, 2020. The incremental borrowing rate applied to the lease liability on March 12, 2020 was 5.2%.

The recognition of the MD lease resulted in the following adjustments to the statement of financial position:

| | \$ |
|---|--------------|
| March 12, 2020 - Recognition of lease liability | 5,804 |
| Tenant improvements reimbursed by Landlord | 22 |
| Interest expense | 25 |
| March 31, 2020 - Lease liability | <u>5,851</u> |

The recognition of the MD lease resulted in the following adjustments to the statement of operations and comprehensive loss:

| | |
|---|--------------|
| March 12, 2020 - Recognition right-of-use asset | 5,804 |
| Right-of-use asset amortization | (42) |
| March 31, 2020 - Right-of-use asset | <u>5,762</u> |

(expressed in US dollars, tabular amounts in thousands)

The amortization expense related to the ROU asset is presented with the amortization of property and equipment in the statement of operations and comprehensive loss.

In addition to the ROU assets, the Company presents all property and equipment together on the statement of financial position:

| | |
|---------------------------------------|--------------|
| | \$ |
| Right-of-use asset | 5,762 |
| Other property and equipment | 160 |
| March 31, 2020 Property and equipment | <u>5,922</u> |

The Company has three short term leases for office spaces in Victoria, Edmonton and one other office in the US. For the period ended March 31, 2020 and March 31, 2019, the Company incurred short-term lease expense of \$71,000 and \$16,000 and variable lease expense of \$nil and \$14,000, respectively.

Critical judgements in determining the lease term

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated).

For leases of office space, the following factors are the most relevant:

- If there are significant penalties to terminate (or not extend), the Company is typically reasonably certain to extend (or not terminate).
- If any leasehold improvements are expected to have significant remaining value, the Company is typically reasonably certain to extend (or not terminate).

Otherwise, the Company considers other factors including historical lease durations, government incentives received in connection with the lease, and business disruption required to replace the leased asset or relocate facilities. Most extension options in office leases have not been included in the lease liability, because the Company could replace the leasehold improvement assets and relocate facilities without significant cost or business disruption.

Lease Obligations

The Company's approximate lease obligations for the next five years are as follows:

| | Contractual cash flow \$ | Lease inducements \$ | Total \$ |
|----------------------------|---|-------------------------------------|---------------------|
| 2020 | — | (2,272) | (2,272) |
| 2021 | 287 | — | 287 |
| 2022 | 968 | — | 968 |
| 2023 | 1,061 | — | 1,061 |
| 2024 | 1,085 | — | 1,085 |
| Thereafter | 7,882 | — | 7,882 |
| | <u>11,283</u> | <u>(2,272)</u> | <u>9,011</u> |
| Carrying value (liability) | <u>8,123</u> | <u>(2,272)</u> | <u>5,851</u> |

8 Royalty obligation

The royalty obligation is the result of a resolution of the Board of Directors of the Company dated March 8, 2012 whereby certain executive officers at that time were provided with future potential retention benefits for remaining with the Company as follows:

(a) Pursuant to a resolution of the Board of Directors of the Company on March 8, 2012 and a termination agreement and general release dated February 14, 2014, the Company will be required to pay a royalty, equivalent to 2% of royalties received on the sale of voclosporin by licensees and/or 0.3% of net sales of voclosporin sold directly by the Company to the Chief Executive Officer at the time of the resolution. Should the Company sell substantially all of the assets of voclosporin to a third party or transfer those assets to another party in a merger in a manner such that this payment obligation is no longer operative, then the Company would be required to pay 0.3% of the value attributable to voclosporin in the transaction.

(expressed in US dollars, tabular amounts in thousands)

(b) In addition, pursuant to a resolution of the Board of Directors of the Company on March 8, 2012, and employment agreements, two executive officers, at the time of the resolution, are eligible to receive 0.1675% of royalty licensing revenue for royalties received on the sale of voclosporin by licensees and/or 0.025% of net sales of voclosporin sold directly by the Company. Should the Company sell substantially all of the assets of voclosporin to a third party or transfer those assets to another party in a merger, the executives, at the time of the resolution, will be entitled to receive 0.025% of the value attributable to voclosporin in the transaction, and the entitlement to further royalty or sales payments shall end. Effective October 1, 2019 pursuant to the employment agreements all service conditions have been met. The royalty obligation will terminate upon death.

The Board of Director resolution, dated March 8, 2012, created an employee benefit obligation contingent on the occurrence of uncertain future events. The probability that the specified events will occur affects the measurement of the obligation.

As a result of the completion of the Phase 3 lupus nephritis trial, and the results obtained from the trial in the fourth quarter of 2019 the Company re-assessed the probability of royalty obligation payments being required in the future, and has recorded the royalty obligation at December 31, 2019. Until one of the triggering events described in sections 12(a) or 12(b) occur, no royalty payments are required to be paid. Any royalties on sales or licensing are not expected in the next twelve months and therefore the royalty obligation has been classified as long term. The fair value of the royalty obligation as at March 31, 2020 was estimated to be \$7,800,000 (December 31, 2019 - \$7,200,000).

During the first quarter ended March 31, 2020 the Company re-assessed the royalty obligation and reduced the discount rate from 12% to 10%. The reduction was primarily attributable to the significant decline in interest rates caused by the global coronavirus (COVID-19) pandemic. The change in discount rate and passage of time, on revaluation, resulted in an increase in the royalty obligation of \$600,000 for the three months ended March 31, 2020.

The Company is required to use significant judgment and estimates in determining the inputs into the model. The key assumptions used by management include the estimated probability of market approval of 86%, and the discount rate of 10%. If the probability of success were to increase to 95% this would increase the obligation by \$798,000 and if it were to decrease to 77% this would decrease the obligation by \$831,000. If the discount rate were to increase to 11%, this would decrease the obligation by \$556,000, and if it were to decrease to 9%, this would increase the obligation by \$575,000. An increase in the estimated gross pricing by 10% would result in an increase in the obligation of \$756,000 while a decrease in the estimated gross pricing by 10% would result in a decrease in the obligation of \$789,000. An increase in the number of patients being treated by 10% would result in an increase in the obligation of \$756,000 while a decrease in the number of patients being treated by 10% would result in a decrease in the obligation of \$789,000.

9 Derivative warrant liabilities

In accordance with IFRS, a contract to issue a variable number of shares fails to meet the definition of equity and must instead be classified as a derivative liability and measured at fair value with changes in fair value recognized in the consolidated statements of operations and comprehensive loss at each period-end. The derivative liabilities will ultimately be converted into the Company's equity (common shares) when the warrants are exercised, or will be extinguished on the expiry of the outstanding warrants, and will not result in the outlay of any cash by the Company. Immediately prior to exercise, the warrants are remeasured at their estimated fair value. Upon exercise, the intrinsic value is transferred to share capital (the intrinsic value is the share price at the date the warrant is exercised less the exercise price of the warrant). Any remaining fair value is recorded through the statement of operations and comprehensive loss as part of the change in estimated fair value of derivative warrant liabilities.

| | December 28, 2016 Warrants | | February 14, 2014 Warrants | | Total | |
|---|---------------------------------|---------------|---------------------------------|----------|---------------------------------|---------------|
| | # of warrants (in thousands) | \$ | # of warrants (in thousands) | \$ | # of warrants (in thousands) | \$ |
| Balance at January 1, 2020 | 1,691 | 29,353 | — | — | 1,691 | 29,353 |
| Conversion to equity (common shares) upon exercise of warrants | (1) | (9) | — | — | (1) | (9) |
| Revaluation of derivative warrant liability | — | (9,845) | — | — | — | (9,845) |
| Balance at March 31, 2020 | <u>1,690</u> | <u>19,499</u> | <u>—</u> | <u>—</u> | <u>1,690</u> | <u>19,499</u> |
| Balance at January 1, 2019 | 3,523 | 15,475 | 1,738 | 6,272 | 5,261 | 21,747 |
| Conversion to equity (common shares) upon exercise of warrants | — | — | (1,738) | (5,920) | (1,738) | (5,920) |
| Revaluation of derivative warrant liability | — | (1,373) | — | (352) | — | (1,725) |
| Balance at March 31, 2019 | <u>3,523</u> | <u>14,102</u> | <u>—</u> | <u>—</u> | <u>3,523</u> | <u>14,102</u> |

(expressed in US dollars, tabular amounts in thousands)

Derivative warrant liability related to December 28, 2016 Bought Deal public offering

On December 28, 2016, the Company completed a \$28,750,000 Bought Deal public offering (the Offering). Under the terms of the Offering, the Company issued 12,778,000 units at a subscription price per Unit of \$2.25, each Unit consisting of one common share and one-half (0.50) of a common share purchase warrant (a Warrant), exercisable for a period of five years from the date of issuance at an exercise price of \$3.00. The holders of the Warrants issued pursuant to this offering may elect, if the Company does not have an effective registration statement registering or the prospectus contained therein is not available for the issuance of the Warrant Shares to the holder, in lieu of exercising the Warrants for cash, a cashless exercise option to receive common shares equal to the fair value of the Warrants. The fair value is determined by multiplying the number of Warrants to be exercised by the weighted average market price less the exercise price with the difference divided by the weighted average market price. If a Warrant holder exercises this option, there will be variability in the number of shares issued per Warrant.

At initial recognition on December 28, 2016, the Company recorded a derivative warrant liability of \$7,223,000 based on the estimated fair value of the Warrants.

In the three months ended March 31, 2020, a holder exercised 500 Warrants for \$3.00 per share, for a gross proceeds of \$1,500. These warrants had an estimated fair value of \$8,855 on the date of exercise, determined using the Black-Scholes pricing model. Of this amount \$8,810 was transferred from derivative warrant liabilities into equity (common shares) and \$45 was recorded through the statement of operations and comprehensive loss as a part of the change in estimate fair value of derivative warrant liabilities. There were no derivative warrant exercises in the three month period ended March 31, 2019.

The Company uses the Black-Scholes pricing model to estimate fair value. The Company considers expected volatility of its common shares in estimating its future stock price volatility. The risk-free interest rate for the life of the Warrants was based on the yield available on government benchmark bonds with an approximate equivalent remaining term at the time of issue. The life of warrant is based on the contractual term.

As at March 31, 2020, the Company revalued the remaining derivative warrants at an estimated fair value of \$19,499,000 (December 31, 2019 – \$29,353,000). The Company recorded a decrease in the estimated fair value of the derivative warrant liability of \$9,845,000 for the three months ended March 31, 2020 (March 31, 2019 - \$1,373,000).

The following assumptions were used to estimate the fair value of the derivative warrant liability on March 31, 2020 and December 31, 2019:

| | March 31, 2020 \$ | December 31, 2019 \$ |
|---------------------------|-------------------------|----------------------------|
| Annualized volatility | 49% | 43% |
| Risk-free interest rate | 0.21% | 1.57% |
| Life of warrants in years | 1.75 | 1.99 |
| Dividend rate | 0.0% | 0.0% |
| Market price | 14.51 | 20.26 |
| Fair value per Warrant | 11.53 | 17.35 |

These derivative warrant liabilities are Level 3 recurring fair value measurements.

The key Level 3 inputs used by management to estimate the fair value are the market price and the expected volatility. If the market price were to increase by a factor of 10%, this would increase the estimated fair value of the obligation by approximately \$2,446,000 as at March 31, 2020. If the market price were to decrease by a factor of 10%, this would decrease the estimated fair value of the obligation by approximately \$2,443,000. If the volatility were to increase by 10%, this would increase the estimated fair value of the obligation by approximately \$19,000. If the volatility were to decrease by 10%, this would decrease estimated fair value of the obligation by approximately \$11,000 as at March 31, 2020.

Derivative warrant liability related to February 14, 2014 private placement offering

On February 14, 2014, the Company completed a \$52,000,000 private placement. Under the terms of the Offering, the Company issued 18,919,404 units at a subscription price per Unit of \$2.7485, each Unit consisting of one common share and one-quarter (0.25) of a common share purchase warrant (a Warrant), exercisable for a period of five years from the date of issuance at an exercise price of \$3.2204. The holders of the Warrants issued pursuant to the February 14, 2014 private placement may elect, in lieu of exercising the Warrants for cash, a cashless exercise option to receive common shares equal to the fair value of the Warrants based on the number of Warrants to be exercised multiplied by a five-day weighted average market price less the exercise price with the difference divided by

(expressed in US dollars, tabular amounts in thousands)

the weighted average market price. If a Warrant holder exercises this option, there will be variability in the number of shares issued per Warrant.

In the three month period ended March 31, 2019, the 1,738,000 derivative warrants outstanding at December 31, 2018 related to the February 14, 2014 private placement offering, were exercised. Certain holders of these Warrants elected the cashless exercise option and the Company issued 687,000 common shares on the cashless exercise of 1,274,000 Warrants. The remaining 464,000 warrants were exercised for cash, at a price of \$3.2204 per common share and the Company received cash proceeds of \$1,493,000 upon the issuance of 464,000 common shares. Pursuant to the exercise of these warrants, the Company transferred \$5,920,000 from derivative warrant liabilities to equity (common shares) and recorded a net adjustment of \$352,000 through the statement of operations and comprehensive loss. As a result, the derivative warrant liability of \$6,272,000 at December 31, 2018 related to the February 14, 2014 private placement offering has been extinguished upon the exercise of the aforementioned warrants.

10 Share capital

a) Common shares

Authorized

Unlimited common shares without par value

Issued

| | Common shares | |
|---|---------------------------------|----------------|
| | Number (in thousands) | \$ |
| Balance as at January 1, 2020 | 111,798 | 790,472 |
| Issued pursuant to exercise of derivative liability warrants (note 9) | 1 | 10 |
| Issued pursuant to exercise of stock options | 688 | 4,450 |
| Balance as at March 31, 2020 | <u>112,487</u> | <u>794,932</u> |
| Balance as at January 1, 2019 | 85,500 | 504,650 |
| Issued pursuant to At The Market (ATM) Facility | 4,608 | 28,830 |
| Issued pursuant to exercise of derivative liability warrants (note 9) | 1,151 | 7,413 |
| Issued pursuant to exercise of stock options | 387 | 2,170 |
| Balance as at March 31, 2019 | <u>91,646</u> | <u>543,063</u> |

November 30, 2018 ATM facility

On November 30, 2018 the Company entered into an Open Market Sale Agreement (the “Sale Agreement”) with Jefferies LLC (Jefferies) pursuant to which the Company could sell, through at-the-market (ATM) offerings, common shares that would have an aggregate offering price of up to US\$30,000,000.

During the first quarter ended March 31, 2019 pursuant to this agreement the ATM Facility was fully utilized resulting in gross proceeds of \$30,000,000 upon the issuance of 4,608,000 common shares at a weighted average price of \$6.51. The Company incurred share issue costs of \$1,170,000 including a 3% commission of \$900,000 paid to the agent and professional and filing fees of \$270,000 directly related to the ATM.

(expressed in US dollars, tabular amounts in thousands)

b) Stock options and compensation expense

A summary of the stock options outstanding as at March 31, 2020 and March 31, 2019 and changes during the periods ended on those dates is presented below:

| | 2020 | | 2019 | |
|---------------------------------------|--------|--|--------|--|
| | Number | Weighted average exercise price in CAS | Number | Weighted average exercise price in CAS |
| Outstanding – Beginning of period | 7,822 | 7.04 | 7,591 | 5.51 |
| Granted pursuant to Stock Option Plan | 2,558 | 23.63 | 1,375 | 8.04 |
| Exercised | (688) | 5.76 | (387) | 4.67 |
| Forfeited | (7) | 7.28 | (234) | 6.59 |
| Outstanding – End of period | 9,685 | 11.52 | 8,345 | 5.93 |
| Options exercisable – End of period | 3,382 | 6.72 | 4,753 | 5.24 |

The maximum number of Common Shares issuable under the Stock Option Plan is equal to 12.5% of the issued and outstanding Common Shares at the time the Common Shares are reserved for issuance. As at March 31, 2020 there were 112,487,000 Common Shares of the Company issued and outstanding, resulting in a maximum of 14,061,000 options available for issuance under the Stock Option Plan. An aggregate total of 8,085,000 options are presently outstanding in the Stock Option Plan, representing 7.2% of the issued and outstanding Common Shares of the Company.

During 2019, the Company granted 1,600,000 inducement stock options to the Chief Executive Officer pursuant to Section 613(c) of the TSX Company Manual at a price of \$6.28 (CA\$8.45). The first 25% of these options vest on the one year anniversary of the grant, and the remaining 75% vest in equal amounts over 36 months following the one year anniversary date and are exercisable for a term of ten years. These options are recorded outside of the Company's stock option plan.

In addition, on May 2, 2016, the Company granted 200,000 inducement stock options to a new employee pursuant to Section 613(c) of the TSX Company Manual at a price of \$2.92 (CA\$3.66). These options vest in equal amounts over 36 months, are exercisable for a term of five years and are recorded outside of the Company's stock option plan. During the period ended March 31, 2020 the employee exercised the remaining 50,000 inducement stock options.

The Stock Option Plan requires the exercise price of each option to be determined by the Board of Directors and not to be less than the closing market price of the Company's stock on the day immediately prior to the date of grant. Any options which expire will be returned to the plan and will be eligible for re-issue. The Board of Directors approves the vesting criteria and periods at its discretion. The options issued under the plan are accounted for as equity-settled share-based payments.

A summary of the stock options granted pursuant to the Stock Option Plan for the period ended March 31, 2020 and March 31, 2019 is presented below:

Three month period ended March 31, 2020

| Grant date | Grant price ⁽⁵⁾ US\$ | Grant price ⁽⁵⁾ CAS | Number (in thousands) |
|--|------------------------------------|-----------------------------------|--------------------------|
| January 2020 - New Employees ⁽³⁾ | 20.71 | 26.98 | 30 |
| January 2020 - Employees ⁽²⁾ | 18.38 | 24.22 | 951 |
| January 2020 - Executives ⁽²⁾ | 18.38 | 24.22 | 443 |
| February 2020 - New Employees ⁽³⁾ | 19.54 | 25.88 | 30 |
| February 2020 - Executive ⁽³⁾ | 18.38 | 24.22 | 413 |
| March 2020 - New Employees ⁽³⁾ | 15.02 | 20.74 | 355 |
| March 2020 - New Executive ⁽³⁾ | 15.38 | 21.12 | 336 |
| | | | 2,558 |

(expressed in US dollars, tabular amounts in thousands)

Three month period ended March 31, 2019

| Grant date | Grant price ⁽⁵⁾ | | Number (in thousands) |
|---|----------------------------|------|--------------------------|
| | US\$ | CAS | |
| January 2019 - Directors ⁽¹⁾ | 6.06 | 8.04 | 210 |
| January 2019 - Executives ⁽⁴⁾ | 6.06 | 8.04 | 875 |
| January 2019 - Employees ⁽²⁾ | 6.06 | 8.04 | 260 |
| January 2019 - New Employees ⁽³⁾ | 6.06 | 8.04 | 20 |
| March 2019 - New Employees ⁽³⁾ | 6.42 | 8.62 | 10 |
| | | | 1,375 |

1. These options vest in equal amounts over 12 months and are exercisable for a term of ten years.
2. These options vest in equal amounts over 36 months and are exercisable for a term of ten years.
3. These options vest 12/36 on the 12-month anniversary date and thereafter 1/36 per month over the next 24 months and are exercisable for a term of ten years.
4. These options vest in equal amounts over 24 months and are exercisable for a term of ten years.
5. A weighted average was used to depict the grant price. Stock options are granted at a Canadian Dollar (CAS) exercise price, and converted to US Dollars (US \$) based on the exchange rate when these stock options are granted.

Application of the fair value method resulted in charges to stock-based compensation expense of \$3,496,000 for the three months ended March 31, 2020 (2019 – \$1,604,000) with corresponding credits to contributed surplus. For the three months ended March 31, 2020, stock compensation expense has been allocated to research and development expense in the amount of \$1,217,000 (2019 – \$862,000) and corporate, administration and business development expense in the amount of \$2,279,000 (2019 – \$742,000).

Stock compensation expense related to key management was \$1,774,000 for the three months ended March 31, 2020 compared to \$902,000 for the three months ended March 31, 2019.

If the stock price volatility was higher by a factor of 10% on the option grant dates in 2020, this would have increased annual stock compensation expense by approximately \$155,000. If the stock price volatility was lower by a factor of 10% on the grant date, this would have decreased annual stock compensation expense by approximately \$156,000.

The Company used the Black-Scholes option pricing model to estimate the fair value of the options granted in 2020 and 2019.

The Company considers historical volatility of its common shares in estimating its future stock price volatility. The risk-free interest rate for the expected life of the options was based on the yield available on government benchmark bonds with an approximate equivalent remaining term at the time of the grant. The expected life is based upon the contractual term, taking into account expected employee exercise and expected post-vesting employment termination behavior.

The following weighted average assumptions were used to estimate the fair value of the options granted during the three months ended March 31, 2020:

| | March 31, 2020 | March 31, 2019 |
|------------------------------------|-------------------|-------------------|
| Annualized volatility | 43% | 53% |
| Risk-free interest rate | 1.20% | 1.84% |
| Expected life of options in years | 3.0 years | 4.0 years |
| Estimated forfeiture rate | 13.0% | 14.2% |
| Dividend rate | 0.0% | 0.0% |
| Exercise price | \$ 17.73 | \$ 6.06 |
| Market price on date of grant | \$ 17.73 | \$ 6.06 |
| Fair value per common share option | \$ 5.44 | \$ 3.43 |

(expressed in US dollars, tabular amounts in thousands)

The following table summarizes information on stock options outstanding as at March 31, 2020:

| Range of exercise prices CAS | Options outstanding | | Options exercisable |
|---------------------------------|--------------------------------------|---|--------------------------------------|
| | Number outstanding (in thousands) | Weighted average remaining contractual life (years) | Number outstanding (in thousands) |
| 3.50 - 4.73 | 1,073 | 4.30 | 1,073 |
| 6.19 - 7.85 | 2,745 | 8.15 | 1,204 |
| 8.04 - 8.97 | 3,228 | 8.82 | 983 |
| 9.45 - 18.16 | 83 | 8.20 | 44 |
| 20.79 - 21.12 | 659 | 9.94 | — |
| 23.99 - 24.59 | 1,424 | 9.83 | 78 |
| 25.63 - 27.85 | 473 | 9.85 | — |
| | <u>9,685</u> | <u>8.40</u> | <u>3,382</u> |

11 Other expenses and finance costs

| | March 31, 2020 \$ | March 31, 2019 \$ |
|---|-------------------------|-------------------------|
| Other expenses | | |
| Revaluation adjustment on contingent consideration (note 6) | 596 | (7) |
| Royalty obligation expense (note 8) | 600 | — |
| Foreign exchange loss | 1,016 | 62 |
| | <u>2,212</u> | <u>55</u> |
| Finance costs | | |
| Interest expense | 25 | 11 |
| | <u>25</u> | <u>11</u> |

Previously, interest income and finance costs were labeled on the statement of operations and comprehensive loss as other expenses. In 2020 they have been disaggregated and relabeled as interest income and finance costs.

12 Net loss per common share

Basic and diluted net loss per common share is computed by dividing net loss by the weighted average number of common shares outstanding for the year. In determining diluted net loss per common share, the weighted average number of common shares outstanding is adjusted for stock options and warrants eligible for exercise where the average market price of common shares for the three month period ended March 31, 2020 exceeds the exercise price. Common shares that could potentially dilute basic net loss per common share in the future that could be issued from the exercise of stock options and warrants were not included in the computation of the diluted loss per common share for the three month period ended March 31, 2020 because to do so would be anti-dilutive.

The numerator and denominator used in the calculation of historical basic and diluted net loss amounts per common share are as follows:

| | March 31, 2020 \$ | March 31, 2019 \$ |
|---|-------------------------|-------------------------|
| Net loss for the period | <u>(16,534)</u> | <u>(12,428)</u> |
| | Number | Number |
| Weighted average common shares outstanding | <u>112,209</u> | <u>90,146</u> |
| | \$ | \$ |
| Net loss per common share (expressed in \$ per share) | <u>(0.15)</u> | <u>(0.14)</u> |

(expressed in US dollars, tabular amounts in thousands)

The outstanding number and type of securities that would potentially dilute basic loss per common share in the future and which were not included in the computation of diluted loss per share, because to do so would have reduced the loss per common share (anti-dilutive) for the years presented, are as follows:

| | March 31, 2020 | March 31, 2019 |
|-----------------------------------|-------------------|-------------------|
| Stock options | 9,685 | 8,345 |
| Warrants (derivative liabilities) | 1,690 | 3,523 |
| | <u>11,375</u> | <u>11,868</u> |

13 Segment disclosures

The Company's operations comprise a single reporting segment engaged in the research, development and commercialization of therapeutic drugs. As the operations comprise a single reporting segment, amounts disclosed in the consolidated financial statements represent those of the single reporting unit. The Company has a total of \$15,560,000 of long-lived assets, of which \$10,998,000 are located in Canada and \$4,562,000 are in the United States.

The following geographic information reflects revenue based on customer location:

| | March 31, 2020 \$ | March 31, 2019 \$ |
|-----------------|-------------------------|-------------------------|
| Revenue - China | <u>30</u> | <u>30</u> |

14 Commitments

The Company has entered into contractual obligations for services and materials required for its clinical trial program, drug manufacturing and other operational activities. Future minimum payments to exit the Company's contractual commitments are as follows:

| | Total (in thousands) \$ | Less than one year (in thousands) \$ | One to three years (in thousands) \$ | Four to five years (in thousands) \$ |
|---|-------------------------------|---|---|---|
| Short-term lease and variable payment obligations | 188 | 188 | — | — |
| Purchase obligations | 8,673 | 8,613 | 60 | — |
| Total | <u>8,861</u> | <u>8,801</u> | <u>60</u> | <u>—</u> |

15 Supplementary cash flow information

Net change in other operating assets and liabilities:

| | March 31, 2020 \$ | March 31, 2019 \$ |
|--|-------------------------|-------------------------|
| Accrued interest and other receivables | (3,143) | (159) |
| Prepaid expenses and deposits | 484 | 61 |
| Accounts payable and accrued liabilities | 1,234 | (871) |
| | <u>(1,425)</u> | <u>(969)</u> |
| Interest received | <u>908</u> | <u>648</u> |

(expressed in US dollars, tabular amounts in thousands)

Cash flows from financing and investing activities:

| | Short term investments \$ | Derivative warrant liabilities \$ | Common shares \$ | Contributed surplus \$ |
|---|---------------------------------|--|------------------------|------------------------------|
| Balance at January 1, 2020 | — | (29,353) | (790,472) | (23,655) |
| Cash flow - Purchase of short term investment | 11,913 | — | — | — |
| Cash flow - Proceeds from exercise of derivative warrants | — | — | (1) | — |
| Cash flow - Proceeds from exercise of options | — | — | (2,920) | — |
| Non-cash changes - Conversion to common shares | — | — | (1,539) | 1,530 |
| Non-cash changes - Fair value adjustments | — | 9,854 | — | — |
| Non-cash changes - Stock Based Compensation | — | — | — | (3,496) |
| Balance at March 31, 2020 | <u>11,913</u> | <u>(19,499)</u> | <u>(794,932)</u> | <u>(25,621)</u> |
| Balance at January 1, 2019 | 7,889 | (21,747) | (504,650) | (24,690) |
| Cash flow - Proceeds from short term investment | (3,910) | — | — | — |
| Cash flow - Net proceeds from ATM | — | — | (28,830) | — |
| Cash flow - Proceeds from exercise of derivative warrants | — | — | (1,493) | — |
| Cash flow - Proceeds from exercise of options | — | — | (1,351) | — |
| Non-cash changes - Conversion to common shares | — | 5,920 | (6,739) | 819 |
| Non-cash changes - Fair value adjustments | — | 1,725 | — | — |
| Non-cash changes - Stock Based Compensation | — | — | — | (1,604) |
| Non-cash changes - Other | (4) | — | — | — |
| Balance at March 31, 2019 | <u>3,975</u> | <u>(14,102)</u> | <u>(543,063)</u> | <u>(25,475)</u> |

16 Subsequent events

Subsequent to March 31, 2020, the Company issued 65,000 common shares upon the exercise of 65,000 stock options for proceeds of \$327,000. The Company also issued 432,000 stock options to new employees at a weighted average exercise price of \$15.79 (CA \$22.13).