

**REPLICEL LIFE SCIENCES INC.**

**MANAGEMENT DISCUSSION AND ANALYSIS (“MD&A”)**

**FORM 51-102F1**

**For the year ended December 31, 2012**

**Dated as of April 15, 2013**

The following management discussion and analysis of the financial position, results of operations and cash flows of RepliCel Life Sciences Inc. (“the Company”, “RepliCel” or “we”), for the year ended December 31, 2012 includes information up to and including April 15, 2013 and should be read in conjunction with the annual audited consolidated financial statements for the years ended December 31, 2012, 2011 and 2010.

The financial statements of the Company for the year ended December 31, 2012 have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

All amounts included in the financial statements and MD&A are expressed in Canadian dollars unless otherwise indicated. The reader is encouraged to review the Company’s statutory filings on the SEDAR website at [www.sedar.com](http://www.sedar.com).

***Cautionary Statement Regarding Forward-Looking Statements***

Statements included in this MD&A that do not relate to present or historical conditions are “forward-looking statements”. Forward-looking statements are projections in respect of future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as “may”, “should”, “intend”, “expect”, “plan”, “anticipate”, “believe”, “estimate”, “predict”, “potential”, or “continue”, or the negative of these terms or other comparable terminology. Forward-looking statements in this MD&A include statements with respect to: the potential of RepliCel’s technology to become the world’s first autologous cellular treatment for hair loss; the anticipated long term results of RepliCel’s technology; the advantages RepliCel’s technology may offer over current hair loss solutions; the timing for completion of RepliCel’s studies; the expected pain and recovery period related to use of RepliCel’s technology. These statements are only predictions and involve known and unknown uncertainties, risks, including the risks in the section entitled “Risk Factors”, and other factors, which may cause RepliCel’s, or its industry’s, actual results, levels of activity or performance to be materially different from any future results, levels of activity or performance expressed or implied by these forward-looking statements. These risks and uncertainties include:

- negative results from RepliCel’s clinical trials, including that its hair cell replication technology may not work as planned or may not be effective at causing the re-growth of hair follicles or the rejuvenation of damaged, miniaturized follicles;
- the effects of government regulation on RepliCel’s business;
- the viability and marketability of RepliCel’s hair cell replication technology;
- RepliCel’s failure to successfully implement its business plan;
- the development of superior technology by RepliCel’s competitors;
- the failure of consumers and the medical community to accept RepliCel’s technology as safe and effective;
- risks associated with RepliCel’s ability to obtain and protect rights to its intellectual property;
- risks and uncertainties associated with RepliCel’s ability to raise additional capital; and
- other factors beyond RepliCel’s control.

Although RepliCel believes that the expectations reflected in the forward-looking statements are reasonable, it cannot guarantee future results, levels of activity or performance. Further, any forward-looking statement

speaks only as of the date on which such statement is made, and, except as required by applicable law, RepliCel undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time, and it is not possible for management to predict all of such factors and to assess in advance the impact of such factors on RepliCel's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement.

## **OVERVIEW**

### ***Nature and History of Operations***

The Company was incorporated under the Ontario Business Corporations Act on April 24, 1967. We are a reporting issuer under the securities laws of the Provinces of British Columbia and Ontario. We are a foreign private issuer in the United States. On June 22, 2011, the Company changed its name from Newcastle Resources Ltd. to RepliCel Life Sciences Inc. ("the Company" or "RepliCel") and its reporting jurisdiction to British Columbia. Its common shares (the "Common Shares") are listed for trading in the United States on the OTC Bulletin Board, trading under the symbol REPCF and on the Canadian National Stock Exchange ("CNSX"), trading under the symbol RP.

### ***Overall Performance***

RepliCel Life Sciences Inc. is a British Columbia, Canada, company that is in the business of developing and patenting a new hair follicle cell replication technology that has the potential to become the world's first autologous cellular treatment for hair loss in men and women. Our cellular replication and implantation technology is designed to rejuvenate damaged, miniaturized hair follicles in balding scalp skin.

Our technology has been developed over ten years of research, experimentation and trials. The mechanics of our technology involve the extraction of as few as 20 hair follicles from the back of a patient's scalp where healthy cycling hair follicles reside. Specific cells are isolated from the hair follicles and are then replicated in a current Good Manufacturing Practice ("cGMP") compliant facility through our proprietary cellular replication process and then reintroduced back into balding areas on a patient's scalp. The implanted cells are expected to rejuvenate damaged hair follicles leading to the growth of new healthy hair fibers. Our anticipated long term result is the restoration of a full head of hair that has been seeded by the patient's own natural hair cells.

The product development path of our technology effectively began in 2000/03 when Drs. McElwee and Hoffmann began focusing on specific groups of cells in the hair follicle described as dermal sheath cup ("DSC") cells. Together they hypothesized that these DSC cells were a reservoir of cells that were responsible for the continued health of the hair follicle and the normal cycling of the hair fiber. Multiple experiments on mice demonstrated that hair follicle DSC cells could induce new follicular growth as well as cause resident hair follicles to grow thicker and longer. The scientists' landmark study was published in the peer-reviewed Journal of Investigative Dermatology in ©2003. Together, the scientists filed patent applications. To date, patents have been issued in Europe and Australia, and are now pending in the US, Canada and Japan.

These results have led us to believe in the effectiveness of the procedure and its potential to become a solution to hair loss for the hair restoration market. From 2004 to 2007, the developers of our technology planned for human clinical trials and cell culture laboratories, and sourced initial funding. In 2007, the developers of the technology assigned the technology, including the intellectual property, to TrichoScience Innovations Inc. ("**TrichoScience**"), all of the shares of which we acquired, in stages, between December 2010 and April 2011.

We believe our technology will offer several advantages over current hair loss solutions. Traditional hair transplantation surgery requires the surgical removal of a prominent band of hair-bearing scalp from the back of the head, dissection of individual hair follicles and then implantation of these follicles into the balding region

of the scalp. Often, a number of similar surgical procedures are required to achieve the desired result. In effect, surgical hair transplantation removes and redistributes a patient's own hair follicles to cover sections of bald scalp, leaving a longitudinal scar across the back of a patient's scalp where the strip of skin tissue carrying the hair follicles was removed. In follicular unit extraction ("FUE") transplants, the back of the scalp is left with multiple small round wound marks where the micro extractions have occurred. The wounds from either procedure may or may not be visible depending on the skill of the surgeon.

In contrast, our technology is designed to replicate a patient's hair cells to rejuvenate miniaturized hair follicles, to grow from the balding scalp with only a minor single suture closure from the tissue extraction site. We believe there will be minimal pain involved and a short recovery period. Our technology is designed to provide the ability to grow a patient's own hair back, rather than to redistribute hair follicles from the back of the scalp to the front.

In addition, hair transplantation surgery requires a team of six or more people, including up to four technicians trained in micro-dissection. The surgical procedure takes up to eight hours to complete. Our technology is designed to be fully performed by a single clinician who requires minimal additional training. We expect the time involved in the clinic to be less than thirty minutes for tissue collection and less than one hour for cell injection.

### **Regulatory Environment and Clinical Studies**

The process of obtaining marketing authorization for the RepliCel™ procedure requires the collection of a thorough body of information that satisfies requirements set forth by regulators that oversee the safety and efficacy of products sold to the public. Each jurisdiction has specific regulatory requirements, many of which differ from region to region.

We are developing a clinical and regulatory strategy that will ensure adherence to regulations that will advance the marketing approval of our technology worldwide. As part of this strategy, plans for the following projects are in development:

1. Completion of a Phase I human clinical trial in Europe; the TS001-2009 trial commenced in December, 2010;
2. Ongoing research and pre-clinical development to enhance knowledge base of our technology; and
3. Initiation of Phase II human dosing clinical trials in Europe.

#### Phase I: TS001-2009

The protocol for the TS001-2009, Phase I study was developed with advice from European Union regulatory authorities responsible for advanced therapy medicinal products (ATMPs) of which our product is one. The clinical trial is designed to test the safety and efficacy of our technology in men and women with AGA through the assessment of the following endpoints:

1. Primary Endpoint: local safety profile of our technology at the 6-month time point as defined by the incidence, relationship, severity and seriousness of adverse events at the injection sites and local tolerance (as judged by the investigator and patient);
2. Secondary safety endpoints:
  - a. the local safety profile (as defined above) of our technology at the 12 and 24 month time points,
  - b. systemic adverse events over the 24-month study,
  - c. analysis of macroscopic images of injection sites, and
  - d. analysis of histopathological biopsies taken at the 6, 12 and 24 month time points; and

3. Secondary efficacy endpoint:

- a. difference in hair thickness and hair density between 6 months (Visit 7) and baseline will be calculated using the TrichoScan<sup>®</sup> procedure.

The protocol, designed in compliance with International Conference on Harmonization guidelines for Good Clinical Practice, underwent thorough scientific and ethical review by the Georgian National Council of Bioethics and approval to conduct the study was granted on October 27, 2010.

Subjects with mild to moderate androgenic alopecia ("AGA") categorized on the Ludwig Scale (female) or the Norwood scale (male) were enrolled in the study over a 4-month period starting in December 2010. These subjects provided blood samples to confirm their health status and scalp biopsies which were sent to a cGMP-compliant facility with the specific license to manufacture the Issuer's product in Austria.

Once the manufacturing process was completed, the 19 subjects returned to the clinic to receive blinded injections of their own (autologous) replicated cells in a carrier medium on one part of the scalp, and another injection of carrier medium without replicated cells (placebo) on the other side of the scalp to allow for better assessment of the safety and efficacy of the Issuer's technology. The final study participant received injections of hair follicle cells in late August 2011, thus marking the end of the treatment phase of TS001-2009.

In the next stage of the TS001-2009 trial, the post-injection follow-up period, subjects returned to the clinic for ten follow-up visits over a 24-month period to have their health closely monitored to ensure that there have been no adverse effects associated with receiving the injections and to determine the efficacy of hair follicle cell injections at stimulating hair growth. Furthermore, at 6, 12 and 24 months post-injection, four subjects at each time point will provide biopsies of the injection sites for histopathological analysis. The post-injection follow-up period will be completed for all subjects by the end of August 2013. The total duration of subject participation in the study is approximately 27 months.

Phase I: Six Month Interim Analysis

An interim analysis of data took place in the first year of 2012 as all subjects had completed their 6-month follow-up visit. The results of this analysis were released on May 2, 2012. This data has allowed for analysis of the primary endpoints of the study; assessment of the local (at treatment sites) safety profile of the Company's product compared to placebo as defined by adverse events with respect to their causality, incidence, severity and seriousness. Secondary outcome measures of systemic (overall) safety (through review of adverse events in a similar fashion as described above) and efficacy (hair growth at treatment sites) were also performed at this time. The 6-month interim analysis showed that significantly more subjects (63%) had an increase in hair density of greater than 5% (vs. control) while some subjects had not yet shown an increase at this time point. These responders averaged an 11.4% change from baseline, including 70% of subjects above 10% (average 14.8%). The total range of responders was from 6.2% to 19.6%. The overall average of all treated subjects including responders and non-responders was 6.2% density increase. Final analysis of safety data from the entire 24-month post-injection follow-up period should be available in late 2013. To date, no serious adverse events have been reported post-injection.

The primary protocol objective of the study was to assess the local (at treatment sites) safety profile of injections of autologous DSC cells at six months post-injection compared to placebo. Secondary protocol objectives were to assess systemic (overall) safety and efficacy (hair growth at treatment sites) at 6 months post-injection and local safety at 24 months post-injection. The six-month interim analysis was designed to provide the Company with safety information to support the regulatory filing for a Phase II clinical trial. The six-month interim analysis results support the continued development of DSC cells for the treatment of androgenetic alopecia.

All 19 subjects (10 male and 9 female) completed six-month post injection follow-up visits and the data collected from these visits was used for the interim analysis of the primary and secondary safety and efficacy endpoints for the TS001-2009 study.

#### Phase II: Proposed Dosing Clinical Trial

RepliCel's next (Phase II) trial is designed to be a dose-finding study which will assess the number of characterized cells and the appropriate treatment pattern necessary to promote optimal hair growth. Subject to regulatory approval, the Company is planning a 12-24 month clinical trial that will include multiple subject cohorts studying different doses of DSC cells. Each subject will be given several different injections, while some cohorts will receive additional injections at subsequent time points. The Company will also review its standard operating procedures (SOPs) of cell biopsy, cell isolation, cell culture media, cell carrier, and injection media to fine-tune those processes in advance of a regulatory submission for a Phase II dosing trial.

The current draft of the RCH-01-2013 trial is designed as follows:

- 120 male subjects
  - 3 injection sites, 1 shaved site per patient as reference
- Treatment Group (96 subjects)
  - 48 treated with single injection (3 different doses)
  - 48 treated with repeat injections (3 different doses) at day 1 and day 91
- Placebo Group (24 subjects)
  - 12 treated with single injection (cell carrier medium at 3 locations)
  - 12 treated with single injection (cell carrier medium at 3 locations) at day 1 and day 91
- 288 treated data sites
- 72 placebo data sites

#### ***Business Model***

The RepliCel™ procedure will be marketed directly to those medical professionals currently engaged in hair transplant procedures, as well as established hair loss and dermatology clinics. Access to, and application of the procedure will be offered to these establishments under a licensing arrangement. Clinicians will be charged a license fee by the company on an annual basis. We will then train and educate the clinicians in the RepliCel™ procedure. Clinicians will extract the patient's tissues through a punch biopsy which will then be shipped to our cGMP facilities where cells will be isolated and proprietary cellular replication will take place. We will be able to maintain full control over the cellular replication process through the use of our own contracted facilities and our own trained technicians. We will charge the clinic a per-patient replication fee, while the clinic will be free to set the price it charges the patient, based on what the market will bear. Therefore, we will have two revenue streams: patient fees and annual license fees.

#### ***Intellectual Property***

The success of RepliCel will be highly dependent on the protection of our intellectual property. We are developing a diverse portfolio of intellectual property for the use of stem cells in the treatment of hair loss, as well as other medical conditions. For example, RepliCel inventors filed an early patent application on the use of hair follicle derived stem cells (see EP 1 509 597 B1) entitled "Method for isolating hair follicle mesenchymal stem cells". This family of patents describes methods for isolating stem cells from hair follicles, and the growth and use of these stem cells for the treatment of a variety of medical conditions (including hair loss). Within this portfolio, there are granted patents in Australia (AU 2003246521) and Europe (EP1 509 597 B1), which were issued unopposed. Related patent applications are also pending in the United States, Canada and Japan.

### ***Plan of Operations***

The sections above contain a broad overview of our plan of operations on a go-forward basis. We intend to specifically focus on continuing our human trials in Europe and preparing for human trials in Canada. During this time, we will attempt to seek regulatory approval in those areas for our technology. We also intend to continue to focus on obtaining patents for our technology in various international jurisdictions. At the same time, we will be taking steps to implement our branding and marketing strategies discussed above under the heading, "Marketing Strategy".

The Company currently has four full time employees, as well as five contractors. These employees have expertise in biotechnology management, clinical trials, financial management and communications.

### ***Marketing Strategy Overview***

We have launched a branded corporate website which can be viewed at [www.replicel.com](http://www.replicel.com) to provide corporate information and information about our technology and the progress of our clinical trials. In the future, this site will act as our principal marketing and communications tool and, in time, we will add sections appropriate to our targeted key audiences – medical professionals, hair restoration clinics and appropriate professional associations. All marketing and communications efforts will feature a constant internet based strategy which we anticipate will allow us to leverage our technology advantages and brand to generate license sales.

We expect that, eventually, a highly targeted marketing effort will supplement the broad communications tactics and website with a focused direct sales campaign to primary licensee markets. We have identified the primary licensee market as more than 800 hair restoration physicians.

### ***Marketing***

On April 12, 2012, the Company entered into an arrangement with a private US company to perform professional services related to the dissemination of corporate marketing materials. In return for these services, the Company has paid US \$338,000. There is no formal agreement with respect to this arrangement.

On June 21, 2012, the Company entered into a professional services agreement with a private German company to perform professional services related to shareholder acquisition and marketing consulting. In consideration for the Services, the Corporation paid €60,000 and granted stock options to purchase up to 300,000 common shares of the Corporation at an exercise price of USD\$1.10 per share.

On July 23, 2012, the Company entered into a professional services agreement with private US company to conduct investor relations activities for the Company and to raise the company's profile in the financial marketplace and the financial press using informational reports and public filings of the Company. Pursuant to the terms of the agreement, the Company will pay a monthly fee of US\$8,500 on a month by month basis; and a retainer of US\$8,500.

On January 15, 2013, the Company entered into an arrangement with a Berlin-based investor relations firm, to conduct investor relations activities for the Company and to raise the Company's profile in the financial marketplace and the financial press using informational reports and public filings of the Company. Pursuant to the terms of the agreement, the Company will pay a monthly fee of €3,500 per month for a period of 12 months.

### **Reverse Takeover Transaction**

On December 22, 2010, RepliCel closed a Share Exchange Agreement with TrichoScience Innovations Inc. ("TrichoScience") and with certain accepting shareholders of TrichoScience, whereby RepliCel (formerly Newcastle Resources Ltd.) acquired 50.7% (4,860,000) of the issued and outstanding shares of TrichoScience in exchange for 11,155,165 common shares (at an exchange ratio of 2.2958), 5,577,580 Class B preferred shares and 5,577,580 Class C convertible preferred shares of RepliCel (the "Acquisition"). Also at closing, RepliCel acquired an additional 1,000,000 common shares of TrichoScience for \$1,000,000 ("Investment One"), thereby increasing RepliCel's ownership in TrichoScience to 55.4% at December 31, 2010, resulting in 63% of the voting rights in RepliCel being held by former TrichoScience shareholders.

TrichoScience was incorporated under the Canada Business Corporations Act on September 7, 2006 and is currently in the research and development stage and therefore has not yet realized any revenues from its planned operations.

As the former shareholders of TrichoScience controlled 63% of the issued voting shares of RepliCel after the closing of the transaction, the transaction was accounted for as TrichoScience being the continuing entity and the resulting consolidated financial statements are presented as a continuation of TrichoScience. At the date the share exchange was completed the common stock of RepliCel became 22,653,960 common shares, comprising of 11,155,165 common shares issued to participating shareholders of TrichoScience and 11,498,795 common shares held by existing RepliCel shareholders (total common shares 22,653,960). During the year ended December 31, 2011 the remaining TrichoScience shareholders tendered 4,724,800 TrichoScience shares in exchange for 10,844,846 common shares of RepliCel.

As TrichoScience is deemed to be the acquirer for accounting purposes, its assets and liabilities are included in the consolidated balance sheets for the continuing entity at their historical carrying values. The Company's assets and liabilities at the date of the transaction are also included in the consolidated balance sheets at their historical carrying values.

RepliCel is not considered a business as defined by IFRS. As a result, at the date of the acquisition, the transaction was accounted for as a share based payment transaction under IFRS 2 Share Based Payments whereby TrichoScience is deemed to have issued shares in exchange for the net assets of RepliCel together with the listing status of RepliCel.

The net identifiable assets of RepliCel at the date of the acquisition were as follows:

Cash	\$	1,109,664
Sales taxes recoverable		19,319
Prepaid expenses		13,392
Accounts payable and accrued liabilities		(146,050)
<u>Net assets acquired</u>	<u>\$</u>	<u>996,325</u>

The Company recognized \$85,000 as listing expense during the year ended December 31, 2010, being the difference between the fair value of the share based payment of \$1,081,325 and the net identifiable assets received. The fair value of the share based payment was determined with reference to the fair market value of Newcastle, (now RepliCel) shares that would have been received by the shareholders of TrichoScience had 100% of the shares been exchanged. The fair value of each Newcastle, (now RepliCel) share was determined with reference to the price at which the shares had been sold in arms' length transaction prior to the acquisition.

At closing, the TrichoScience shareholders who received shares of RepliCel in connection with the closing deposited the common shares with a trustee pursuant to the terms of a pooling agreement between RepliCel and the trustee. The common shares are subject to a timed release schedule under which 15% of the shares will be released on the first day of each of the fiscal quarters occurring after the first anniversary of the closing.

### **Non-Controlling Interest**

At closing, certain shareholders of TrichoScience did not exchange their shares for shares of RepliCel (the “Non-Accepting Shareholders”) and, as such, are treated as a non-controlling interest in the consolidated financial statements. In a reverse acquisition, the non-controlling interest reflects the non-controlling shareholders’ proportionate interest in the pre-combination carrying amounts of the legal acquiree’s net assets. The non-controlling interest at December 22, 2010 was 44.6% and the Company recorded a non-controlling interest of \$325,000, representing the non-controlling interest of the net book value of the net assets of TrichoScience, with a \$62,000 increase in accumulated deficit reflecting the Company’s proportionate increase in ownership in TrichoScience.

During the year ended December 31, 2011, RepliCel purchased 2,050,000 newly issued common shares of TrichoScience for \$2,050,000 (“Investment Two”). As a result, the non-controlling interest increased by \$505,345 representing the non-controlling interests’ proportionate share in Investment Two.

During the year ended December 31, 2011, the remaining 4,724,800 shares of TrichoScience were tendered for exchange by the Non-Accepting Shareholders in exchange for 10,844,848 common shares with an ascribed fair value of \$262,000, 5,422,420 Series B Preferred Shares and 5,422,420 Series C Preferred Shares of the Company. As a result the non-controlling interest was eliminated and the Company recorded an adjustment of \$348,866 into deficit attributable to the Owners’ of the Parent, representing a decrease in the non-controlling interest of the net book value of the net assets of TrichoScience.

At December 31, 2011, 100% percent of the non-accepting shareholders had tendered their shares in exchange for RepliCel shares. As a result of achieving Investment One and Investment Two, TrichoScience is now 100% owned subsidiary of RepliCel. As a result, the Class B preferred shares were extinguished for no consideration. There is no non-controlling interest at December 31, 2012 (December 31, 2011: \$nil; December 31, 2010: \$325,000).

### **Class B and C Preferred Shares**

Pursuant to the Share Exchange Agreement, Class B and C preferred shares were created and issued. No amount of the value assigned to share capital issued with the Share Exchange Agreement was allocated to the Class B preferred shares or the Class C convertible preferred shares due to these shares having assessed nominal value of \$204 at the time of closing. The Class B preferred shares have been extinguished, as the Company has achieved the following milestones during the year ended December 31, 2011:

- RepliCel purchased common shares of TrichoScience in aggregate amount of not less than \$3,000,000 and RepliCel raised the proceeds to make these investments by selling its shares at not less than \$1 per share (completed); and
- RepliCel acquired at least 90% of the issued and outstanding common shares of TrichoScience (completed).

Each Class C convertible preferred share is voting and convertible into ½ of one common share of RepliCel upon approval by the United States Food and Drug Administration of the commercial sale of TrichoScience’s hair cell replication technology in the United States. Other than transfers of Class C Shares amongst original

shareholders of TrichoScience Innovations Inc., the Class C convertible preferred shares cannot be sold, transferred or otherwise disposed of without the consent of the Company's directors.

During the year-ended December 31, 2011, 13,000,000 of the Company's Class C preferred shares (each, a "Class C Share"), being all the issued and outstanding Class C Shares, were converted, on a 5:1 ratio, into 2,600,002 common shares of the Company (each, a "Common Share") by the holders thereof. All of the Common Shares issued on conversion of the Class C Shares have been deposited with a trustee pursuant to the terms of pooling agreements between RepliCel, the trustee and the respective shareholders. The Common Shares are subject to a timed release schedule under which 15% of the shares will be released on the first day of each of the fiscal years beginning January 1, 2013.

#### **583885 B.C. Ltd.**

Concurrent with the reverse acquisition, RepliCel also acquired all of the issued and outstanding common shares of 583885 B.C. Ltd. ("583885") in exchange for 4,400,000 common shares of RepliCel. 583885 did not have any assets or liabilities at the date of acquisition and was a private company controlled by RepliCel's incoming Chief Executive Officer ("CEO"). 3,400,000 shares of RepliCel controlled by the Company's CEO were deposited with an escrow agent pursuant to the terms of an escrow agreement between RepliCel and the escrow agent. These shares are released upon satisfaction of certain performance conditions as set out in the escrow agreement and each release of shares from escrow will be considered a compensatory award.

During the year-ended December 31, 2012, the performance condition with respect to 500,000 shares (Year ended December 31, 2011: 350,000 shares; Year ended December 31, 2010: 850,000 shares, being the completion of Investment Two described above) had been achieved, and \$254,350 representing the fair value of the shares released from escrow was recorded as stock-based compensation (year-ended December 31, 2011: \$178,045; year ended December 31, 2010: \$432,295). Compensation expense relating to the transaction date fair value of the remaining 1,700,000 common shares will be recognized in the period the respective performance condition is probable and amortized over the period the performance condition is met.

At December 31, 2012, there were 1,700,000 common shares held in escrow (December 31, 2011: 2,200,000 common shares; December 31, 2010: 2,550,000 common shares).

The other 1,000,000 common shares issued were not subject to escrow provisions and thus were fully vested, non-forfeitable at the date of issuance. Stock based compensation of \$Nil (representing the fair value of the shares issued) was recognized for these shares during the year ended December 31, 2012 (December 31, 2011: Nil; December 31, 2010:\$508,800).

#### **SELECTED CONSOLIDATED FINANCIAL INFORMATION**

The following financial data summarizes selected financial data for our company prepared in accordance with IFRS as issued by the IASB for the three fiscal years ended December 31, 2012, 2011 and 2010.

	<b>Year ended Dec. 31, 2012 (IFRS) (audited)</b>	<b>Year ended Dec. 31, 2011 (IFRS) (audited)</b>	<b>Year ended Dec. 31, 2010 (restated for IFRS) (audited)</b>
Net sales or total revenues	\$Nil	\$Nil	\$Nil
Net loss	\$(3,363,175)	\$(3,713,439)	\$(2,542,525)
Basic and diluted loss per share	\$(0.08)	\$(0.10)	\$(0.12)
Loss attributable to owners of the Parent	\$(3,363,175)	\$(3,493,960)	\$(2,542,525)
Total assets	\$505,488	\$631,419	\$1,308,742
Long-term liabilities	\$Nil	\$Nil	\$Nil
Dividends declared	\$Nil	\$Nil	\$Nil

## RESULTS OF OPERATIONS

### *Year ended December 31, 2012 compared to year ended December 31, 2011*

	Year ended December 31,		Change 2012 to 2011	
	2012	2011	Increase/ (Decrease)	Percent Change
Clinical development	638,734	637,649	1,085	0%
Research and development	426,341	381,759	44,582	12%
General and administrative	3,408,894	2,713,918	694,976	26%
Other items	(1,110,794)	(19,887)	(1,090,907)	5486%
Total operating expenses	3,363,175	3,713,439	(350,264)	(9)%

The Company had no revenue from operations during the years ended December 31, 2012 or 2011. General and administrative expenses totalled \$3,408,894 for the year ended December 31, 2012 compared to \$2,713,918 for the year ended December 31, 2011. The increase in general and administrative expenses was primarily the result of increased insurance (2012: \$54,591, 2011: \$48,006), marketing and investor relations fees (2012: \$639,997, 2011: \$334,709), office (2012: \$198,377, 2011: \$170,975), salaries (2012: \$656,803, 2011: \$623,027), and transfer agent and filing fees (2012: \$54,755, 2011: \$26,973). The increases in insurance, marketing and investor relations fees, office costs, salaries and transfer agent and filing fees were due to increased operational activities in 2012.

We recognized a stock based compensation charge of \$1,381,589 for the year ended December 31, 2012 (2011: \$947,272) for stock options granted under the Company stock option plan and founders stock option agreements described above under the heading "Information on RepliCel Life Sciences Inc. – Corporate Information and Important Events – Stock Options". The overall increase in stock-based compensation expense in 2012 compared to 2011 was primarily due to the issuance of 1,190,000 stock options that were granted to employees and consultants of the Company; 250,000 share purchase warrants which were issued as compensation to a consultant of the Company and the release of 500,000 shares from escrow as discussed above under the heading 'Corporate Information and Important Events' during the year ended December 31, 2012.

During the year ended December 31, 2012, we incurred costs of \$638,734 relating to our clinical trials compared to \$637,649 in the year ended December 31, 2011. We incurred research consulting fees of \$329,909 and intellectual property costs of \$96,432 in 2012 compared to research consulting fees of \$292,207 and intellectual property costs of \$89,552 in 2011. These increases were all the result of increased operational activities in 2012 related to our Phase I trial and on-going clinical development.

During the year ended December 31, 2012 the company experienced a \$1,116,445 gain on the change in fair value of warrants denominated in a foreign currency due to marked to market adjustments.

We incurred a net loss for the year ended December 31, 2012 of \$3,363,175 or \$0.08 per share on a basic and diluted basis compared to a net loss of \$3,713,439 or \$0.10 per share on a basic and diluted basis for the year ended December 31, 2011. The increased loss was the result of increased operational activities in 2012.

## Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

	Year ended December 31,		Change 2011 to 2010	
	2011	2010	Increase/ (Decrease)	Percent Change
Clinical development	637,649	367,763	269,886	73%
Research and development	381,759	182,486	199,273	109%
General and administrative	2,713,918	1,992,276	721,642	36%
Other items	(19,887)	-	(19,887)	100%
Total operating expenses	3,713,439	2,542,525	1,170,914	46%

Our company had no revenue from operations during the years ended December 31, 2011 or 2010. General and administrative expenses totalled \$2,713,918 for the year ended December 31, 2011 compared to \$1,992,276 for the year ended December 31, 2010. The increase in general and administrative expenses was primarily the result of increased accounting and audit fees (2011: \$120,357, 2010: \$81,456), insurance (2011: \$48,006, 2010: \$30,472), legal (2011: \$118,950, 2010: \$116,954), marketing and investor relations (2011: \$334,709, 2010: \$57,353), office (2011: \$170,975, 2010: \$53,259), salaries (2011: \$623,027, 2010: \$109,830), transfer agent and filing fees (2011: \$26,973, 2010: \$24,851) and travel and promotion (2011: \$130,098, 2010: \$51,065). The increases in accounting and audit fees, insurance, legal fees, marketing and investor relations, office, salaries, transfer agent and filing fees, and travel and promotion expenses were due to increased operational activities in 2011, these expenses were offset by a decrease in consulting fees (2011: \$185,959, 2010: \$198,196).

We recognized a stock based compensation charge of \$947,272 for the year ended December 31, 2011 (2010: \$1,176,900) for stock options granted under our company stock option plan and founders stock option agreements. The overall decrease in stock-based compensation expense in 2011 compared to 2010 was primarily due to the share exchange with 583885 in 2010, 350,000 shares were released from escrow in 2011 upon the achievement of one milestone contained in the escrow agreement, compared to a release of 850,000 in 2010, resulting in decreased stock based compensation expense in 2011.

During the year ended December 31, 2011, we incurred costs of \$637,649 relating to our clinical trials compared to \$367,763 in the year ended December 31, 2010. We incurred research consulting fees of \$292,207 and intellectual property costs of \$89,552 in 2011 compared to research consulting fees of \$132,100 and intellectual property costs of \$50,386 in 2010. These increases were all the result of increased operational activities in 2011.

We incurred a net loss for the year ended December 31, 2011 of \$3,713,439 or \$0.10 per share on a basic and diluted basis compared to a net loss of \$2,542,525 or \$0.12 per share on a basic and diluted basis for the year ended December 31, 2010. The increased loss was the result of increased operational activities and on-going clinical development in 2011.

### FOURTH QUARTER INFORMATION

During the quarter ended December 31, 2012, the Company received \$24,851 in share subscriptions. The units were issued subsequent to December 31, 2012 at CAD\$0.31 per unit.

### SUMMARY OF YEARLY RESULTS

The following is a summary of our financial results for the eight most recently completed years. The figures for the year ended December 31, 2012 are calculated from the Company's annual consolidated financial statements prepared under IFRS.

	Dec 31, 2012 \$	Sept 30, 2012 \$	Jun 30, 2012 \$	Mar 31, 2012 \$	Dec 31, 2011 \$	Sept 30, 2011 \$	Jun 30, 2011 \$	Mar 31, 2011 \$
Revenues	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Net loss	(934,175)	(36,393)	(1,641,143)	(751,464)	(787,883)	(890,773)	(1,137,485)	(897,298)
Basic and diluted loss per share	(0.02)	(0.00)	(0.04)	(0.02)	(0.02)	(0.02)	(0.03)	(0.03)

## LIQUIDITY AND CAPITAL RESOURCES

Our consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue to realize its assets and discharge its obligations and commitments in the normal course of operations. At December 31, 2012, the Company had not yet earned revenue from its business, had accumulated losses of \$10,233,396 since incorporation and expects to incur further losses in the development of its business, which casts substantial doubt about the Company's ability to continue as a going concern. Our financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts of and classification of liabilities that might be necessary in the event that the Company cannot continue as a going concern.

The Company's ability to continue as a going concern is dependent upon its ability to generate future profitable operations and/or to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal business operations when they come due. The Company has financed its operations to date through the issuance of equity. The continued volatility in the financial equity markets may make it difficult to raise funds by private placements of shares. There is no assurance that the Company will be successful with its financing ventures.

### ***Operating Activities***

During the year ended December 31, 2012, we used net cash in operating activities of \$2,957,711 compared to \$3,115,623 for the year ended December 31, 2011. The decrease in cash used in operating activities was the result of a reduction in accounting and audit fees as well as consulting fees in 2012. Cash used in operational activities in 2011 also included large payments in 2011 of accounts payable and accrued liabilities working capital balances at December 31, 2010.

### ***Investing Activities***

During the year ended December 31, 2012, the net cash used in investing activities was \$9,090 compared to net cash used in investing activities of \$12,929 for the year ended December 31, 2011. Investing activities relate mainly to the purchase of computer equipment.

### ***Financing Activities***

During the year ended December 31, 2012, RepliCel completed private placements consisting of 1,875,046 units at US\$1.50 per unit for proceeds of US\$2,812,569 (CAD\$2,796,740). Each unit issued consists of one common share of the Company and one common share purchase warrant. Each warrant entitles the holder to purchase an additional common share at US\$2.50 per share for a period of 24 months from the closing of the Financing. We paid \$35,647 as finder's fees in connection with the private placement. At December 31, 2012, we had working capital of \$67,768. Additional working capital will be required for general and administrative expenses and to further our business plans.

During the year ended December 31, 2011, RepliCel issued 2,550,000 common shares at US\$1.00 per share for proceeds of US\$2,550,000. We issued 101,200 common shares as finder's fees in connection with the private placement. At December 31, 2011, we had working capital of \$382,863.

## OUTSTANDING SHARE DATA

<i>Issued and Outstanding – Common Shares</i>	Number of Shares
Balance, December 31, 2010	27,053,960
Shares issued for cash:	
- Private placements at US\$1.00	2,651,200
Issued on tender of TrichoScience shares	10,844,846
Conversion of Class C Preferred shares	2,600,002
Shares issued for cash:	
- Private placements at US\$1.50	1,875,046
- Private placements at CAD\$0.31	1,643,555
Balance, April 15, 2013	46,668,609

### *Private Placement*

Subsequent to December 31, 2012, we completed a private placement (the "Financing") of 1,643,555 units at CAD\$0.31 per unit for proceeds of \$509,502, of which \$24,851 was included in share subscriptions as at December 31, 2012. Each unit issued consists of one common share of the Company and one common share purchase warrant. Each warrant entitles the holder to purchase an additional common share at CAD\$0.50 per share for a period of 24 months from the closing of the Financing. Additional working capital will be required for general and administrative expenses and to further our business plans.

### *Stock Option Plans*

Under various stock option agreements, certain founders of TrichoScience granted stock options to acquire TrichoScience shares to employees and consultants of TrichoScience during the year ended December 31, 2011. Each founders' options was to be exercisable into one common share of TrichoScience at a price of \$1 per share, with 1/3 of such options vesting one year from the date of grant and the remaining 2/3 vesting on a monthly basis over between 24-month and 36-month periods expiring after six to seven years. Pursuant to the terms of the TrichoScience share exchange agreement, the right to receive TrichoScience shares under these agreements was converted into a right to receive Common Shares of RepliCel from the Founders. All other terms remained the same.

On December 22, 2010, the Company approved a Stock Option Plan whereby the Company may grant directors, officers, employees and consultants' stock options. The maximum number of shares reserved for issue under the plan cannot exceed 10% of the outstanding Common Shares as at the date of the grant. The stock options can be exercisable for a maximum of 7 years from the grant date and with various vesting terms. On July 9, 2012 the Company and certain optionee's amended certain provisions of their stock option agreements dated December 22, 2010, to reflect a reduction in the number of stock options granted by the Company to the Optionee. As a result, 300,000 company stock options exercisable at US\$0.50 were cancelled.

On March 11, 2011, the Company granted 1,350,000 stock options to directors, officers, employees and consultants. The options vest over a period of three years and each is exercisable into one Common Share at US\$1.00 per share until March 11, 2018.

On January 3, 2012, the Company granted 100,000 options to a consultant of the Company. Each option is exercisable into one Common Share at US\$2.35 per share until January 3, 2019. The options vest according to specific milestones.

On April 18, 2012, the Company granted 790,000 options to employees and consultants to the Company. The options vest over a period of three years and each is exercisable into one Common Share at US\$1.50 per share until April 18, 2019. During the year ended December 31, 2012, 75,000 of these options were forfeited.

On June 21, 2012 under the Company Stock Option Plan, 300,000 options were granted to a consultant of the Company. The options vest over a period of three years and are exercisable at US\$1.10 per share until June 21, 2017.

As at April 15, 2013 there are 2,630,000 stock options available for exercise.

<b><i>Stock Options Outstanding</i></b>	Number	Weighted Average Exercise Price
Balance, December 31, 2010	1,485,000	US\$0.50
Granted March 11, 2011	1,350,000	US\$1.00
Granted January 3, 2012	100,000	US\$2.35
Granted April 18, 2012	790,000	US\$1.50
Granted June 21, 2012	300,000	US\$1.10
Cancelled/forfeited	(375,000)	US\$0.70
<b>Balance, April 15, 2013</b>	<b>3,650,000</b>	<b>US\$0.98</b>

#### ***Share Purchase Warrants***

Share Purchase Warrants (“Warrants”) granted in February, March and April 2012 entitle the holder to purchase an additional Common Share at US\$0.50 per share for a period of 24 months from the date of grant. Warrants issued May 17, 2012 entitle the holder to purchase an additional Common Share at US\$2.00 per share for a period of 48 months from the date of grant. Warrants issued April 10, 2013 entitle the holder to purchase an additional Common Share at CAD\$0.50 per share for a period of 48 months from the date of grant.

<b><i>Share Purchase Warrants Outstanding</i></b>	Number	Weighted Average Exercise Price
Balance, December 31, 2010	-	-
Granted February 29, 2012	66,304	US\$0.50
Granted March 29, 2012	876,042	US\$0.50
Granted April 18, 2012	502,667	US\$0.50
Granted April 20, 2012	430,033	US\$0.50
Granted May 17, 2012	250,000	US\$2.00
Granted April 10, 2013	1,643,555	CAD\$0.50
<b>Balance, April 15, 2013</b>	<b>3,768,601</b>	<b>US\$0.60</b>

Warrants denominated in a currency other than the Company’s functional currency meet the definition of a financial liability and accordingly are presented as such on the Company’s consolidated statement of financial position and are fair valued at each reporting period.

## **RELATED PARTY TRANSACTIONS**

As at December 31, 2012, included in the accounts payable and accrued liabilities, were \$52,333 (December 31, 2011: \$19,596) due to directors and/or officers of the Company and/or companies they control or of which they were significant shareholders for accrued clinical trial costs, research consulting fees, general and administrative consulting fees, office and legal fees. The amounts owing are unsecured, non-interest bearing and due on demand.

During the year ended December 31, 2012, 2011 and 2010, the Company had the following related party transactions:

- Clinical trial costs of \$110,703 (December 31, 2011 - \$103,563; December 31, 2010 - \$nil) were paid to a company owned by a director of the Company;
- Research consulting fees totalling \$163,543 (December 31, 2011 - \$135,044; December 31, 2010 - \$144,100) were paid to a director and companies owned by directors and officers of the Company;
- General and administrative consulting fees totalling \$nil (December 31, 2011 - \$45,750; December 31, 2010 - \$116,475) were paid to directors and officers and companies owned by directors and officers of the Company;
- Office totalling \$nil (December 31, 2011 - \$9,000; December 31, 2010 - \$15,000) were paid to directors and officers and companies owned by directors and officers of the Company;
- Legal fees totalling \$nil (December 31, 2011 - \$6,621; December 31, 2010 - \$39,326) were paid to directors and officers and companies owned by directors and officers of the Company;
- The Company considers key management to be the Chief Executive Officer, Chief Financial Officer and executive directors. Salaries totalling \$411,000 (December 31, 2011 - \$425,209; December 31, 2010 - \$30,000) and stock-based compensation totalling \$161,565 (December 31, 2011 - \$313,665; December 31, 2010 - \$432,395) were paid to key management.

These transactions were in the normal course of operations having been measured at the exchange amount, being the amount established and agreed to by the parties.

## **OFF BALANCE SHEET ARRANGEMENTS**

None.

## **PROPOSED TRANSACTIONS**

None.

## **EVENTS AFTER THE REPORTING DATE**

Subsequent to December 31, 2012, we amended the exercise price of the warrants expiring March 1, 2014, March 29, 2014, April 18, 2014 and April 20, 2014 from US\$2.50 to US\$0.50 per share. The Warrants entitle holders to purchase an aggregate of 1,875,046 common shares.

Subsequent to December 31, 2012, we completed a private placement of 1,643,555 units at a price of \$0.31 per unit for gross proceeds of \$509,502, of which \$24,851 was included in share subscriptions as at December 31, 2012. Each unit issued consists of one common share and one common share purchase warrant. Each warrant entitles the holder to purchase an additional common share at \$0.50 per share for a period of 24 months from the closing of the financing.

Subsequent to December 31, 2012, we received a proposed assessment as a result of Canada Revenue Agency's audit of the Scientific Research & Experimental Development (SR&ED) Claim filed by TrichoScience for

the period ending December 21, 2010. As a result of the assessment, TrichoScience will receive a refundable investment tax credit in the amount of \$148,296.

## **CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS**

RepliCel Life Sciences Inc. makes estimates and assumptions about the future that affect the reported amounts of assets and liabilities. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. In the future, actual experience may differ from these estimates and assumptions.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the period of the change, if the change affects that period only, or in the period of the change and future periods, if the change affects both.

Information about critical judgments in applying accounting policies that have the most significant risk of causing material adjustment to the amounts reported in these financial statements are discussed below:

### ***Share Based Payments***

The Company measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date at which they are granted. Estimating fair value for share-based payment transactions requires determining the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determining the most appropriate inputs to the valuation model including the expected life of the share option, volatility and dividend yield and making assumptions about them. The assumptions and models used for estimating the fair value for share-based payment transactions are disclosed in Note 8 (e).

Similar methodology to the share-based payments is used to determine the fair value of derivative liabilities related to warrants denominated in U.S. dollars. The assumptions and models used for estimating the fair value for derivative liabilities are disclosed in Note 8(g).

### ***Income Taxes***

Significant judgment is required in determining the provision for income taxes. There are many transactions and calculations undertaken during the ordinary course of business for which the ultimate tax determination is uncertain. The Company recognizes liabilities and contingencies for anticipated tax audit issues based on the Company's current understanding of the tax law. For matters where it is probable that an adjustment will be made, the Company records its best estimate of the tax liability including the related interest and penalties in the current tax provision. Management believes they have adequately provided for the probable outcome of these matters; however, the final outcome may result in a materially different outcome than the amount included in the tax liabilities.

In addition, the Company will recognize deferred tax assets relating to tax losses carried forward to the extent there are sufficient taxable temporary differences relating to the same taxation authority and the same taxable entity against which the unused tax losses can be utilized. However, utilization of the tax losses also depends on the ability of the taxable entity to satisfy certain tests at the time the losses are recouped.

## **SIGNIFICANT ACCOUNTING POLICIES**

The Company's significant accounting policies can be found in Note 4 to its annual audited consolidated financial statements for the year ended December 31, 2012.

## ACCOUNTING STANDARDS, AMENDMENTS AND INTERPRETATIONS NOT YET EFFECTIVE

Certain pronouncements were issued by the IASB or the IFRS Interpretations Committee that are mandatory for accounting periods beginning after January 1, 2013 or later periods. The following new standards, amendments and interpretations, which have not been early adopted in these consolidated financial statements, will or may have an effect on the Company's future results and financial position:

- IFRS 9 Financial Instruments

IFRS 9 Financial Instruments is part of the IASB's wider project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The standard is effective for annual periods beginning on or after January 1, 2015. The Company is in the process of evaluating the impact of the new standard.

- IFRS 10 Consolidated Financial Statements

IFRS 10 builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. This standard is applicable for annual periods beginning on or after January 1, 2013. The adoption of this standard is not expected to have material impact on the consolidated financial statements.

- IFRS 13 Fair Value Measurement

IFRS 13 aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRS. The requirements, which are largely aligned between IFRS and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRS or US GAAP. The standard is effective for annual periods beginning on or after January 1, 2013. The adoption of this standard is not expected to have material impact on the Company's financial statements.

- Amendment to IAS 1 Presentation of Financial Statements

The amendments to IAS 1 revise the presentation of other comprehensive income (OCI). Separate subtotals are required for items which may subsequently be recycled through profit or loss and items that will not be recycled through profit or loss. The standard is effective for annual periods beginning on or after July 1, 2012. The Company has determined that there is no material impact as a result of these amendments on the presentation of the income statement.

- Amendment to IAS 32 Financial Instruments: Presentations

The amendments to IAS 32 pertained to the application guidance on the offsetting of financial assets and financial liabilities, focused on four main areas: the meaning of 'currently has a legally enforceable right of set-off', the application of simultaneous realization and settlement, the offsetting of collateral amounts and the unit of account for applying the offsetting requirements. The standard is effective for annual periods beginning on or after January 1, 2014. The Company is in the process of evaluating the impact that the adoptions of this standard may have on its financial statements.

- Amendment to IFRS 7, Financial Instruments: Disclosure

Amended standard IFRS 7 Financial Instruments: Disclosures outlines the disclosures required when initially applying IFRS 9 Financial Instruments. The standard is effective for annual periods beginning on or after January 1, 2015. The Company is in the process of evaluating the impact that the adoptions of this standard may have on its financial statements.

There are no other IFRS or IFRIC Interpretations that are not yet effective that would be expected to have a material impact on the Company.

## **FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS**

As at December 31, 2012, the Company's financial instruments are comprised of cash, accounts payable and accrued liabilities and warrants denominated in a foreign currency. The fair values of cash, accounts payable and accrued liabilities approximate their carrying value due to their short-term maturity. The Company is exposed through its operations to the following financial risks:

- Currency risk
- Credit risk
- Liquidity risk
- Interest rate risk

In common with all other businesses, the Company is exposed to risks that arise from its use of financial instruments. This note describes the Company's objectives, policies and processes for managing those risks and the methods used to measure them. Further quantitative information in respect of these risks is presented throughout these financial statements.

There have been no substantive changes in the Company's exposure to financial instrument risks, its objectives, policies and processes for managing those risks or the methods used to measure them from previous periods unless otherwise stated in this note.

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 has an exposure to the European Euros as certain expenditures and commitments are denominated in European Euros and the Company is subject to fluctuations as a result of exchange rate variations to the extent that transactions are made in this currency. In addition, the Company holds a significant amount of cash in US dollars and is therefore exposed to exchange rate fluctuations on these cash balances. The Company does not hedge its foreign exchange risk. At December 31, 2012 the Company held cash balances of \$371,930 (US\$373,836) (December 31, 2011: \$307,756 or \$US\$302,611; December 31, 2010: \$nil). A 1% increase/decrease in the US dollars foreign exchange rate would have an impact of ±\$3,719 (US\$3,738) on the cash balance held at December 31, 2012.

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's credit risk is primarily attributable to its cash. The Company limits exposure to credit risk by maintaining its cash with large financial institutions. The Company's maximum exposure to credit risk is the carrying value of its financial assets.

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages liquidity risk through the management of its capital structure, more specifically, the issuance of new common shares, to ensure there is sufficient capital in order to meet short term business requirements, after taking into account the Company's holdings of cash and potential equity financing opportunities. The Company believes that these sources will be sufficient to cover the known short and long-term requirements at

this time. There is no assurance that potential equity financing opportunities will be available to meet these obligations.

The following table sets out the contractual maturities (representing undiscounted contractual cash-flows) of financial liabilities as at December 31, 2012:

Year of expiry	Accounts payable and accrued liabilities	Total
Within 1 year	\$ 416,125	\$ 416,125

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. As the Company's cash is currently held in an interest bearing bank account, management considers the interest rate risk to be limited.

## **RISKS AND UNCERTAINTIES**

### ***Risks Relating to our Business***

In addition to the other risks and uncertainties set out earlier in this MD&A, the Company is also exposed to the following risks and uncertainties:

*Our company currently does not generate revenue from its planned operations, and as a result, it faces a high risk of business failure.*

We have not generated any revenues from our planned operations to date. As of December 31, 2012, we had accumulated \$10,233,396 in losses since inception. Our business is focused on the development of a new hair cell replication technology. In order to generate revenues, we will incur substantial expenses in the development of our business. We therefore expect to incur significant losses in the foreseeable future. Our company recognizes that if we are unable to generate significant revenues from our activities, our entire business may fail. There is no history upon which to base any assumption as to the likelihood that we will be successful in our plan of operation, and we can provide no assurance to investors that we will generate operating revenues or achieve profitable operations in the future.

*Our auditors' opinion on our December 31, 2012 financial statements includes an explanatory paragraph in respect of there being substantial doubt about our ability to continue as a going concern.*

We have incurred a net loss of \$10,233,396 for the cumulative period from September 7, 2006 (inception) to December 31, 2012. We anticipate generating losses for at least the next 12 months. Therefore, there is substantial doubt about our ability to continue operations in the future as a going concern, as described by our auditors with respect to the financial statements for the year ended December 31, 2012. Our financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts of and classification of liabilities that might be necessary in the event that we cannot continue in existence. Our business operations may fail if our actual cash requirements exceed our estimates and we are not able to obtain further financing. If we cannot continue as a viable entity, our shareholders may lose some or all of their investment in our company.

*Our business is at an early stage of development and difficulties obtaining regulatory approval, technical deficiencies and other challenges may hinder the development and marketing of our hair cell replication technology.*

Our hair cell replication technology is at an early stage of development and we may not develop hair cell replication technology that can be commercialized. We are still in the early stages of identifying and conducting research on our technology. Our technology will require significant research and development and preclinical and clinical testing prior to regulatory approval, if required, being obtained in the United States or other countries. We may not be able to obtain regulatory approvals, if required, to complete necessary clinical trials for our hair cell replication technology, or to commercialize it. Our technology may prove to have undesirable and unintended side effects, or other characteristics adversely affecting its safety, efficacy or cost-effectiveness could prevent or limit its use. Our technology may fail to provide its intended benefit, or achieve benefits equal to or better than our competitor's products at the time of testing or production and, if so, our business may fail.

*Our clinical trials may fail to produce successful results or could be suspended due to unacceptable safety risks, which could cause our business to fail.*

Clinical trials are subject to extensive regulatory requirements, and are very expensive, time-consuming and difficult to design and implement, in part because they may be subject to rigorous regulatory requirements. Our products may fail to achieve necessary safety and efficacy endpoints during clinical trials. We believe that our clinical trials will take a substantial period of time to complete. Furthermore, failure can occur at any stage of the trials, and we could encounter problems that cause us to abandon or repeat clinical trials. The commencement and completion of clinical trials may be delayed by several factors, including: unforeseen safety issues; lack of effectiveness during clinical trials; slower than expected rates of patient recruitment; and inability to monitor patients adequately during or after treatment. In addition, we or regulatory officials may suspend our clinical trials at any time if it appears that we are exposing participants to unacceptable health risks. If our clinical trials fail to produce successful results, or are suspended due to unacceptable safety risks, our business may fail.

*Our success depends on the acceptance of our hair cell replication technology by the medical community and consumers as a safe and effective solution.*

The success of our hair cell replication technology will depend on its acceptance by potential consumers and the medical community. Because our technology is new in the treatment of pattern baldness, the long term effects of using our new hair cell replication technology are unknown. The results of short-term clinical trials do not necessarily predict long-term clinical benefit or reveal adverse effects. If results obtained from future commercial experience indicate that our hair cell replication technology is not as safe or effective as other hair restoration treatments, adoption of this technology by consumers and the medical community may suffer and our business will be harmed.

*If we are not able to effectively protect our existing intellectual property, our business may suffer a material negative impact and may fail.*

The success of our company will be dependent on our ability to protect and develop our technology. We currently have registered patents for our hair cell replication technology in Australia and the European Union. If we are unable to protect our intellectual property, our business may be materially adversely affected. Further, we cannot be sure that our activities do not and will not infringe on the intellectual property rights of others. If we are compelled to prosecute infringing parties, defend our intellectual property or defend ourselves from intellectual property claims made by others, we may face significant expense and liability, as well as the diversion of management's attention from our business, any of which could negatively impact our business or financial condition.

*The successful acquisition and maintenance of patent rights is critical to our business and any failure in this regard could hinder the development and marketing of our technology.*

We currently have patent applications pending in the United States and several other countries around the world. Our pending patent applications may not result in the issuance of any patents. The applications may not be sufficient to meet the statutory requirements for patentability in all cases or may be the subject of interference proceedings by patent offices. These proceedings determine the priority of inventions and, thus, the right to a patent for technology. In the past, our patent applications have experienced delays and our patent applications may be delayed in the future. If others file patent applications or obtain patents similar to those we have licensed, such patents may restrict the use of our discoveries. The risk of third parties obtaining patents and filing patent applications will continue to increase as the hair restoration market expands. We cannot predict the ultimate scope and validity of existing patents and patents that may be granted to third parties, nor can we predict the extent to which we may wish or be required to obtain licenses to use such patents, or the availability and cost of acquiring such licenses. To the extent that licenses are required, the owners of the patents could bring legal actions against us to claim damages or to stop our manufacturing and marketing of the affected technology. If we become involved in patent litigation, it could consume a substantial portion of our resources.

*Competitors in the hair restoration and related fields may currently offer, or may develop, superior hair loss solutions which could limit the market for our technology.*

The market for hair restoration products and technology is competitive. We expect that some of our most significant competitors will be more established companies. These companies may have greater capital resources or experience in research and development, manufacturing, testing, obtaining regulatory approvals or marketing capabilities. As a result, our competitors may develop more competitive or affordable products, or achieve earlier patent protection or product commercialization than we are able to achieve. We face competition from companies offering traditional more established products and technologies.

*Our company may be subject to changes and uncertainties in laws and government regulations.*

Our company is subject to regulation by domestic and foreign governmental agencies with respect to many aspects of developing hair cell replication technology. In addition, relevant new legislation or regulation could occur. Any such new legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to our company's business, or the application of existing laws and regulations to hair cell replication technology, could have a material adverse effect on our company's business, prospects, financial condition and results of operations.

#### ***Risks Relating to our Management***

*We are dependent on the services of certain key consultants and the loss of any of these key consultants may have a materially adverse effect on our company.*

While engaged in the business of developing a new hair cell replication technology, our company's ability to continue to develop a competitive edge in the marketplace will depend, in large part, on our ability to attract and maintain qualified key management personnel. Competition for such personnel is intense, and we may not be able to attract and retain such personnel. Our company's growth has depended, and in the future will continue to depend, on the efforts of our key management consultants. Loss of any of these people would have a material adverse effect on our company. Currently, our company does not have key-man life insurance.

*Conflicts of interest may arise as a result of our company's directors and officers being directors or officers of other life sciences companies.*

Certain of our company's directors and officers are, or may become, directors or officers of other life sciences companies. While we are engaged in the business of developing a new hair cell replication technology, such

associations may give rise to conflicts of interest from time to time. Our company's directors are required by law to act honestly and in good faith with a view to our company's best interests and to disclose any interest that they may have in any project or opportunity of our company. If a conflict of interest arises at a meeting of our company's board of directors, any director in a conflict must disclose his interest and abstain from voting on such matter. In determining whether or not our company will participate in any project or opportunity, our company's directors will primarily consider the degree of risk to which our company may be exposed and our financial position at the time.

*Our company's by-laws contain provisions indemnifying our officers and directors against all costs, charges and expenses incurred by them.*

Our company's by-laws contain provisions limiting the liability of our officers and directors for all acts, receipts, neglects or defaults of themselves and all of our other officers or directors or for any loss, damage or expense incurred by our company which may happen in the execution of the duties of such officers or directors. Such limitations on liability may reduce the likelihood of derivative litigation against our company's officers and directors and may discourage or deter our shareholders from suing our company's officers and directors based upon breaches of their duties to our company, though such an action, if successful, might otherwise benefit our company and our shareholders.

*As a majority of our directors and officers are residents of countries other than the United States, investors may find it difficult to enforce, within the United States, any judgments obtained against our company, directors and officers.*

We are a British Columbia, Canada company. A majority of our directors and officers are nationals and/or residents of countries other than the United States, and all or a substantial portion of such persons' assets are located outside the United States. Consequently, it may be difficult for United States investors to effect service of process in the United States upon those directors or officers who are not residents of the United States, or to realize in the United States upon judgments of United States courts predicated upon civil liabilities under United States legislation. There is substantial doubt whether an original action based solely upon such civil liabilities could be brought successfully in Canada against any of such persons or our company.

#### **OTHER INFORMATION**

The Company's website address is [www.replicel.com](http://www.replicel.com). Other information relating to the Company may be found on SEDAR at [www.sedar.com](http://www.sedar.com)

#### **BOARD APPROVAL**

The board of directors of the Company has approved this MD&A